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The Hartford Financial Services Group, Inc. NYSE:HIG

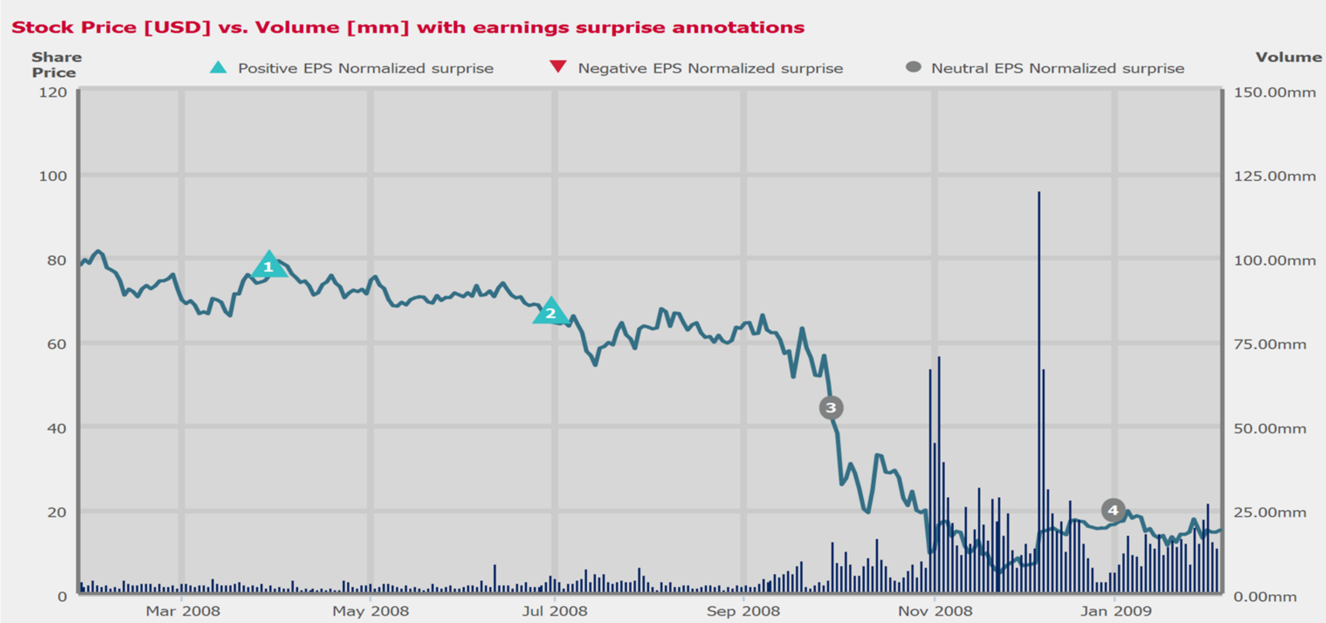
FQ1 2009 Earnings Call Transcripts

Friday, May 01, 2009 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2009-			-FQ2 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(3.14)	(3.66)	NM	1.31	0.65	5.53
Revenue	-	-	(0.50 %)	-	-	-
Revenue (mm)	6149.00	6118.00	-	6026.00	23636.50	25163.00

Currency: USD
Consensus as of May-01-2009 12:03 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ1 2008	2.46	2.51	2.03 %
FQ2 2008	2.10	2.22	5.71 %
FQ3 2008	(1.45)	(1.40)	NM
FQ4 2008	1.30	(0.72)	NM

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Presentation

Operator

(Operator Instructions) Welcome everyone to the Hartford First Quarter 2009 Earnings Conference Call. Mr. Rick Costello, Senior Vice President, Investor Relations, you may begin.

Rick Costello

Thank you for joining us for today's first quarter 2009 financial results conference call. As you know, our earnings release and financial supplement were issued yesterday. To help you follow our discussion, a slide presentation is also available on our website at www.TheHartford.com. Ramani Ayer, Chairman & CEO, and Liz Zlatkus, CFO will provide prepared remarks today. We will conclude with a question and answer session.

Also participating on today's call are Greg McGreevey, Chief Investment Officer, John Walters, President and COO of our Life Company, Jonathan Bennett and Juan Andrade, Co-Presidents of our P&C Company and Alan Kreczko, General Counsel.

Turning to the presentation, on slide two please note that we will make certain statements during the call that should be considered forward looking statements as defined in the Private Securities Litigation Reform Act of 1995. These include statements about The Hartford's future results of operations. We caution investors that these forward looking statements are not guarantees of future performance and actual results may differ materially.

Investors should consider the important risks and uncertainties that may cause actual results to differ including those discussed in our press release issued yesterday, our quarterly report on Form 10-Q for the quarter ended March 31, 2009, our 2008 annual report on Form 10-K and other filings we make with the Securities & Exchange Commission. We assume no obligation to update this presentation which speaks as of today's date.

Today's discussion of The Hartford's financial performance includes financial measures that are not derived from Generally Accepted Accounting Principles or GAAP. Information regarding these non-GAAP and other financial measures including reconciliations to the most directly comparable GAAP financial measure is provided in the investor financial supplement for the first quarter of 2009, in the press release we issued yesterday, and in the investor relations section of The Hartford's website at www.TheHartford.com.

Now, I would ask you to move to slide three as I turn it over The Hartford's Chairman and CEO Ramani Ayer.

Ramani Ayer

As you know, the first quarter was another challenging quarter. The US and the rest of the world remained deep in recession. Unemployment rates in the US have ratcheted up and they're expected to keep rising throughout 2009 and into 2010. Moreover, the outlook for a return to more stable markets or an economic recovery is unclear.

Please turn to slide four. Given the state of the global economy and the equity and credit markets we have been intensely reviewing our business operations. Our goal is to enhance shareholder value while maintaining our commitments to policyholders. We have begun a process to reposition the company with an aim to reduce risk, preserve capital and stabilize our ratings. The actions we announced yesterday to narrow the focus of our variable annuity businesses represents one step in this effort.

First we have decided to suspend new business in Japan. We have come to this decision after a careful review of the capital markets and competitive environment in that country, as well as our own exhaustive product development efforts. At the end, we concluded that the current balance of risks and returns in the Japan market was unacceptable to us.

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Therefore, effective June 1st we will suspend new business sales. We will adjust our operations in Japan to reflect the implications of this decision. We have over 500,000 policyholders and $30 billion in account value in Japan. We will continue to service our existing policyholders and just as important, we remain well capitalized to meet their needs.

Second, we're suspending all sales in the UK market. While we have had some successes in this market we have decided to suspend sales and to cancel our planned entry into the German market in order to narrow the focus of our VA business. Again, we will maintain our Dublin based service operation to serve existing policyholders and to honor our commitments.

Finally, turning to the US, as you know, we began a process to reduce risk in our VA business last year. AT that time we said the US VA industry needed to change, that the guarantees had become to rich. In fact, the US market is now in the midst of tremendous change. Across the board, insurers have modified their products to eliminate some of the riskier provisions and in many cases have increased prices. The fact that this market is being reshaped is clear. What we don't know is how the product landscape will look at the conclusion of this process.

In the third quarter we are planning to launch a new variable annuity founded on the pillars of simplicity, competitive costs, and lower risk profile. In the meantime, we're implementing additional changes to our existing product lineup. We're increasing pricing by 20 basis points on our LIB (Lifetime Income Benefit Portfolio) living benefit income rider and we're eliminating the LIB selects rider for new policyholders.

The portfolio's rider requires asset allocation and is priced accordingly. The selects income rider does not require asset allocation and thus is a more difficult and expensive product to hedge. These changes are likely to reduce sales and we have reduced our outlooks accordingly.

Please turn to slide five. We also announced a number of additional actions yesterday. We're exploring options for our institutional markets business. This business is one of the most sensitive to ratings. Given the downgrades we experienced in the first quarter we believe it is appropriate to look for alternatives for this collection of products focused on the institutional market.

Our efforts have not been limited to business operations. As Greg McGreevey explained in detail during our December investor day, he and is team continue to take steps to change the composition of our investment portfolio. During the first quarter we sold over $600 million of financials and a lesser amount of CMBS. We also bought additional protection to hedge our portfolio exposures to certain economically sensitive sectors including financials, lodging, gaming, and retail.

Going forward we cannot make wholesale changes quickly but we remain committed to reducing asset risk on our balance sheet in a prudent manner that focuses on value and capital preservation.

Finally, we're committed to cutting expenses at The Harford. Last fall we set out to reduce our enterprise wide expense run rate by $250 million by the end of this year. We're on track to accomplish that goal with a reduction of workforce, elimination of open positions, and a hiring freeze in many business lines. In addition, we have sharply reduced our other operating expenses. As we go forward we will identify more expense savings in the course of the actions we take on our business portfolio with the goal of right sizing our organization.

Before we move on there has been a lot of media speculation regarding potential transactions involving The Hartford. As a general policy matter we do not comment on media speculation. We're not going to make specific comments today on hypothetical transactions. However, I want to be clear that we're considering a range of additional potential actions. At the same time, it is important to recognize that beyond the announcements we made last night we may determine that the best course is to continue with a diversified business model.

I'd like to now briefly discuss the first quarter results on slide six. We recorded a net loss of $1.2 billion or $3.77 a share in the first quarter of 2009. The net loss was driven by a $1.5 billion charge relating to the off cycle DAC unlock. As we said on our earnings call in February, based on the equity market performance in the fourth quarter of '08 and the first quarter of this year, with the S&P 500 declining almost one third we unlocked our assumptions for future estimated gross profits in our Life businesses.

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The effect was a charge of $4.66 per share.

Excluding the effect of the DAC unlock core earnings for the first quarter were an even $1.00 per share. Much of the decline from the prior year was due to a reduction in net investment income.

One of the contributing factors that lowered investment income was a $209 million pre-tax loss from limited partnerships and other alternative investments. Its worth noting that we expect continued weakness in this asset class in the second quarter and then a moderation in the second half of the year. This is reflected in our guidance.

Another factor that drove a decline in net investment income is our increased holding of short term investments and US Treasuries. Given the current investment landscape and uncertain market environment we have steadily increased liquidity in our portfolio and now hold more than $15 billion in liquid securities.

Moving now to our operating highlights. A number of our businesses are executing well in this difficult environment. The strong performances could be overlooked given our other comments this morning, that would be a mistake. I'm now working from slide seven. Our Property & Casualty business continues to demonstrate its value as a franchise, from its earnings power to its award winning service. Our underwriting discipline is crucial in these economic times and our ongoing initiatives such as expanding products and investing in new technologies are paying off in terms of higher production.

Property & Casualty core earnings were $321 million in the first quarter. Most of the decline from the year ago period was driven by weaker net investment income. As I stated, our P&C operations continue to demonstrate very good earnings power. The combined ratio in ongoing operations for the first quarter was 90, within roughly two points of the 2008 period. Loss costs are behaving and we're maintaining pricing discipline in very competitive markets.

Total net written premiums were $2.5 billion down about 5% from the first quarter of 2008. The decline was due in part to our planned exist from the Florida agency homeowners market as well as the first quarter sale of our specialty property operations. Excluding these two items written premium was down 3.5%.

The economic downturn is having a dampening effect on written premium. All the premiums we collect this year will be lower then in the past as payrolls and exposure levels shrink and our commercial policyholders predominantly small and mid-sized business owners made difficult expense reductions and decisions in these challenging economic environment.

The P&C market remains intensely competitive and we believe that environment will continue at least through the end of the year. Independent agents are under pressure as they face declining revenues and the contracting economy removes premium from the market. It is a pretty staggering number but we estimate that as much as $1.6 billion of workers compensation premium has vanished from the Property & Casualty industry based on the loss of an estimated five million jobs since the recession started in December of 2007.

The economy is also changing policyholder purchasing behavior. New business levels increased in most of our lines in the first quarter while policies in force remained relatively stable. We believe these figures suggest market churn as more renewals are being shopped in an effort to reduce the cost of coverage. The Hartford is seeing the impact of this in a decline in average written premium as customers engineer their policies towards higher deductibles and lower limits. Agents are shopping policies to bring customer costs down, increasing the quote flow in the market.

Loss costs on the other hand are generally behaving very well. Frequency trends are still pretty good across our businesses. At the same time, we have seen an up tick in severities which is within our expectations. That said, we continue to watch the trends very closely. As for pricing, I think we're close to a real turn in the pricing environment in commercial insurance. We're seeing this trend particularly in middle market where written pricing declined by only 2% in the first quarter of '09 compared to a 6% decline in the first quarter of '08.

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As we move towards a gradually hardening market we believe our Property & Casualty franchise is well positioned. We have an expanding distribution system with strong relationships with both independent agents and AARP. We have a disciplined underwriting competency that has taken years to build and tune. This core competency of The Hartford is critically important in today's environment as we approach the point at which pricing in a number of markets begins to harden.

Finally, we have an award winning high quality service culture. We have cultivated that culture through the deep relationship we have with AARP which I'm pleased to say has reached 25 years. We have successfully leveraged it for our customers in small commercial, middle market, and specialty commercial. All in I feel good about our Property & Casualty operations. We're excited about our ability to capitalize on the new business opportunities created by the changes in consumer purchasing behavior while relying on the competencies that serve us well.

Moving on to our Life results on slide eight. Over the last 12 months, declining equity markets have eroded more than $60 billion in assets under management. At the same time, deposits in equity based products have fallen victim to consumer's current aversion to equities. The first quarter 2009 epitomized that trend and made for a particularly challenging quarter.

Core earnings excluding the unlock fell significantly as declining account values reduced asset based fees. Other factors that dragged at core earnings were increased DAC amortization caused by lower actual gross profits, as well as lower net investment income. Obviously some pretty tough results, a performance we're certainly not pleased with.

It is important though not to lose sight of the fact that some of the Life companies businesses performed remarkably well even in this tumultuous environment. Our group benefits business had an excellent quarter with a 6% increase in fully insured premiums. That growth was fueled by a 5% increase in sales and strong persistency. While we saw a tick up in our loss ratio, this was primarily in our experienced based business, where losses and commission expenses tend to offset. Importantly, the economic downturn is not having a measurable impact on our group benefits claims experienced to date.

Our retirement plans business also had a very good quarter from a deposit perspective. The business recorded $2.2 billion in deposits, a 12% sequential increase. Ongoing contributions and new mutual fund sales were the largest contributors of the strong deposits. When you consider how challenging the first quarter environment was that is a pretty noteworthy result.

In retail mutual funds the entire industry was down as many investors stayed on the sidelines but we held our own with over $2 billion in deposits. A number of our larger funds posted strong relative performance in the first quarter and we will look to a build up on that going forward.

In summary, although the first quarter was challenging for our Life operations, our less equity sensitive businesses continue to see strong sales. On the Property & Casualty side The Hartford's strong franchise continued to drive solid underwriting profitability in the quarter.

With that I'm going to turn it over to Liz for a brief update on guidance and capital.

Liz Zlatkus

I'll begin on slide nine. As we announced last night we have updated our 2009 core earnings guidance. Our revised outlook incorporates our actual performance in the first quarter, including the DAC unlock. I won't go over the specific assumptions listed on slide nine but I'd be happy to answer any related questions in the Q&A section.

Now let's turn to slide 10. As you know, risk base capital ratios are required to be calculated at year end only, so we did not perform a full blown RBC calculation this quarter. However, in order to give you a sense of our capital position we have estimated our March 31, 2009, RBC ratio to be somewhere between 420% and 430%. The net impact of capital market changes in the first quarter reduced surplus by about $1 billion.

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This reflects the decline in global equity markets, partially offset by weakening of the end. These market impacts were offset by actions we have taken to increase fee revenue and lower expense levels as well as incorporating observed policyholder behavior. Net all in there was essentially no impact on capital from our VA business this quarter. In addition, first quarter credit impacts reduced our capital positions by about $300 million.

As to 2009 year end capital, our Life RBC ratio will be a function as you know, of many factors including our operating results, actual market performance and the implementation of VA CARVM which estimate could be reduce surplus by roughly $1 billion. All of these variables make it difficult to project year end RBC levels. With these caveats we continue to believe that at a year end S&P of 700 we could maintain an RBC ratio in excess of 325% with the existing capital available across the enterprise.

The estimate does not assume any draw down of our contingent capital or bank lines nor does it provide any provision for future credit or other market effects. Our estimate though does reflect the pay down of $375 million of commercial paper which was completed this month.

Now let’s turn to slide 11 which summarizes our current capital position at the enterprise level. In our P&C operations statutory surplus ended the first quarter basically unchanged as operating income from the business roughly offset losses on the sale securities, impairments and mark to market effects. We did not dividend any money out of the P&C companies during the quarter.

As I said before, it is our intent to maintain P&C capital at or above levels associated with historical AA standards. Finally, the holding company has $1 billion of excess capital. Of course after give effect to the repayment of all commercial paper as I mentioned.

In addition, our $500 million contingent capital facility and $1.9 billion credit facility remain on tap and are fully available to us should the need arise.

With that I’ll turn the call over to Ramani.

Ramani Ayer

We have made a number of important announcements and I want to get to our Q&A session. However, I would first ask each caller to limit himself or herself to two questions to allow us to get as many callers as possible. Also, as I indicated earlier, we will not be commenting on potential strategic actions beyond those that we have announced. We believe this approach is prudent and best serves the interests of the company and our shareholders so I’d appreciate your understanding on this point.
With that I’m going to turn it over to the operator. Operator would you please open the call to questions.

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Question and Answer

Operator

(Operator Instructions) Your first question comes from Nigel Dally - Morgan Stanley

Nigel Dally
Morgan Stanley

On capital, first you have $2.1 billion net capital employed in your Japanese operations. Given your decision not to write new business how should we be thinking about that capital? How much of that potentially could be freed and over what timeframe? Second, with your estimated RBC ratio of 420% to 430% I'm assuming that includes permitted practices. I think that benefit is roughly $1 billion. Would you also have that ratio without the permitted practices, which I think is also a metric with some of the rating agencies?

Liz Zlatkus

In terms of our Japanese operations there are certain rules and regulatory requirements in terms of accessing that capital. I would say that we cannot do that for the next several years. It's important to note that we are well capitalized in Japan. In terms of the RBC ratio all of the forecasts that I mentioned about looking at year end do not include the permitted practices as you mentioned. They were worth about $900 million and our estimated RBC is in the $1.3 billion to $1.4 billion range.

Operator

Your next question comes from Josh Shanker - Citi

Josh Shanker
Citi

I wanted to ask questions about the changes you made in your methodologies regarding the reserves on the GMIB products that are mentioned in the Q whether or not the effect those had on your capital and what changed in the core to allow you make those reserve changes?

Ramani Ayer

I believe you're thinking about the three wind product, there is no real change in the methodology.

Josh Shanker
Citi

More the standing capital change that you made.

Liz Zlatkus

I think you're referring to the adjustments to the FAS 157 liability for living benefits. There were two changes one was the credit standing adjustment where we previously used long term applied default rates for a AA credit company and it was a very small adjustment. With the volatility in the market and our CDS spreads as well as those of re-insurers we did think it was appropriate to move towards something that uses the implied default rates from our CDS but it is important to note that in that case we also look at that for any uncollateralized reinsurance. You'll see some more volatility going forward because of that because you'll have to look at our spreads as well as our re-insurers.

In terms of the policy holder behavior changes what we would call our behavior margin, we have observed policyholder behavior that's more favorable then what we had anticipated and so we thought it was prudent to put that in. Again, we're not putting all of the behavior we're seeing but some of it as we watch that emerge. All in, just to give you a sense, the behavior margin that remains at the end of the quarter after those adjustments is still over $1 billion.

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Josh Shanker
Citi

In terms of that effect on capital from a GAAP standpoint from a statutory standpoint and whether or not, any thoughts about the potential for those reserve adjustments be premature.

Liz Zlatkus

First of all that was my comments related to the GAAP liability so that's not the same as capital. However, I also mentioned that we did have changes to our statutory capital; I'm just saying the calculations are a little different. Those changes were the result of several things; most importantly the management actions that we've taken so we've reduced expenses.

We've increased rider fees now twice and we also have seen actual experience that emerged both in our first quarter composition of our books so actual policyholder is better than we had forecasted as well as a continuation of that so we put some of that into our future expectations. It's the same kind of concept improved our capital position.

Josh Shanker
Citi

The reserves are only affected on the GAAP side and do you have any thoughts on the potential for what information has to happen that might reverse that situation or potentially might, should we see this as a trend going forward as we go into 2Q09 you see the trend, you see what you're marking and you'll take more credit for that over time that will actually continue to improve the position.

Liz Zlatkus

You started to ask about GAAP versus stat but I'll stick with capital which is probably what you're most interested in. I would say that if we continue to see the policyholder behavior that is emerging then yes we would tend to see some more benefit over time.

Ramani Ayer

I just want to be sure you got Liz's answer but she answered two parts.

Josh Shanker
Citi

Two questions that are related, they're both useful.

Operator

Your next question comes from Eric Berg - Barclays Capital

Eric Berg
Barclays Capital

Given the extensive research that The Hartford undertook many years ago to enter Japan it's obviously a major decision to exit the country given your extreme high level of optimism about the long term savings prospects. My first question is, is it correct to call this an exit of Japan, in other words, are you leaving the country or are you temporarily suspending sales. I understand you're going obviously service your existing contract which is an exit. Why are you leaving the country?

My second question also broad is what is the future of the variable annuity business and in particular what I mean by that question is do you see the business becoming one of simpler, cheaper products or products that are more expensive with tighter restrictions, where is this product category headed?

John Walters

Relative to Japan we have announced, as you saw, that we have suspended sales in Japan. We obviously will continue to have a large presence in Japan because we have 500,000 plus clients and $30 billion

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more or less dollars of assets under management that we have to service in Japan. The reasons that we have decided to suspend are because of both the competitive environment and where the competitive environment has gone in Japan and the capital markets environment that we're in and a need to preserve capital.

We do, because we're going to have an ongoing operation in Japan, have the opportunity to reenter that market if those conditions change and we feel it's appropriate. In the meantime what we'll be doing is managing that business to service existing customers and adjusting the organization to reflect the fact that we have suspended sales. We do have the opportunity to get back in if we choose to given that those reasons for exit may change over time.

Secondly, on the future of the VA as we stated in our investor day back in December, we had a view that the VA is going to align along really two different end points. One is you're going to have some companies that choose to do products with richer guarantees, higher expenses, and more fulsome benefits for consumers. Then you're going to have other companies that align towards simpler products, less expensive products and products that focus more on the core basic guarantees of lifetime income and things of that nature.

We are seeing that happen right now where some firms are sticking with the historical guarantees that they've had and just mostly changing price. Other firms are doing a complete retooling to try to keep the price lower and to go to simpler products that are less complex to manage and less complex to communicate to policyholders.

We are going down the second path so we are going down the simpler, less expensive path and that is reflected in the fact that we have deferred the launch of our new product for May so that we could further retool the product and we currently have plans to introduce that product in the mid to late third quarter and it will be a simpler, less expensive product that is focused on the basic income needs that people have as they approach retirement.

Ramani Ayer

John answered the question very well. The point I would say which John mentioned too, this is still in such a state of flux in the market and its direction and customer's reaction to those directions are all in the making. It will be very interesting to see what happens over these next several quarters. The second point on Japan, I just want to say is we're very committed to providing the best quality service there in that country because you're right to say we're very, very optimistic about our entry in that country but we are very devoted and committed to making sure that our customers receive the best care there.

Operator

Your next question comes from [Mike Seremski] - Credit Suisse

Mike Seremski
Credit Suisse

How should we think about taxes should you sell the P&C business. I know you guys aren't commenting if you're going to sell it. I guess essentially what's the cost basis of that.

Ramani Ayer

Very important point and I said earlier I'm not going to comment on specifics in areas. I think it bears repeating how we're thinking about this process. As we are pursuing multiple initiatives to best position us as a company going forward especially for these market conditions and that is an important notion but going to your specific question the tax basis of the P&C company is somewhere between $7 to $7.5 billion, I don't have a precise number.

Mike Seremski
Credit Suisse

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There's $1.8 billion of DAC tied to your international business. I guess how should we think about that DAC respectively given that you guys are exiting Japan and the UK. Also, how much capital and/or free cash flow you think will be freed up by exiting those businesses?

Liz Zlatkus

In terms of the DAC balance remember DAC relates to in the fourth book so over time if some markets perform well then kind of you wouldn't expect to have big charges or anything and you can even have unlocks to deposit. I would look at DAC really from in force perspective, there's no impact from suspending new sales. If you have higher lapses it could have an impact or those kinds of things.

In terms of the capital, as I said before suspending new sales won't have a material impact on capital its kind of accumulates over time. We're very well capitalized in Japan in terms of any kind of repatriation that will take several years.

Operator

Your next question comes from Ian Gutterman - Adage Capital

Ian Gutterman
Adage Capital

I had a follow to the questions on the VA. Over time when things recover how important a piece of The Hartford is the US VA marketing going to be? What I'm wondering is if you're going to be a smaller company in many ways and one of the problems was the VA concentration it would seem the VA business when you just shrink more than the rest of the business as a part of your balance sheet but should imply even plus these changes that we're not going to see a significant recovery in sales down the road. Is that fair as far as what you're appetite will be down the road or can you go back to being a top three, top five player in the US VA market when equity markets recover?

Ramani Ayer

Several points and I welcome John to add to whatever I'm about to say. The thing that we want to be very clear on when we spoke to you all in December is the current risk reward relationship in the VA business does not make any sense to us.

As we reverse engineer all these different kinds of products that are being put out there with current capital markets and what's going on in those its not making sense and so much of our engineering of the product as we think about a fall launch is to try to figure out how to best do this where we bring good customer value, keep the costs affordable from a customer perspective as well as simplicity and transparency are something that we're thinking about.

What is hard to see at the present time is how competitors might react and how the industry might restructure itself and how consumers might think about the VA product given all these different alterations and structural changes that might occur in there. The customers out there are still thinking about lifetime income benefits and equity market guarantees as being critical to them because over the last decade they have seen two very, very severe retrenchments in these markets.

We need to see that unfold, we need to have much better clarity before we can really get a sense of our long term positioning in the VA market. In the near term I think John expressed very clearly where we're going and given the kinds of changes we have seen in the near term market we have, as you well know, adjusted our guidance downwards so that's reflected in the guidance that you have received.

John Walters

I would just say that we think of this as a transformation that we have to go through relative to the VA market in the US that we're part of. We're thinking about that down the lines that I described earlier. We have reduced our outlook to $2 to $3 billion for the year in VA and I think that does say there's going to be substantially lower then it's been in the past as we go through this transformation. As both consumers and advisors adjust to what the new market place is going to be for VA's.

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Ian Gutterman
Adage Capital

I'm trying to think as we go forward what's going to be the main franchise of The Hartford? Is this going to be more of a group company, is that going to sort of be. For the last 10 years we thought of the lead piece of the company being VA's and P&C. Is there going to be more group and retirement is that what I should be thinking about being the drivers going forward, or is there another vision that you can maybe elaborate on.

Ramani Ayer

The first thing is we have to think about this as much more US centric as a company, a focused operation. Focused on both capital and management of risk, those are very important things for us. Our insurance businesses between Property & Casualty, Benefits and Life Insurance are very, very critical drivers of our future expectations. Don't ignore the retirement and mutual funds businesses both of which are very good and they have outstanding performance out there with respect to sales and deposits.

The VA relationship as far as new deposits and new sales as John mentioned a second ago will be a lower percentage of our total sales outlook at least for the foreseeable future that's how I would characterize the portfolio.

Ian Gutterman
Adage Capital

Have you had any thoughts as far as distribution, it seems part of the reason the VA product returns got computed down was just the wire house channel is so competitive as far as what you have to pay for production to get on the shelf. Do you need to move your distribution channel across your products to more of the tradition life insurance independent type distribution in VA and outside of VA?

John Walters

We do not see the cost of distribution as the issue in this. We've kept our distribution costs well under control. It fits within most of our pricing for all of our products. We have the broadest distribution of just about any company in the industry across mutual funds, life insurance, variable annuities, retirement plans and group benefits. We see that being sustainable going forward. We do not see that as an issue.

Operator

Your next question comes from Darin Arita - Deutsche Bank

Darin Arita
Deutsche Bank

Starting with Japan, as you evaluated your decision to suspend sales there can you talk about how you thought the risks are different in the Japanese variable annuity market versus the US market?

John Walters

Its a few things. First of all as you look at the Japanese market the nature of the competition in the Japanese market has really changed over the last several years. When we first entered that market we were the first one in there. We were the number one seller and the domestic companies were really non-existent in this market.

As the domestic companies have come in, they've been prepared to do products that we were not comfortable with that did not make sense for us and so that has shifted the focus of the market place and what the appetite is in the market place toward products that were less comfortable with which has caused an erosion of market share for us.

In addition, at the same time, we've had a dramatic increase in both the volatility of the market place and obviously a move down in both equity and fixed income and lower interest rates all of which affect our ability to manage this business effectively. You take all those things together, a much more competitive

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environment with products that we were a lot less comfortable with and the higher volatility and lower interest rates in equity and debt markets and it just made a combination for us that didn't make sense from a risk standpoint and at the same time from capital standpoint.

Writing new business does consume capital and so suspending new business will allow us over time to consume less capital in Japan which we thought was a good move in today's environment given that we're not optimistic for the foreseeable future about our ability to compete effectively in that market.

Darin Arita
Deutsche Bank

Is it really about that last point then because in terms of players doing products you're not comfortable with and the volatility in the markets? That's the same story in the US.

John Walters

Its different in the US I think for a variety of reasons. First of all the products that are most heavily sold in Japan right now are different products then those most heavily sold in the US. They're more focused around shorter term products and GMAB products that give the money back much quicker to the client. Those products for the most part don't really exist in the US.

Secondly, it is more difficult to manage the risk in Japanese products then it is I the US both because of the size and liquidity of the derivative markets over there and because of interest rates. There are real substantive differences between the Japanese market and the US market right now.

Darin Arita
Deutsche Bank

When I look at slide 10 in terms of the RBC ratio estimate of 325% with the S&P up 700, what was the impact at VA CARVM on that estimate?

Liz Zlatkus

As I mentioned, VA CARVM impact is about in the range of $1 billion. That's incorporated into that 325%. Part of that delta is from where we sit today, we do have the AG39 relief in our 331 numbers which go away at the end of the year.

Darin Arita
Deutsche Bank

The VA CARVM $1 billion and that's separate from the deferred tax asset permitted practice?

Liz Zlatkus

Yes.

Operator

Your next question comes from Dan Johnson - Citadel

Dan Johnson
Citadel

The Japanese Yen movement and RBC, at year end you'd indicated that it had a negative impact during the fourth quarter. Can you give us some level of sense as to how sensitive the RBC is to the movements of the Yen?

Liz Zlatkus

At the end of the year you saw that the Yen had moved actually strengthened right from 93, 91 and we told you that was about $150 million. I wouldn't extrapolate that. When you go from 91 up to 99 it's probably what you're thinking it's roughly in that order but you have the Yen/Euro and Yen/Dollar and the

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Yen/Euro actually weakened less then the Yen/Dollar did. When you add it all up it's probably in the $400 to $500 million of positive for the quarter. Then obviously global equities declining and other movements were negative.

Operator

Your next question comes from Paul Soren - FPK

Paul Soren
FPK

How much capital is back in the institutional solutions group, how much could be freed up by running off the current book of general account products and over what kind of time frame that could happen?

Liz Zlatkus

It's in the range of $500 to $700 million that backs that business and obviously some of that is very long tail business. It would take many years for that to emerge.

Paul Soren
FPK

On the status of the captive that you talked about setting up to reinsure some of the variable annuity risks, is that active now? So what kind of impact is it having? If not, what kind of timing are you looking at?

Liz Zlatkus

We still are undertaking our valuation. We're looking at both offshore as well as potential onshore captives. There's a lot of legal and tax and other issues we're working through so we should be able to update you on that in the second quarter.

Ramani Ayer

It's in the plan for '09.

Liz Zlatkus

We are not anticipating any benefit from that in the forecast that I gave you. If we are able to achieve it, it would be an upside to the numbers that I had mentioned.

Paul Soren
FPK

It's not in the 325% but you do anticipate it being in place by year end?

Liz Zlatkus

It's not in the 325% correct. Again, we're still evaluating it so I can't say for certainty that we are going to take those measures but we are diligently working on it.

Operator

Your next question comes from Chris Summers - Greenlight

Chris Summers
Greenlight

Earlier you guys talked about assumption changes related to lower expenses, increased fees and better policyholder experience and it improved your statutory capital. Can you quantify how much that improved the statutory capital?

Liz Zlatkus

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All in it was about $1 billion benefit, more than half of that, or most of that is actual results then the remainder is kind of putting in that observed policy holder behavior into assumptions of the future. We did not put all of the favorable experience we're seeing in to assumptions but we thought it was appropriate to put some of it in.

Chris Summers
Greenlight

Actual results meaning policies and prices you already had in place that you're carrying forward versus modeling further price increases?

Liz Zlatkus

Let me give you a little bit more color. When you do your statutory reserving you need to look at what are you actually operating at today, so what are your expense levels, what are the fees that you're charging on your product so when I say actual, we already know that we are running at 'x' level of expenses, we already know that we are charging 'y' level of fees in our products so that's what I mean by actual.

The other part of actual is the in force composition of the book both at 12/31 and 3/31 we're seeing it emerge so actual policyholder that occurred at 3/31 more favorable then we had anticipated. That's what I mean by actual. Going forward it's the same policy holder behavior in terms of lapses and withdrawals that we're seeing that was better than anticipated is also much better then our modeling looking forward. We've put some of that benefit into the future as you just count those cash flows for your reserve calculations.

Chris Summers
Greenlight

In the context of the competitive landscape, lower expenses arguably suggest lower customer service via fewer Hartford employees per customer. Combining this with higher fees how does this contrast with your view of improved policyholder experience in the future?

Liz Zlatkus

Let me just explain expense side then John may want to talk about the service which still remains exceedingly good. The expenses we're talking about are just that assets were coming down; it takes a while for us to cut our expenses just in total. Obviously our sales our down etc. What I'm talking about reduced expenses it's just some of the expense cuts that we've actually have occurred just due to volume decreases.

John Walters

Already this year we've taken our run rate of expenses down by a little over $100 million. That is before the actions that we have announced today which we'll be working through in the second quarter. We've been able to do that without impacting in any meaningful way the service levels that we provide to the client. We are very focused on making sure that we do continue to provide the service levels people are accustomed to but as there's a lower volume of activity we're able to adjust our expense structure accordingly and that's what we've been focused on doing.

Operator

Your next question comes from Tisha Jackson - Columbia Management

Tisha Jackson
Columbia Management

I was actually wondering if you could kind of discuss on the captives what's the decision process in terms of off shore versus on shore since I thought there was a benefit to capital if going off shore.

Liz Zlatkus

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I would just start out by saying its quite complex the difference is. You can get red space capital benefits in terms of what I would call less volatility in both those scenarios. I would say that it's not easy to tell at this point which ones better for us. It depends on your own set of situations. They both could be an improvement for us. We would only do it obviously if there was up side. It's hard to give you specificity around which one would work better for us.

Tisha Jackson
Columbia Management

Could you discuss the capital position of the Property & Casualty business, what's the RBC ratio there or something that we can quantify?

Ramani Ayer

The best way that we characterize that for you is our historical AA standard levels is where we're trying to maintain that capital north of that and that is where the Property & Casualty capital position is.

Liz Zlatkus

The capital is essentially unchanged for the quarter and it remains very, very strong. We have excess capital above what we consider the historical standards, different rating agency models but I'd say we have excess.

Tisha Jackson
Columbia Management

So there is excess capital in the Property & Casualty?

Liz Zlatkus

Yes.

Operator

Your next question comes from [Ahnat Christian - Four Research & Management]

Ahnat Christian
Four Research & Management

A clarification question, I heard you say that the updated assumptions were related to policyholder behavior changes resulted in a $1 billion benefit to the RBC ratio. In the 10-Q you also talk about a $965 million benefit given by the Connecticut Insurance Department. Are these two numbers the same or are they relative.

Liz Zlatkus

No, they're not the same. The issue you're referencing in the K is the permitted practice that we received after our fourth quarter earnings call and that benefit is surplus. That goes away for our 2009 forecast because we're under new rules which are VA CARVM. The policyholder behavior and again expenses and increased rider fees, those changes, much of that is permanent and obviously policyholder behavior we'll continue to watch. That does remain through the end of the year and in the future.

Ramani Ayer

I'm now going to bring this call to a close. We've discussed a number of strategic actions today as we work to reposition The Hartford to navigate this what I consider very challenging market environment as we move further into the second quarter. We will certainly update investors and other stakeholders as events and actions warrant.

I want to thank you all for joining us on the call today and I appreciate your attention to The Hartford's quarterly performance. Thank you again.

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Operator
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