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S&P Capital IQ

The Hartford Financial Services Group, Inc. NYSE:HIG

FQ4 2010 Earnings Call Transcripts

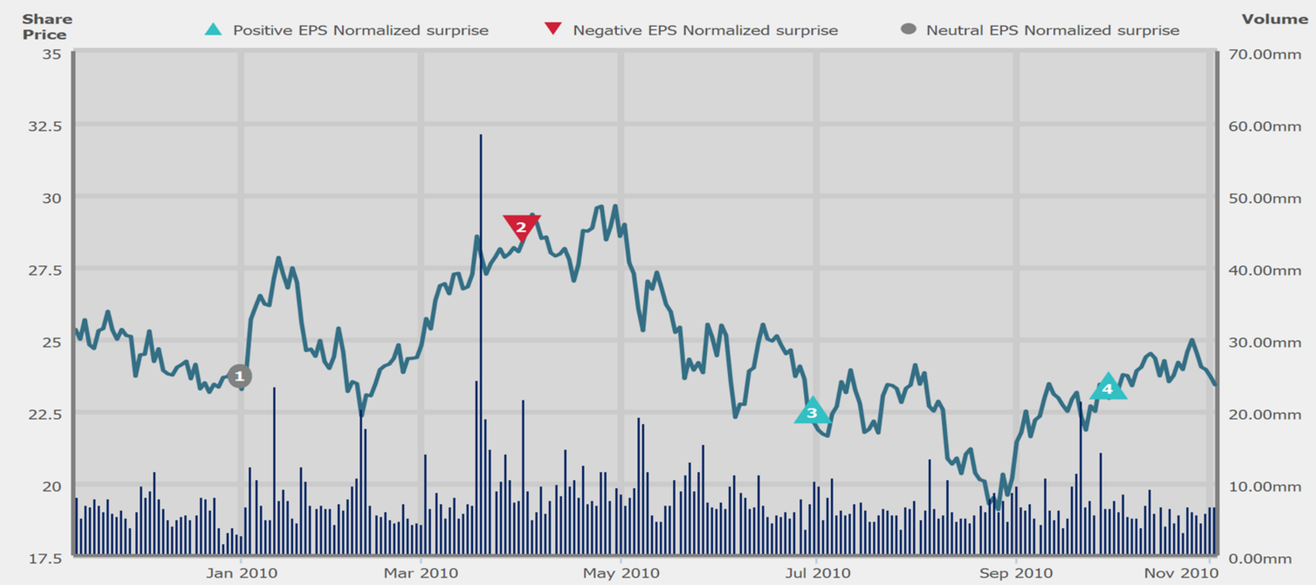
Thursday, February 03, 2011 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2010-			-FQ1 2011-	-FY 2010-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.95	1.06	▲11.58	0.95	2.87	2.89
Revenue (mm)	6348.32	6055.00	▼(4.62 %)	6079.49	23020.98	22383.00

Currency: USD
Consensus as of Feb-03-2011 7:48 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2009	1.51	1.51	➊0.00 %
FQ1 2010	0.25	0.14	▼2 (44.00 %)
FQ2 2010	0.77	0.92	▲3 19.48 %

FQ3 2010	0.93	1.43	▲53.76 %

Call Participants

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Presentation

Operator

Good morning. My name is Angela, and I will be your conference operator today. At this time, I would like to welcome everyone to the Hartford Financial Services Group, Inc. Fourth Quarter 2010 Earnings Call. [Operator Instructions] I would now like to turn the call over to Mr. Rick Costello.

Richard Costello

Thank you, Angela. Good morning, and thank you for joining us for The Hartford's fourth quarter 2010 conference call. The earnings release and financial supplement were issued yesterday, and the slide presentation for today's call is available on the company's website. Chief Executive Officer, Liam McGee and Chief Financial Officer, Chris Swift will provide prepared remarks this morning, and we will finish with Q&A. Also participating on today's call are Dave Levenson, President of Wealth Management; Andy Napoli, President of Consumer Markets; Andy Pinkes, Acting Head of Commercial Markets; Greg McGreevey, Chief Investment Officer; and Alan Kreczko, General Counsel.

Turning to Slide 2 of the presentation, 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 2010 quarterly reports on Form 10-Q, our 2009 annual report on Form 10-K and other filings we make with the Securities and 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 also 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 measures, is provided in the Investor Financial Supplement for the fourth quarter of 2010 and in the press release we issued yesterday, both of which can be found on The Hartford's website.

Now I will hand the call over to the Hartford's Chairman, President and CEO, Liam McGee.

Liam E. McGee
Former Chairman

Thank you, Rick. Good morning, everyone, and thank you for joining us. As you saw in yesterday's announcement, The Hartford reported strong fourth quarter and full year 2010 performance. Over the last year, we've been intensely focused on executing our strategy, and today's results demonstrate the fundamental strength of The Hartford. I thank my Hartford teammates for their great work.

In the fourth quarter, net income increased 11% year-over-year. For the full year, we reported net income of $1.7 billion or $2.49 per diluted share, compared to a net loss of $2.93 per share in 2009. Core earnings for the fourth quarter were $526 million or $1.06 per diluted share. For full year 2010, core earnings per diluted share were $2.89. This represents a 56% year-over-year increase. Obviously, from all perspectives, this is a significant turnaround from 2009.

Now while we have more to do, I feel good about the company's accomplishments and where we finished the year, as well as how The Hartford is positioned for 2011 and beyond. The Hartford's capital position is strong and improving. As Chris will cover in detail, by any measure, we ended the year with a strength in capital position. In December, we said we would begin to evaluate potential capital management actions. And yesterday, as you know, we announced a 100% dividend increase. Doubling the current dividend is a meaningful milestone and an important first step.

Going forward, we will prudently evaluate future capital management actions, which could include dividends, share and warrant repurchases, and de-risking transactions.

The Investment portfolio is in good shape. This quarter, we saw the lowest level of credit losses in three and a half years and at the low end of the $50 million to $100 million range I discussed in December. Over the last 12 months, the net unrealized loss position declined by $4.4 billion, and the gross unrealized loss position was cut in half.

Municipal bond holdings have been top of mind recently. During 2010, we have been repositioning our Muni portfolio, reducing our positions in a number of the more challenged states and improving overall credit quality in this asset class. Going forward, we expect to see some price volatility in munis, and we will continue to dynamically manage this portfolio.

During the fourth quarter, we also took actions to sharpen The Hartford's Business portfolio. In December, we announced a definitive agreement to sell specialty risk services for $278 million, as well as the closing of the sale of our Canadian Mutual Fund business to CI Financial. As you know, we said last April that we would regularly evaluate The Hartford's Business portfolio, and we are committed to that discipline going forward.

The customer-focused organizational structure we launched over the summer is already contributing to our results. The Hartford has three business units: Commercial Markets, Consumer Markets and Wealth Management. Commercial Markets delivers The Hartford's capabilities targeting companies integrated into a single business largely focused on the same third-party distribution. We like this business model, as evidenced by the $70 million of sales realized last year through the combined efforts of the Group Benefits and P&C Commercial sales team. We're targeting about $100 million of additional new joint sales for 2011.

The Hartford's leadership in Small Commercial will continue to be a growth driver with attractive pricing, granular risk assessment and strong growth in policies.

Now middle-market P&C remains competitive. Our growth in that business remains careful and selective with pricing discipline, quality underwriting and a focus on areas that we understand. In that regard, the team's efforts to grow profitably by targeting industry verticals are also bearing fruit. As an example, in 2010, the Middle Market business wrote nearly $150 million of premium for health care customers, nearly double what it did in 2009.

Overall, we're seeing early signs of economic improvement in P&C Commercial, particularly with small businesses. Audit and endorsement premium are both up year-over-year and sequentially, and we're confident that sustained exposure growth will emerge in 2011. Profitability in the Group Benefits business remains challenged by elevated claims incidence in long-term disability. In response, we are taking appropriate price increases.

In Consumer Markets, we've stopped mass marketing P&C Personal Lines and are focusing on our AARP relationship, adding new affinity partners and the attractive 40-plus age demographic segment. You can see the effect of this sharper focus in the fourth quarter results. Consumer Markets written premium is down with the transition to a more profitable book of business. And we expect recent pricing increases will drive improved underwriting margins in 2011.

In the fourth quarter, we announced a new affinity relationship with the American Kennel Club. AKC has all the elements of an ideal affinity partner, strong brand name with significant growth potential, loyal and committed members, and multiple product opportunities. The Consumer Markets business has a strong pipeline of additional affinity opportunities and expects to announce several new relationships during 2011.

The Hartford has strength in the Wealth Management market with individual life insurance, annuities, mutual funds and retirement products. Key elements of our growth strategy include expanding distribution, targeting business owners and building a profitable and competitive suite of annuity products.

In 2010, Individual Life sales in the independent channel exceeded sales through banks and wire houses for the first time ever. Through the Monarch program we introduced last year, we sold $18 million in life insurance. We've signed up more than 500 of the nation's largest independent producers. And every one of them, notably, has submitted at least one application. We're also having success selling life insurance through our P&C channels and expect about $25 million in sales in 2011.

In retirement plans, our commercial P&C sales channel has grown to be the fifth largest distributor of our 401(k) products. We have $230 million in sales through those channels in 2010, and we expect over $300 million this year.

So these results in life insurance and retirement plans demonstrate some of the new ways we are leveraging our multiline structure. In mutual funds, deposits recovered after a bumpy third quarter for industry equity fund closed. With rising equity markets and strong deposits, assets under management and our nonproprietary mutual funds are at their highest level ever.

In variable annuities, the team is on track with the next product for the rational suite of products we are developing. Now given where we are on the regulatory process, I'm not going to go into details, but we expect a late second quarter launch. Our goal remains the same: to sell products that are good for customers and for The Hartford.

So we accomplished a great deal in the fourth quarter and 2010 with improved profitably, a stronger capital position and greater focus. The businesses are executing their strategies with discipline and urgency, which we are confident will leverage The Hartford's overall strengths in product, distribution and customers, and in doing so, realize the unique benefits of the diversity of our multiline businesses. But there is more for us to do. Chris will provide more detail on Japan, but as I said in December, the risk is manageable, and we have time to do so. We have already taken a number of actions to mitigate some of the period-to-period surplus volatility, and we will put in place a comprehensive hedging strategy designed to enable the company to retain some of the economic upside from a market recovery, while limiting the downside to acceptable levels. In doing so, we will prudently balance economics, risk and capital.

We're looking forward to another year of strong performance in 2011 with a plan of 8% adjusted core earnings growth over 2010. Our outlook reflects expectations for a gradual but steady economic recovery. The plan also positions us to achieve our 2012 financial targets.

So in summary, The Hartford had a strong finish to a very good 2010. We delivered another quarter of steady profitability, consistent operating performance and strong execution. With confidence in the company's capital position and business outlook, we have taken a first capital management action by doubling the dividend. We know we still have work to do and are committed to building on our momentum in 2011 and beyond.

And with that, I'll now turn the call over to Chris.

Christopher John Swift
Chairman & CEO

Thank you, Liam. Good morning, everyone. Let's begin on Slide 4. As Liam said, the fourth quarter was a great finish to 2010. We posted net income of $619 million or $1.24 per diluted share. Core earnings were $526 million or $1.06 per diluted share. Earnings were driven by steady operating performance, as well as strong investment results and rising equity markets. At the end of 2010, book value per share was $44.44. This is up 14% over prior year and down 3% sequentially, due to rising interest rates in the fourth quarter. Diluted book value per share, excluding AOCI, continued its steady climb increasing 2% in the fourth quarter to $42.40 on healthy net income.

Now let's move to Slide 5 to discuss adjusted core earnings and the expense ratio. For the fourth quarter, adjusted core earnings were $451 million or $0.91 per diluted share. As a reminder, 2010 adjusted core earnings serve as the baseline going forward for our 2012 earnings growth target. This excludes two items: a DAC unlock benefit of $48 million, a net prior year reserve releases in Property-Casualty of $27 million. Given the strength of global equity markets, the DAC unlock was smaller than you may have expected. The primary reason was rising interest rates, which caused the value of fixed income securities in the separate accounts to decline. Adjusted core earnings for the full year 2010 were $1,768,000,000. This is a very good result and demonstrates the underlying earnings power of the company's businesses.

On the same basis, the adjusted core ROE, excluding AOCI for 2010, was 8.7%. This calculation excludes the impact of the CPP repayment in March.

For the expense ratio, we ended the year with an 80 basis point improvement compared to 2009. As we said last quarter, the efficiency ratio should be relatively flat in 2011. We intend to fund growth and efficiency initiatives in 2011, which will offset improvements in the underlying expense run rate. However, these investments will help position us to achieve the full 200 basis point improvement by the end of 2012.

Now let's move to a discussion of our business results beginning with Commercial Markets on Slide 6. P&C Commercial lines performed well in the quarter. The top line continued its recovery with written premiums up 4% over prior year for the second consecutive quarter. Underwriting profitability remains solid. P&C Commercial reported a 95% ex-cat [catastrophe] current accident year combined ratio. This includes three points of reserve strengthening for the first nine months of 2010. We slightly increased loss ratios because actual pricing increases ran short of our plan. When you back out prior-quarter adjustments, the underlying result for the fourth quarter was a 92% combined ratio. For full year 2010, the ex-cat current accident year combined ratio was 93.4%. This is at the midpoint of our original 2010 guidance, and a very disciplined result at this stage in the pricing cycle.

Turning to 2011, we expect the combined ratio to be flat to slightly higher, reflecting small earned pricing increases and slightly higher loss cost. This range of underwriting profitability will position us to meet our earnings growth targets for 2011 and 2012.

On the top line, we continue to see the positive trend that began in the third quarter. Much of the growth is coming from small commercial. Our outstanding market position in new product introductions have enabled us to take rate and to continue to grow policy count. We are taking a measured approach in Middle Market, where the pricing environment is much more competitive.

In addition, we again saw improvement in exposures across the P&C Commercial lines. Order premiums and endorsements are all improving over the prior year. For 2011, we expect written premium growth between 3% and 6%. This reflects three primary drivers: first, one to two points of exposure growth; second, one to two points of written pricing increases; and third, policy count growth in small commercial.

In Group Benefits business, the fourth quarter profitability was challenged by elevated claims incidence in long-term disability. As you know, we began implementing price increases in disability in the second half of 2010. These actions will improve profitability, but this will take time. As a result, our guidance for Group Benefits loss ratio in 2011 is similar to that of 2010.

In summary, it was a good end of the year for Commercial Markets, with P&C Commercial lines reporting written premium growth and solid underwriting profitability in the quarter.

Now let's turn to Slide 7 for a discussion of Consumer Markets results. In Personal Lines, we are executing the strategy we set out in April, bringing greater focus to our agency book of business, improving profitability over time and positioning ourselves to grow. On the top line, written premiums declined 6% in the fourth quarter, driven by rate and underwriting actions. We again took meaningful rate in the fourth quarter, with renewal pricing increases for auto and home of 7% and 10%, respectively. We plan to continue to take rate increases in 2011, but at a more modest pace. We expect mid-single-digit increases in auto and high single-digit increases in home. For 2011, we expect written premium to be flat to slightly down. Our actions to re-underwrite the agency book of business will be substantially complete by the end of 2011.

Consumer Markets profitability in the fourth quarter was impacted by heavy cat activity, driven by the Arizona hailstorm we mentioned on last quarter's call. Excluding cats, the current accident year combined ratio was 96.8%. For the full year, the ratio was 93.6%.

Looking ahead to 2011, we expect to generate about three points of margin improvement. This reflects the substantial pricing increasing we have taken in 2010 and our expectations for modest loss cost increase.

In summary, we are doing what we set out we were going to do in Consumer Markets. We are taking appropriate rate in underwriting actions. We expect to see meaningful combined ratio improvement in 2011, and we're focusing our efforts on expanding the AARP program in growing our affinity pipeline.

Now let's discuss Wealth Management results on Slide 8. Ex-DAC unlock, core earnings were up 23% over prior year. Rising equity markets, strong limited partnership returns and top line growth in our non-VA [variable annuity] businesses drove improved margins.

For global annuities, core earnings, ex the DAC unlock were $193 million, a 13% over prior year. The Life Insurance business posted another strong quarter. Ex-DAC unlock, core earnings were $51 million. Mortality was slightly favorably in the quarter, which is offset by higher expenses. The increase in expenses reflect timing differences and a couple of one-timers. Individual Life insurance sales increased 7% over prior year. As Liam noted in his comments, we're getting a lot of traction in the independent channel with the Monarch program.

Retirement plans had another great quarter. Deposits were $2.1 billion, up 13% over prior year, bringing total AUM to a record of $52.5 billion at the end of 2010. Indications for 2011 deposits are also positive, as we had a record fourth quarter for new plan sales, up a full 20% over prior year. With sales momentum and a little tailwind from healthy equity markets, we could hit the $10 billion mark in deposits in 2011.

In mutual funds, deposits totaled $4.1 billion, a strong recovery from the third quarter. Retail mutual fund deposits were up 7% over prior year. Total mutual funds AUM ended 2010 over $100 billion for the first time. The Hartford mutual funds posted excellent performance in the fourth quarter, with 78% of the retail funds outperforming their Morningstar peers.

In summary, we're entering 2011 with a pipeline, top line momentum and healthy margins in life insurance, retirement plans and mutual funds. And we're excited about the VA product launch later this year.

Now please turn to Slide 9 for a review of The Hartford's year-end capital position. The Hartford's capital position improved in 2010 by any measure. The Property & Casualty companies ended the year with $7.7 billion of statutory surplus, up $400 million net of $800 million of dividends upstream to the holding company in 2010. The P&C capital margin was $1.8 billion above AA levels, unchanged from prior year. The U.S. Life operations ended the year with surplus of $7.7 billion, up $400 million during 2010. Our estimate of Hartford Life and Accident 2010 RBC ratio is approximately 435%. This reflects statutory surplus of $6.6 billion at HLA, up from $6 billion at the end of 2009. The White River Captive reinsurer ended the year with an estimated RBC ratio of 180%, well above the targeted level. In total, the U.S. Life operations finished 2010 with a margin of $2 billion above our targeted RBC levels. The holding company ended the year with $2.1 billion, virtually unchanged from year end 2009. The bottom line, The Hartford grew stronger from a capital perspective in 2010. We repaid the CPP funds, statutory surplus grew over $750 million, total capital margins increased by $600 million and debt-to-equity levels and debt coverage ratios improved from their post CPP levels. All this while maintaining over $2 billion at the holding company.

Now let's turn to Slides 10 and 11 for more detail on the fourth quarter changes in statutory surplus. In aggregate, statutory surplus was up about $300 million. The key drivers were VA-related surplus, which grew $200 million. Credit-related impacts were essentially flat. P&C statutory income of $300 million, about half of which was upstream to the holding company. Our Non-annuity Life businesses consumed about $100 million of statutory surplus. This includes a small net increase in reserves related to fixed annuities and institutional spread businesses in the quarter, reflecting the impact of low interest rates. This brings the total increase for 2010 to approximately $400 million.

Now let's move to Slide 11 to briefly examine the VA surplus impacts. Most of the information on this slide is self-explanatory, so I'll cover the highlights. VA-related statutory income, excluding changes in reserves and hedge assets, contributed about $200 million. Statutory VA liabilities improved $900 million, driven by global equity market strength, higher rates, partially offset by yen strengthening. Hedge assets declined $900 million, as well, due to the same market forces that drove the improvement in the liabilities.

Looking forward, we have extended and modified our currency hedging for 2011 using short-term forward hedges. We moved to a forward-based program in 2011 because we concluded that it provided a better risk return profile in the near term. Last quarter, I estimated the quarterly cost of the remaining macro hedge equity options at $65 million through the end of 2011. I want to clarify that that $65 million figure was a pretax number. As of the end of 2010, the remaining value of the equity option is about $200 million. The value declined in the fourth quarter due to strong equity market performance. Therefore, the quarterly cost for 2011 is about $50 million pretax. Of course, this does not include mark-to-market gains and losses related to our forward and futures positions.

Now let's turn to Slide 12 and spend a few minutes on our Japan business. I want to make three points about our Japan book today. First, the Japan risk is manageable. Second, we have the benefit of time as policy holders can't begin to annuitize their income benefits and material amounts before 2014. And third, while continuing to hedge with our macro program, we are reviewing a number of risk mitigation strategies with the intention of implementing a more comprehensive and dynamic solution over time.

Slide 12 contrasts the recent changes in net retained amount of risk for the U.S. and Japan VA blocks. In the U.S., strong equity markets in the fourth quarter capped a year of recovery. As a result, the net amount at risk measures in the U.S. declined significantly for both the quarter and the year. GMDB net amount of risk in Japan rose in 2010. There are three reasons for this. First, Japanese equities were relatively flat during 2010, weaker than the S&P performance. Second, a larger percentage of the Japan book is invested in fixed income securities. These investments underperformed global markets in 2010. And third, the yen strengthening, about 12% against the dollar and 19% against the euro during the year.

Slide 12 also clarifies a potential point of confusion. The net amount at risk for our GMIB product is not identical to the death benefit NAR primarily because about 15% of the policies-in-force have only a death benefit feature.

Finally, it's critical to remember that a policy owner may receive a death benefit or an income benefit, but not both, so the NAR amounts are not additive.

Now let's turn to Slide 13 and take a closer look at The Hartford's GMIB products. In the typical GMIB product, at the 10-year contract anniversary, the policy holder may elect to withdraw the account value without penalty. They may elect to annuitize or they may do nothing and maintain their benefits. If the policy holder elects to annuitize and the account value is worth less than the original amount invested, they receive a payout annuity of the original premium amount in equal installments over the next 15 years without interest. That's a critical point in understanding The Hartford's obligations in Japan. There is no interest component to the payout annuity over the next 15 years. It's also important to understand how the money moves. At annuitization, the separate account assets are liquidated, and the proceeds are transferred to The Hartford's general account. We can invest those funds and generate a return during the payout period. As the chart on Slide 13 shows, the GMIB block in Japan will reach the annuitization window over the 12 years beginning 2013, with more than 2/3 between 2014 and 2017. This gives global markets time to continue to recover. It also provides us with time to deploy investment strategies to generate future yields on these assets.

Now let's turn to Slide 14 for a brief look at a simple 2010 profit and loss statement for the Japan VA block. The key point is that the Japan business is generating almost $1 billion of fee and other revenues a year. This provides a lot of capacity to fund reserve increases, DAC amortization, operating expenses, as necessary over the coming years. I hope this detail about Japan is helpful. As I've said, we are confident that the Japan risk is manageable. With the yen and interest rates at levels we do not believe are sustainable long-term, we have been managing tail risk in Japan with short-term derivatives. We intend to put into place a more comprehensive and dynamic solution designed to enable the company to retain some of the economic upside from the market recovery, while limiting the exposures to acceptable levels at the appropriate time.

Now let's turn to slide 15 to discuss guidance. As we announced last evening, our 2011 plan calls for core earnings per diluted share between $3.70 and $3.90. Slide 15 includes all the key assumptions underlying the guidance, including the full year diluted share count of 503 million shares. At the midpoint, our EPS range equates to adjusted core earnings growth of 8% in 2011 against the baseline of $1,768,000,000. This leaves us well-positioned to achieve the company's 2012 earnings growth targets.

Going forward, The Hartford's guidance will focus more on adjusted core earnings. Rather than providing quarterly updates to our EPS outlook, going forward, we will comment on how we are tracking against adjusted core earnings growth targets. This will better align our guidance to how we are managing the company, plus adjusted core earnings provides a more accurate picture of the run rate earnings power of the company.

In addition, we will continue to provide detailed operating driver guidance, which we will update quarterly. Bottom line, our 2011 plan calls for healthy growth over 2010, and we are confident that the company is on track to meet its earnings growth targets we've established for 2012. We're also targeting an 11% core return on equity by the end of 2012. There are two key drivers to achieving this target: first, executing on our core earnings goals over the next two years; second, as Liam discussed, we will prudently evaluate future capital management actions over time. So the key takeaway is that this management team is operating the firm focused on running our businesses well and prudently managing the balance sheet to achieve the 11% core ROE target.

With that, I'll turn the call over to Rick.

Richard Costello
Thank you, Chris. Before we begin the Q&A session, I would ask callers to limit themselves to two questions. Operator, you may now open the call to questions.

Question and Answer

Operator

[Operator Instructions] And your first question is from the line of Jimmy Bhullar of JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

You raised the dividend. I think it's about $100 million of additional spending than before. So maybe, if you could address, what would have to happen for you to get comfortable enough to start buying back your stocks? And then secondly, on just your annuity product, if you could talk about your new product strategy, what type of a product do you plan on introducing? I think -- does it had some equity component in it and a living benefit? And tell us about when it could begin to contribute to your deposit growth.

Liam E. McGee
Former Chairman

Jimmy, this is Liam, I'll take the first question, and then I'll ask Dave Levenson to take the question on the variable annuity new product. Jimmy, first of all, we think that the dividend doubling is a significant milestone for The Hartford and an important first step, as I said in my prepared remarks. I'd also say the context for us looking at any capital management activities is really prudent balance sheet management and prudent capital management action. We're obviously just having implemented the dividend increase. We're in the very early stages of our thinking about prospective next steps. I gave you a fairly complete list of things we might consider, but quite frankly, it's too early for us to kind of get into next steps.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Is it reasonable to assume that buybacks are unlikely this year?

Liam E. McGee
Former Chairman

As I said, Jimmy, we're in the very early stages of our thinking, and I think I gave you a sense that both management and the board will continue to evaluate that. And I gave you a sense of the prospective actions we might consider. I really am not prepared to say any more at this time.

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

Jimmy, this is Dave Levenson. On the annuity question, I would say that we're in the middle of our regulatory filings. So I can't really provide a lot of comments as far as what that product will look like. I will tell you that we are on track for a second quarter launch. So as far as when this product will start contributing, it should start contributing to our sales in the second half of 2011. And as we said multiple times, this is just one of several products that we will have in our lineup as we kind of construct a portfolio of rational products by 2012.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Could you comment on whether the product would have any equity-based guarantees or equity-based living benefit?

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

Jimmy, again, we're in the midst of the filings, so I'd rather not at this time.

Operator

Your next question is from the line of Edward Spehar Bank of America Merrill Lynch.

Edward A. Spehar
BofA Merrill Lynch, Research Division

Chris, I have a couple of questions on hedging. Just to clarify what you said, in terms of the macro hedge, are you saying that for currency and equity market, you're thinking $50 million per quarter pretax in '11?

Christopher John Swift
Chairman & CEO

I think the point of clarity is that the equity in protection, I think in terms of $50 million pretax per quarter in '11 and that the FX portion, given that we moved a substantial portion of it to futures, I didn't really give you a cost. But there is, I'll call it, data out there that we provided in the Q, sort of the percentage move for market activities. I think you might be able to calculate that on yourself for each percentage yen move.

Edward A. Spehar
BofA Merrill Lynch, Research Division

What was the comparable number that you had talked about for the equity piece on the last call?

Christopher John Swift
Chairman & CEO

As we said in our prepared comments, we said $65 million. So it came down slightly.

Edward A. Spehar
BofA Merrill Lynch, Research Division

And both of those were pretax?

Christopher John Swift
Chairman & CEO

Yes.

Edward A. Spehar
BofA Merrill Lynch, Research Division

This is, I think, at least, the second quarter in a row where the change in statutory reserves and the change in the hedge assets were about the same. And I guess, my understanding was that there was part of the reason that you would have a captive is that there was a difference in sort of how those two pieces move. So what am I missing on that?

Christopher John Swift
Chairman & CEO

I don't think you're missing anything. I mean we would sort of expect it to be fairly correlated. I think the only, I'll call it, economic thing that we've talked about in the past is you might have some differences on interest rates, but generally, things are fairly well correlated right now.

Edward A. Spehar
BofA Merrill Lynch, Research Division

But is that because of the captives here or is that something else?

Christopher John Swift
Chairman & CEO

No. It's not the captive.

Edward A. Spehar

BofA Merrill Lynch, Research Division

I guess my point is I thought the reason to have a captive is that if you have the hedge assets and the reserves at the mark-to-market on hedge assets is more real time versus not the same mark-to-market or the reserves so that you can have a mismatch when the market moves. That's not correct?

Christopher John Swift
Chairman & CEO

Not with our design.

Edward A. Spehar
BofA Merrill Lynch, Research Division

The next question is on the statutory cushion that you talked about $2 billion for the Life operations. How is that calculated?

Christopher John Swift
Chairman & CEO

That is, again, our traditional, we call it, stress scenario RBC level at 325.

Edward A. Spehar
BofA Merrill Lynch, Research Division

So that's like roughly, that's a little bit more than $1.5 billion, I guess, at Hartford Life and Accident and the rest is the captive?

Christopher John Swift
Chairman & CEO

Yes, I would say the captive. As I said in my comments is that, at 180, that's above our targets of 125.

Operator

And your next question is from the line of Mark Finkelstein with Macquarie.

A. Mark Finkelstein
Macquarie Research

Liam, in your opening remarks, you talked about the use of capital as potentially on de-risking strategies. I understand the macro hedge on kind of on the annuity block, on the global annuity block. But I guess, can you just elaborate on what kinds of things you were alluding to in that comment?

Liam E. McGee
Former Chairman

I'm going to pass it off to Chris here in a second to give you a little detail on what we may be thinking about. But I do want to bring the context that, that was just a list of possible things we would consider, not necessarily anything we have decided. And I'd reiterate what I said in my response to Jimmy's question that we are -- having made the dividend decision, we're in the very early stages of our thinking about prospective next steps. So with that context, I'll turn it over to Chris to comment a little bit more specifically, if he wants.

Christopher John Swift
Chairman & CEO

Particularly, I think I heard the question on related to de-risking. I think what we would say, Mark, is that to de-risk, to continue some of our actions will require a certain outlay of capital and earnings over a period of time. So when we speak about having the earnings and capital to do that, it's just a function of how much and when are we going to start to significantly de-risk.

A. Mark Finkelstein

Macquarie Research

Just on Consumer Markets, I'm just thinking about the combined ratio guidance of 89% to 92%. The fourth quarter combined ratio is a little elevated, close to 97%, but the trailing four quarters was in the 94% combined ratio range. I understand the rate increases, and I understand they're moderating a little bit, but why is it a realistic expectation for that to come in as much as we have it coming in as a baseline assumption?

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

This is Andy Napoli talking. Before I address that, I'd like to provide some context around what's brought us to this point consistent with the April strategy. We are deliberately and very intentionally narrowing our focus in Consumer Markets in a way to deliver consistent profitable growth. We'd have to take some pretty tough actions. We've imposed significant underwriting restrictions in agency and taken rate where needed to get on top of loss trends. And when you go in into that, that our top line would be sort of impacted by that. So all difficult things to do but necessary. So from a profitability perspective, 2010, we talked about the written rate earning in throughout 2011. And we view that as the single most, the largest driver of hitting our profit target. To add to that, the profitability will also benefit from a fairly dramatic mixed shift to more preferred segments with lower frequency profiles. So that, coupled with the rate increases, gets us to our profit target.

A. Mark Finkelstein
Macquarie Research

How much of the Consumer Markets business would you characterize as core today versus what you would classify as maybe non-core?

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

Core today?

A. Mark Finkelstein
Macquarie Research

The over 40, the AARP, et cetera.

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

AARP is certainly core, right, so that's $3 billion right there. And then with an agency, the way we talk about it is 80% of our business that we're writing today is hitting that segment. So still some cleaning up to do there. [ph] (01:01:51)

Operator

And your next question is from the line of Darin Arita with Deutsche Bank.

Darin C. Arita
Deutsche Bank AG, Research Division

I have a question on the efficiency ratio. It went up for the full year to 18.3%. I think we're running at 17.9% for the first nine months. So I was wondering if expenses in the fourth quarter were higher than normal.

Christopher John Swift
Chairman & CEO

Darin, this is Chris. I would just say it's just fourth quarter seasonality. Again, the data we see, there isn't anything unusual except for the year-end accruals and true-ups. So I think we should still feel very confident that we'll achieve that 200 basis point improvement.

Liam E. McGee
Former Chairman

Darin, this is Liam. I would just add a little bit to what Chris said. We feel more confident today about hitting the 200 basis point efficiency improvement by the end of 2012 than we did when we announced that target in April of last year. I totally agree with Chris' description that we're just in timing differences in the fourth quarter. But we've got a lot of great work going on, and you'll see the fruits of that in our run rate toward the latter part of '12.

Darin C. Arita
Deutsche Bank AG, Research Division

Turning towards the Commercial Market segment, reserve releases were a lot smaller this quarter. Can you talk about how you're thinking about reserve adequacy there?

Andrew J. Pinkes
Former Executive Vice President of P&C Claims and President of Heritage Holdings Inc

This is Andy Pinkes. Here's really how I think about that. Really our reserve position overall remains very strong. Our carried reserves continue to be greater than our actuarial indications. Our carried reserves versus actuarial indications, if you look at our Ks ([ph] (01:02:45) or if you look at the IFS, have really remained very steady over the last several years. So we feel very good about that strength of our reserve position. And to also add to that, we have a very robust reserve review process, and so we've got actuary certainly in the reserving sectors, but also in our pricing and claim areas who are getting really quick and accurate current claim data and trend, so we can take appropriate action. So really that's our baseline in terms of how we think about it. And then as we go into the year, the pace, if at all, of prior-year reserve development will be determined as a result of our reserving process as we proceed through the year.

Operator

Your next question is from the line of Chris Giovanni with Goldman Sachs.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Question, I guess, for Liam. Can you talk some about conversations you're having with the rating agencies regarding capital stability and deployment? From the past, you've targeted the 325% RBC and wanted to see if you've received any indication that that number needs to move higher. I guess the reason being is a number of your competitors have alluded to the agency's kind of being comfortable with where RBC ratios stand today. But that any future capital deployment needs to be done with future capital generation and not what's currently on the books.

Liam E. McGee
Former Chairman

I'll make a couple of comments and then I'll ask Chris to provide some more detailed flavor. Our conversations with the rating agencies, as you would expect with all important constituents, were really about the dividend action, that first step that we took. And as I said earlier, we're in a very early stage of thinking through other prospective actions in '11 and in '12. I'd also remind you to your question that the 325% is only a stress scenario number. And that the firm, as Chris noted today, is running at about 435 basis points, as we currently speak. So, Chris, you want to add any flavor?

Christopher John Swift
Chairman & CEO

Sure. We have good and active conversations with the rating agencies throughout the year. I think as Liam really context the capital management actions, we're early in our thinking. So there really hasn't been any substantive discussions about our specific facts and potential actions. And we'll approach that when it is necessary with them. And we also said that we did consult with them on the dividend and, obviously, we took the actions we did.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

And then one quick one for Dave. I appreciate that you can't comment sort of on the new VA product until you get the approval. But what, I guess, simplistically gives you the confidence that the new product will kind of address the meaningful weakness in sales you've seen and get you closer to your desired annuity capacity?

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

Just given where the demographics are and what our research tells us, this product will be complementary to our PRM product, which we are still going to sell. It's just going to go after a different segment. So I think the fact that it's going to be complementary going after a different segment makes us feel good that we can achieve the sales levels that we have talked about in the past.

Operator

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

Thomas George Gallagher
Crédit Suisse AG, Research Division

I wanted to touch on the hedge cost just so I understand exactly what's going on. The $200 million pretax, Chris, is for the equity puts you're buying?

Christopher John Swift
Chairman & CEO

Yes. We call it our macro equity protection that we put into place and extended in April through the end of 2011.

Thomas George Gallagher
Crédit Suisse AG, Research Division

So those are one-year puts? And you were previously buying yen puts, and now you're using yen futures, is that -- that's what's changed?

Christopher John Swift
Chairman & CEO

Yes, right.

Scott Frost
HSBC

And I appreciate you haven't sort of articulated a cost associated with that, but if you were previously spending, I think, it was $50 million to $65 million a quarter, do you view there being an economic cost associated with the program you've moved to? Or is it essentially -- do you think of the futures not necessarily having a cost, really just being dependent on the direction of the currency? Because obviously, with the premium outlay on the puts, that's very direct. We can measure it. How do you think about that change, and what it's costing The Hartford?

Christopher John Swift
Chairman & CEO

I think it's a good important point. There is economic cost to this, we know that. And again sort of the risk return profile in the short term as we continue to work on our larger, as I said, dynamic solution. We just view this was the most effective at this point in time. But we do know, there is economic cost as markets move around and maybe economic benefits if there's more yen strength.

Thomas George Gallagher

Crédit Suisse AG, Research Division

Can you just indicate in terms of the, I guess, the range of options you are considering. I don't know, this is either for Chris or Liam, in terms of the potential risk solutions for Japan, should we be thinking about the timing associated with something like this? Is it really dependent on if the yen were to weaken materially, that would give you a much better window to implement a comprehensive solution, or is it more you need to build more capital? I just want to get a sense for where your head is at in terms of thinking about the variables we should be looking at?

Christopher John Swift
Chairman & CEO

I think you ought to think in terms of what we're thinking is sort of what is the amount of tail protection we would want, which implies we're trying to size sort of our risk appetite to retain a certain level of risk in broad market levels, whether it be equity markets, whether it be interest rates or yen. At what levels do we want to start to put on significant amounts of what’s called [ph] (01:09:32) structure protection?

Operator

And your next question is from the line of Andrew Kligerman with UBS Securities.

Andrew Kligerman
UBS Investment Bank, Research Division

Around the property casualty area, and some of it was touched on, but when I read in your writeup that you've gotten 7% rate increase in Auto, 10% in Homeowners and then shifting over to Commercial, you've got 1% there. I spend more of my time focused on the Life sector. But the feedback I get from more P&C focused people is that this is not really consistent with what they're seeing in the market. So it'd be great if you could give a little granularity, a little color on where you're getting the rate increases in commercial and then the same thing on consumer?

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

Andrew, this is Andy Napoli with Consumer. So when you look at the rate increases that are implemented across the board and communicated by all the carriers and you start -- we decompose those, and so that's more of a consistent view of what's happening with price. Our conclusion is that we're more in line with our competitors than that. How these are implemented vary greatly from state to state, segment to segment. So I think we're more in line than you think.

Andrew J. Pinkes
Former Executive Vice President of P&C Claims and President of Heritage Holdings Inc

Andy Pinkes on Commercial. So the way I think about it is for standard commercial, we are plus-one for price. We frankly view there's some real strong execution by us in the market as we've been disciplined in our underwriting in our approach. In addition, there's no doubt that our Small Commercial business, which is an incredible franchise, has performed very well. We have very sophisticated pricing analytic tools there, which we use. And playing into that segment of the market has been very successful for us in terms of profitability as well as growth.

Andrew Kligerman
UBS Investment Bank, Research Division

Is most of the rate increase coming from Small Commercial? Is that really where it's coming? And are there any product areas that you're getting rate increase in particular in?

Liam E. McGee
Former Chairman

Our core business owners policy is the core and heart of that franchise, and we are seeing rate increases there -- that is clearly what's driving rate for us both today and we see it going into next year, as well.

Andrew Kligerman
UBS Investment Bank, Research Division

It looked like the 2010 accident year was developing a little too quickly. What are your thoughts there about the 2010 accident year?

Liam E. McGee
Former Chairman

Let me give you a little context on the 2010 accident year. Really, our 2010 plan included, in hindsight, a more aggressive Middle Market pricing than the market would bear. We were a little ahead of our skis on that one. And so to be clear it's really about pricing, and loss costs have remained relatively benign. We've not seen any unfavorable claim emergence there. So that's really what's going on with the current accident year.

Andrew Kligerman
UBS Investment Bank, Research Division

On the Group Benefits, I understand you're targeting a 77% to 79% benefits ratio. Maybe just a little granularity around it. I know you're implementing rate increases, as well. Just a little granularity about what you're seeing there? What the pressure points are? Just Hartford's view of that world.

Andrew J. Pinkes
Former Executive Vice President of P&C Claims and President of Heritage Holdings Inc

We've spent a lot of time, as you would imagine, unpacking what's going on with incidence. As we talked about in the third quarter, what we've seen has really not changed. It's pretty widespread. We view it as an industry phenomena. It's really not in any particular plan size or business or industry or geography or issue year. We're seeing it fairly widespread. So as you know, we are taking rate, but we're going to be smart about that. We have tools, and we'll look at our portfolio to make sure that we're putting in rate in the right places and meeting our expectations. And with regard to 2011, we have taken into consideration, as you look at our 2011 guidance what we experienced in 2010. So that gives you the basis. You can see that in our guidance.

Andrew Kligerman
UBS Investment Bank, Research Division

Is the magnitude of the rate increases in double digits or is it more?

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

I would not say it's double digits. And remember, it's not peanut butter. There's a rate that goes into our target, but then it's based on our renewal, how those particular pieces account by account are performing and what we need to achieve target rate. So we have a pretty disciplined approach there, and we are, frankly, enhancing our discipline as we operate in this challenging market.

Operator

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

Randolph Binner
FBR Capital Markets & Co., Research Division

Just a quick follow-up on the line of questioning around the hedging in Japan. I guess I took it from Chris' comments that ideally you would wait for more optimal macro environment. I think Tom Gallagher was asking about that. I guess what I'm trying to get a sense of is how long can you wait? Is there kind of a breakdown point where you have to commit to a more permanent hedge even if the end in [ph] (01:15:37) interest rate and market levels kind of remain where they are currently?

Christopher John Swift

Chairman & CEO

Randy, it's Chris. I don't think there is a tipping point and sort of go-or-no-go point. We've continued to obviously account for and put up reserves and capital associated with the business. So there's not a tipping point in my mind.

Randolph Binner
FBR Capital Markets & Co., Research Division

The $50 million pretax cost per quarter is kind of sustainable looking out. And then if there's an opportunity, you take advantage of it. Is that the way should think about it?

Christopher John Swift
Chairman & CEO

That is the options-based program. Again, to be sort of complete, we still have some futures-based equity protection of roughly $1.6 billion notional that we put on during this year. And obviously, we have our futures positioned for FX. So you put them all together, and I know you're listening to Tom's question, we will continue this on a short-term basis. We know the economics are there. And we still feel comfortable with this short-term approach.

Randolph Binner
FBR Capital Markets & Co., Research Division

And if I could just hit the personal retirement manager issue one more way. I guess I won’t ask you to comment on the new product, but as far as the existing products, to the extent that it can still be sold, is there any shift at all? I'm thinking about the distribution that goes through without the income benefit, which is a feature that basically exists on all your competitors' products. Is the personal retirement manager potentially a better product for outside of the independent financial advisor channel? That's the question. Is there a potentially different way to distribute the product that could help with the negative flows there?

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

This is Dave Levenson. We are always looking at alternative ways that we can distribute product. But I would say that PRM, at least for the short term, is going to be sold through our traditional distribution. And remember, one of the things that we said in the past is this product actually shows well when interest rates are much higher. So in that type of economic scenario, I'd expect that our PRM sales will be significantly higher.

Operator

And your next question is from the line of John Nadel with Sterne Agee.

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

I've got two quick questions. One on the VA business. It's more on the surrender rate. It picked up this quarter, it was over 12% annualized. I just was wondering if you could give us some perspective on what's happening there. Is that something that's a little bit more by design? Or do you see that spiking because there's some shift into the newer product or is that business leaving you?

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

It's Dave Levenson again. I would say this is really a function of our dynamic lapse modeling. And as we've seen the market snap up a little bit, actually quite a lot in the fourth quarter, we have seen an uptick in the lapses. So that's really what's causing it.

John Matthew Nadel

Sterne Agee & Leach Inc., Research Division

What does dynamic lapse mean?

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

So as we see the market essentially move up, there's more people that tend to surrender their policies.

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

Their decision?

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

Their decision.

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

Just a question broadly on the guidance. If my math is reasonable, it appears that you're guiding us to an ROE that's around 8% for 2011 based on your range of $3.70 to $3.90. Yet, I think at the outset, you indicated you're on target to achieve your 2012 objective of 11% ROE. So I respect the fact that you're in the early stages of your capital management strategy, but you also laid out that various specific target about a year ago now. So I'm wondering if you can walk us through how you bridge the gap from 8% to 11% without actually frankly massive buybacks.

Liam E. McGee
Former Chairman

John, this is Liam. This management team is running the firm with 11% return on equity as a goal for us. We took an important first step with our dividend action, and as I've said several times today, and a very important point, that on the heels of that, we're in the early stage of thinking about potential subsequent actions I've outlined in my prepared remarks. A few of the ones we might consider. I don't think there's a specific road map to get there. It'll probably be a combination of things that we'll do. As far as the plan and the ROE, I'll ask Chris to comment on that. Final thing I'd say is anything we do, any capital management actions we do or consider, as well as any balance sheet actions that we may consider, will always be on the context of prudent management of both of those and along with creating maximum shareholder value. So, Chris, any more specific thoughts there?

Christopher John Swift
Chairman & CEO

I think you said it well. John, the only thing I'd add is we can talk about your numbers and tweak them a little bit at the margin, but we do know there is a significant amount of capital to manage here. And as Liam mentioned, we're at the early stages of that. And we're going to be very, very thoughtful and prudent about it.

Operator

And our final question is from the line of Larry Greenberg with Langen McAlleney.

Larry Greenberg
Langen McAlenney

I just want to be certain I understand what was going on with the accident year re-estimation for the first nine months of the year. So you're saying that your loss picks were just a bit too optimistic because you didn't get the pricing that you had expected. Is that a correct interpretation?

Andre A. Napoli

Former Executive Vice President and President of Consumer Markets & Enterprise Business Services

That's right, that's right. Just to be clear, with regard to loss costs, they have remained within our expectations and have remained benign. And that we, in our plan, had more pricing than we had achieved.

Larry Greenberg
Langen McAlenney

Did it hit any specific product lines more than others or was it pretty much across the board?

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

Pretty much across the board, but really in the Middle Market space.

Larry Greenberg
Langen McAlenney

And then your expectation for 2011 of one to two points of pricing, it's not a big change, but on the margin, perhaps a little bit more than you got in 2010. Is there any thinking that the marketplace could be more accommodating for you to get a little bit more price?

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

We're hopeful that it's going to be more accommodating for sure. But the driver here for us is small business and our capabilities there. And we've got some very exciting products and capabilities that are just being launched and some more will be launched midyear. And so we have a good feeling about being able to achieve another point or so than we achieved last year.

Larry Greenberg
Langen McAlenney

Any change in tone in the marketplace over the last couple of quarters that you've been able to detect?

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

There's optimism, but I would say it's still competitive out there. I think that it's still very tough sledding, particularly the more you go head up [ph] (01:23:32) market in the Middle Market space and north of that. It's still very competitive out there.

Liam E. McGee
Former Chairman

Larry, the only comment I'd add is that's why we feel so good about the small-business franchise we have. It has very unique, very competitive capabilities, which enable us, as Andy suggested, to get rate when others who are more focused on Middle Market in that market quite simply can't.

Richard Costello

Thank you. Operator, this concludes the call. We appreciate all of your participation, and we look forward to seeing all of you soon. That concludes the call.

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