S&P Capital IQ

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The Hartford Financial Services Group, Inc. NYSE:HIG

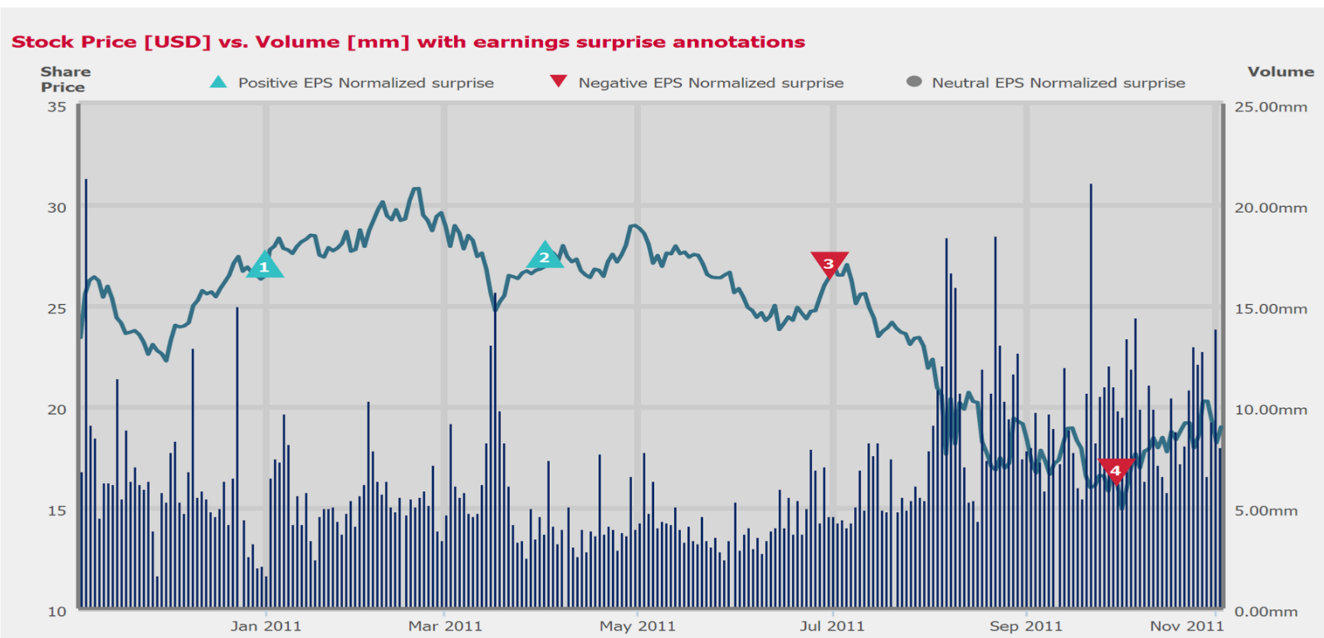
FQ4 2011 Earnings Call Transcripts

Wednesday, February 08, 2012 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2011-			-FQ1 2012-	-FY 2011-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.62	0.69	▲11.29	0.86	1.88	1.94
Revenue (mm)	5872.37	5638.00	▼(3.99 %)	5633.11	22163.20	21867.00

Currency: USD
Consensus as of Feb-08-2012 12:11 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ4 2010	0.95	1.06	▲1 11.58 %
FQ1 2011	0.95	1.16	▲2 22.11 %
FQ2 2011	0.01	0.00	▼3 (100.00 %)

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FQ3 2011	0.25	0.05	(80.00 %)

Call Participants

EXECUTIVES

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

Christopher John Swift
Chairman & CEO

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

Douglas G. Elliot
President

Liam E. McGee
Former Chairman

Sabra R. Purtill
Senior Vice President of Investor Relations

ANALYSTS

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Presentation

Operator

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

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you. Good morning, and welcome, everyone, to the Hartford's Fourth Quarter 2011 Financial Earnings Conference Call. The press release, financial supplement and slide presentation for today's call are posted in the investor information section of our website. Liam McGee, The Hartford's Chairman, President and CEO has some opening comments, after which, Chris Swift, our CFO, will provide a financial overview. We will then open the call for questions. Other members of our senior management team are also present for our call, including Doug Elliot, Alan Kreczko, Dave Levenson, Andy Napoli, Bob Rupp and Hugh Whelan.

Please note that as discussed on Page 2 of the presentation, any statements made today concerning The Hartford's future results or actions should be considered forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not guarantees of future performance, and actual results may differ materially. We assume no obligation to update these statements.

You should also consider the important risks and uncertainties that could cause actual results to differ, which are listed in our press release, our third quarter 10-Q, 2010 10-K and other filings we make with the SEC.

In our presentation, we use some financial measures that are not derived from Generally Accepted Accounting Principles or GAAP. Definitions and reconciliations of these measures to the comparable GAAP measures are provided in our financial filings. I'll now turn the call over to Liam.

Liam E. McGee
Former Chairman

Thank you, Sabra. Good morning, everyone, and thank you for joining us today. Last evening, we announced fourth quarter results that were in line with what we discussed in December, with book value per diluted share up 17% over the last year. Results were improved from the third quarter, but 2011 was a challenging year with the weak macroeconomic environment and unusually bad weather.

We're encouraged by some of the recent economic developments. Domestic business activity, employment data and consumption trends all suggest a return to moderate GDP growth. And the European Central Bank's additional support measures have had a positive impact in the marketplace. But we remain cautious about the operating environment for 2012. Many of the factors -- low interest rates and market volatility -- are likely to continue to have some impact in 2012.

So given this environment, as we said in December, we are aggressively managing the levers within our control to increase profitability and generate shareholder value. Across the organization, as you'll hear, we are prioritizing profit over sales volume, driving greater expense efficiencies and growing where we are generating appropriate return.

In Commercial Markets, we achieved accelerated rate increase across most P&C Commercial lines. As we expected, pricing crossed the inflection point and exceeded loss costs for most of our lines in the fourth quarter. As these written pricing changes earn in over 2012, we expect to see margin expansion throughout the P&C Commercial portfolio, particularly in our Middle Market book.

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Doug and his team have accomplished a great deal since his arrival. They're making material improvements across their business like building our property capabilities to move us to a more diversified P&C Commercial book. We now have dedicated property specialists in each of our Middle Market regions. And in addition, we've hired several senior underwriters to strengthen our core property team and have significantly enhanced our property risk tools. This focused effort has already turned several strong prospects into Hartford customers.

We've also realigned the sales force against customer segments for both Commercial and Consumer Markets. This will increase our responsiveness to customers, brokers and agents, while heightening accountability for results.

In Consumer Markets, Andy and his team have focused the book on a more targeted, preferred customer segment. This strategy is paying off with notable margin improvement in the fourth quarter.

The AARP relationship continues to be a competitive advantage for us. Along with strong new business growth in the AARP Direct business, we are seeing good momentum with the AARP products sold through the agency channel. About 80% of new business is hitting our targeted, mature preferred demographic.

For Wealth Management, as you know, we separated several of the division's businesses into a Runoff segment in December. The financials are broken out for the first time this quarter, so you can better evaluate progress on our ongoing businesses as well as those in Runoff.

Earlier this week, we appointed a new, separate, dedicated leadership team for the group, with Dave Bedard, the former CFO for Wealth Management, heading the team. Dave is a 26-year finance veteran with expert knowledge of these and other complex financial products. Dave will be joined by Aidan Kidney, who was the CEO and President of our Japan business; and Peter Sannizzaro, who was most recently CFO of the Global Annuity business. I'm pleased that Dave, Aidan and Peter are taking on these important new roles.

This team is charged with more efficiently managing these blocks of business, reducing their size, risk, volatility and capital consumption, and we will run this business as its own segment with segregated financials.

In the ongoing Wealth Management businesses, Dave Levenson and his team are focused on increasing returns and managing risk in this low-rate environment. As an example, we've raised rates on Life Insurance several times in the last 18 months. We also believe that our targeted product and distribution initiatives are ensuring that we successfully compete in the marketplace and achieve adequate returns.

For example, we recently announced an agreement where Wellington Management will serve as the sole subadvisor, pending the mutual fund board approval for The Hartford's fixed income and equity mutual funds. Our largest distribution partners are excited about this relationship as it positions The Hartford as a more significant player in the fixed income space and the mutual fund industry overall.

In Life Insurance, we have significantly expanded our distribution efforts, opening up new sales channels. We're maintaining our leadership in wirehouses and banks, but the independent channel now makes up about 48% of our total sales.

As you know, we are also focused on driving greater efficiency at The Hartford and are making good progress toward our aggregate $450 million target by streamlining operations, rationalizing management layers and leveraging technology. This is a 3-year effort. We reduced run rate expenses by $150 million in 2011, and we'll continue to deliver on this objective in '12 and '13.

Fourth quarter results also demonstrated the effectiveness of our risk management capabilities. We discussed our Japan hedging program in detail back in October and the year-end surplus performed in line with what we told you in December. As a result of continued confidence in our capital position, in December, we began repurchasing shares. We have bought back just under $100 million of shares to date and expect to be active in the market again shortly. We intend to complete the full $500 million share buyback by early second quarter 2012.

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With the company stabilized and strengthened, our entire team is working to increase shareholder value. We do not believe the current stock price reflects the true value of the company. And so as I said in December at our investor presentation, we are evaluating our strategy and our business portfolio for opportunities to deliver greater value for shareholders. We will be objective and pragmatic about the best ways to achieve this goal.

I'll now turn the call over to Chris.

Christopher John Swift
Chairman & CEO

Thank you, Liam. Good morning, everyone. I'll begin on Slide 5. As Liam mentioned, fourth quarter results were in line with the outlook we provided in December. We saw areas of good performance throughout the ongoing businesses that provide positive momentum for 2012. Fourth quarter core earnings were $339 million, including a $47 million DAC unlock benefit.

On Slide 5, you'll see several items that adversely impacted core earnings this quarter. These items totaled $69 million, including several items that I estimated at our Investor Day. The principal difference was that the original estimate was for catastrophe losses, which totaled $14 million pretax.

During the quarter, we had $39 million of new cat losses that were offset by $25 million of favorable development on second and third quarter cats. This compares to our fourth quarter estimate of about $50 million. In addition, we had favorable DAC unlock of $47 million. At Investor Day, we estimated fourth quarter core earnings would be between $0.80 and $0.85 per diluted share. Adjusted for the items that we just discussed, actual results were $0.83.

Returns on alternative investments, which are volatile, were essentially 0 in the quarter versus $67 million pretax in the third quarter. Fund valuations were negatively impacted by third quarter equity market performance. Given the typical one quarter lag, we'd expect alternative returns to rebound in the first quarter of 2012.

On Slide 6, we have broken out fourth quarter core earnings into our ongoing and Runoff divisions. These numbers exclude the Corporate division, which reflects holding company interest income and expenses. Going forward, we'll provide you with this breakout on a quarterly basis to clearly show the earnings performance of our ongoing businesses.

On Slide 7, book value per diluted share rose to $47.25, an increase of 17% over the last 12 months. Excluding AOCI, book value per diluted share rose by 6% to $44.86. These amounts do not reflect the implementation of the new DAC accounting standard, which is effective January 1 of this year. After adoption, all-in book value will decline about $1.5 billion or $3.09 per share. We will publish restated 2011 segment results that reflect the impact of the new accounting standard in March.

As Liam mentioned, we began our share repurchase program in December. Through early 2012, we have completed $94 million of the $500 million authorization. We will be active in the market very soon and intend to complete the authorization by early second quarter of 2012.

Let's turn to our business results by segment. Slide 8 shows the summary results for Commercial Markets. Core earnings were $40 million compared with $231 million in the prior year. This quarter results reflect adverse reserve development in P&C Commercial as well as challenges in Group Benefits. P&C Commercial reported core earnings of $25 million, reflecting the $109 million pretax of net prior year development and $87 million pretax of current year development.

These increases, which we discussed in early December, reflect higher claim frequency on the 2010 accident year in our Worker's Compensation book and the roll-forward impact on the 2011 accident year. The increase in frequency is an industry-wide trend. The current accident year reserve strengthening was 5.6 points on the fourth quarter combined ratio of 101.5 x cats and x prior year. Early indications of claim activity since this adjustment show our estimates for 2010 and 2011 are holding, but it's still early for these accident years.

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As Liam mentioned, we saw accelerating rate increases across all lines in the fourth quarter. Overall, renewal pricing increased 5% with stronger results in our Middle Market business, where we achieved a 10% increase on workers' comp renewals. This grew from 7.5% in October to over 11% in December. We did see a decline in retention, but we are willing to shed some renewal business to improve margins.

Shifting to Group Benefits. Core earnings of $15 million were below our expectations. The loss ratio of 80.5 reflected elevated disability incidents. Our management actions have been focused on improving pricing to offset loss ratio pressure. We continue our highly selective pricing approach, targeting specific rate actions on a case-by-case basis. While we are making progress in putting more rate into the book, the market remains competitive for well-performing accounts.

Consumer Markets core earnings of $83 million are summarized on Slide 9. The combined ratio x cats x prior year was 93.0, 3.8 points better than prior year. This largely reflects 2011 price increases earning into our book of business, particularly in auto. New business written premium rebounded strongly in the second half of 2011. It's now back to acceptable levels after a decline in 2010 and the first half of 2011. These improvements are a direct result of targeted new business initiatives and the expansion of the AARP Agency platform. While new business and retention have increased significantly year-over-year, we have not yet reached the pivot point where new business outweighs non-renewals. Our retention level in auto has improved by 2 points to 83%, still a few points below our target. Improving retention remains a key goal for this segment.

Turning to Slide 10. Wealth Management core earnings x DAC unlock were $155 million, 11% lower than prior year. This decrease was largely due to 11% decline in assets under management, primarily from net outflows in Individual Annuities. As a reminder, results for International Annuity, Institutional Annuity and Private Placement Life Insurance are included in the Runoff division, not Wealth Management.

Individual core earnings -- Individual Annuity core earnings x the DAC unlock were $86 million, down 10% from prior year. Sales improved in the quarter, marking the first sequential sales increase since 2008. We also have began rolling out our new fixed indexed annuity. As we said in December, we are optimistic about growing the annuity business, but our timeframe is not unlimited.

In terms of risk return trade-off, we like our balanced product position. Our VA product is priced for competitive returns, and the product design prudently balances our risk management appetite with customer needs. This innovative design is working from a risk management perspective and offers features that appeal to consumers.

Individual Life core earnings x DAC unlock were $40 million, $4 million lower than prior year, reflecting modestly elevated mortality in the quarter. Fourth quarter Individual Life sales were strong. It's important to note that we did not win this business by being the low-cost provider. Our pricing is responsible, and we can achieve adequate returns on the business we're putting on the books.

With that said, the current interest rate environment is causing pricing pressure. In order to stay ahead of this, we have made periodic pricing adjustments, including the increase we made earlier this week. The catalyst behind the increase in fourth quarter Life Insurance sales were our innovative product riders and a focus on expanded distribution. Sales grew in every distribution channel, including a 58% increase in sales through P&C agents.

Retirement Plans core earnings x DAC unlock were $9 million, $2 million lower than prior year, reflecting spread compression on the general account products. Assets under management were flat, and deposits were down 2%, primarily reflecting weakness in the tax-exempt market. We are pleased with the progress we're making to grow the 401(k) business. Sales were up modestly in the quarter, and our efforts to expand distribution are beginning to pay off. Sales in the $5 million to $25 million Middle Market space were up 29% and sales in the P&C channel grew 33%.

Mutual Fund core earnings at $20 million were $4 million lower than last year, reflecting a 15% decline in retail assets under management. This quarter was challenging for the mutual fund industry, in particular for equity funds. Right now, about 2/3 of our mutual fund AUM is in equity funds. As Liam mentioned, our expanded partnership with Wellington strengthens our product offering by providing competitive products

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for various economic environments. As a result, over time, we expect our concentration in equity funds to be reduced and to have a more balanced fund family.

The results for our Runoff division are on Slide 11. Core earnings x DAC unlock were $84 million. We have provided additional details on the Runoff division in the IFS. As Liam mentioned, we recently named a new management team for the Life portion of the division. We look forward to updating you on the progress they are making to more efficiently manage these blocks of business in the quarters ahead.

Slide 12 has the results of the hedging program. The program continues to work as designed. As you would expect, in a rising equity market, we generate realized losses, but these losses are offset by reductions in required reserves. On a GAAP basis, VA generated a net loss of $430 million. On a statutory basis, VA generated a gain of $107 million as the decline in the VA carbon liability was greater than the change in value of the hedges. The difference in results on a GAAP versus statutory basis reflects the inherent differences in the accounting for the liabilities.

The investment portfolio performed well this quarter. As you can see on Slide 13, impairments and changes to the mortgage loan loss reserve were $35 million. Our net unrealized gain position improved to $2.8 billion pretax, largely due to declining interest rates. Our portfolio yield was 4.1% excluding alternatives, down 10 basis points from the fourth quarter of 2010.

Given the Fed's recent announcement that it plans to keep short-term interest rates at historic lows through 2014, we updated our sensitivity analysis of lower rates on our investment portfolio on Slide 14. If interest rates stay flat through 2014, as opposed to following the forward curve, the impact to our outlook for after-tax core earnings is negligible in 2012, given the low level of rates. The impact on the current portfolio rises to $30 million to $40 million in 2013 and up to $100 million in 2014 under this scenario. Importantly, these impacts do not reflect any changes we would make in our investment strategy to offset extended period of low interest rates.

On Slide 15 is our statutory surplus roll forward. Surplus levels at the end of the quarter were essentially unchanged at both the P&C and Life companies. VA-related impacts to surplus were a positive $300 million. Increased reserves related to cash flow testing resulted in a negative non-VA statutory earnings for the Life company of $100 million.

During the quarter, we contributed $100 million to Champlain Life Reinsurance, our Life Insurance captive, to reflect the impact of lower interest rates on Life Insurance-related reserves. This contribution was primarily funded from Life company resources.

On Slide 16, you can see that we ended the year with a strong balance sheet. We have over $17.7 billion of resources in the U.S. insurance operations and Japan and at the holding company. We ended the year with $1.6 billion of holding company resources, down $500 million from September 30. $400 million of this decline relates to the October debt repayment. In addition, we completed $51 million of share repurchases before the end of the year.

For the first quarter of 2012, we expect results to be in the range of $0.85 to $0.90 per diluted share. The improvement reflects a rebound in alternative investment returns, as well as seasonality and catastrophe budgets and assumed weather-related losses. The budget for first quarter catastrophes is about $70 million pretax.

For the full year 2012, as we discussed in December, we see core earnings of $3.30 to $3.60 per diluted share x DAC unlock and prior-year development.

Before I wrap up, we have received a number of calls from investors recently looking for our perspectives on the idea of separating the P&C and Life companies. The company has reviewed this idea in the past, but this management team recently took a fresh look with assistance from advisers. We wanted to share with you some of the meaningful challenges to creating shareholder value via a split that may not be fully understood.

As you can see on Slide 17, these challenges fall into 3 categories: the interplay of ratings and debt allocation, the need for regulatory approval and other costs. Put briefly, due to the Life company's

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current limited capacity to generate statutory earnings and dividends, at least 2/3 of our current holding company debt would need to be allocated to the P&C group. As a consequence, we would need to take potentially dilutive actions at the P&C company to de-lever its balance sheet. As a condition of approval, our regulators might require capital contributions or keep-well agreements between the standalone companies. In addition, we would have to deal with other challenges to creating shareholder value, including those listed on the slide.

So you can see that there are significant challenges to creating shareholder value from a separation of the companies. In closing, although we have accomplished much over the past 2 years, we know more is required in order to create ROE expansion and deliver more consistent operating performance. As we've said, we are evaluating our strategy and business portfolio for opportunities to deliver greater value for shareholders. We will be objective and pragmatic about the best way to achieve these goals.

As we start 2012, we are confident that our portfolio review, balance sheet strength, business momentum and efficiency plans will position us well to achieve these goals we have set for the organization.
At this point, I'd like to turn the call over to Sabra to begin the Q&A session.

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Question and Answer

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Chris. [Operator Instructions] Keesha, could you please poll the call for questions?

Operator

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

Jay H. Gelb
Barclays PLC, Research Division

I had 2 questions for you. Thanks for the update on the -- what you view as the challenges to separate the Life and the P&C companies. And you talked about the financial reasons why it may not make sense, but I'd like to hear your thoughts, strategically, whether you feel these 2 operations should still be together.

Liam E. McGee
Former Chairman

Thanks for the question. As we said, and I think Chris's comments were pretty complete in addition to the slide, there are significant challenges to making a split possible. We're not unaware of some of the potential benefits if it was possible in terms of greater focus, but it's, in our view, the challenges are fairly significant at the present time.

Jay H. Gelb
Barclays PLC, Research Division

Okay. And then as a follow-up, Liam, in terms of the process, in terms of looking at which units are potentially underperforming or need to be reduced in presence, I mean, when will we get some more news on that?

Liam E. McGee
Former Chairman

Well, Jay, let's go back to -- thanks again for the follow-up. Let's go back to our December investor conference, and as you recall, in my remarks, I did break the company down into a portfolio businesses, I think, at a fairly granular fashion, then I made comments on each of the businesses in terms of, first of all, where it stood relative to its current returns and our growth, or profit maximization, strategies. And as you recall, in the top right quadrant, there were a number of businesses that have actually very current attractive returns, and we're trying to grow those because we can do so profitably. And then some of them, in the middle to bottom left, that have below optimal returns today, and we're really working hard to maximize the profitability. Since we met with you in December, I would say this team is working on that very thoroughly, very rigorously, and we have a sense of urgency about doing that. Because first of all, we're not -- we don't believe the current stock price reflects the value of the company. We're evaluating these businesses individually by their ROE, their capital generation and their future capital requirements or capital consumption, their risk profile and their growth potential. And what I'll say is we're being objective, rigorous and thorough about the types of actions that might enable us to achieve the goal of increasing shareholder value, and I think we'll keep you informed as we make those decisions.

Operator

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

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Wanted to draw down a bit more just on the commentary regarding the strategy that you alluded to in December. Can you maybe just put some parameters around what this may or may not include? And then

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how are you thinking about sort of balancing your review, sort of, with kind of the voices you've been hearing from investors in terms of their patience and in terms of generating shareholder value?

Liam E. McGee
Former Chairman

Thanks, Chris, for the question. I think I commented pretty extensively in the prior question about the process we're going through. I'd add a couple of other things. First of all, in this environment, this management team is very focused on managing the levers that we can control. I think the progress we've made on making the company more efficient in '11 and will continue to do so in '12 and '13 are appropriate and necessary in view of the current low interest rate environment and the market volatility. The balance sheet is much stronger today, starting with the investment portfolio. The progress that we've made there over the last 2 years, number one. Secondly, the transparency we gave you in October around our balance sheet. Japan, our overall VA book, our ability to withstand stress scenarios. I think our risk management, enterprise risk management, is much stronger and enables us to manage the company better. And we are seeing benefits as a result of our 3 customer-aligned businesses. Just to reiterate, the management team does not believe that the current share price reflects the value of the company. I think we've -- to your point Chris, we've heard that from shareholders, and we've heard it from some other observers, and I think that's why we're communicating very clearly that we are -- we will be objective and pragmatic about the types of actions that may best enable our goal -- to achieve our goal of realizing greater value for shareholders.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay, that's very helpful. And then, just wanted to follow-up on sort of Slide 17 here, I guess focusing more on the Life side of things. You point to kind of not having infinite patience on the VA business and potentially doing something. And you alluded in December that you wouldn't rule out putting that into Runoff. So I guess if you put that into runoff, you'd have a lot of the Wealth Management business in the Runoff block, so why would there be such an intense focus on preserving the single A rating if so much of the business was in Runoff? And could you look to then potentially sell some of the remaining attractive assets like the Group or Mutual Fund business?

Liam E. McGee
Former Chairman

Well, Chris, I -- Chris Swift may have some comment on this as well. I'd just remind you that -- first of all, let's talk about the VA business for a moment. We're well aware of the questions about our strategy in the U.S. VA book. I think in short, we believe we have the components we need to succeed in the business. Distribution, new products that have been out relatively short period of time and, as Chris noted, some period-over-period momentum, and we're seeing signs of that continue early on in the year. In addition, the macro environment appears to be shifting in a way to it'd be more favorable to the types of products that we're offering. However, and just to reiterate what I said in December, I think I was very clear on this, to your question, we are managing the business very closely, watching the trends. David Levenson, I think, is watching them very closely. Our timeframe, as I said in December and as Chris reiterated, is not unlimited. And we do need and I need to see meaningful progress in profitable sales in the near future. So I think that's very consistent with the tone and the statements that we made in December, and I think an appropriate position. In terms of ratings, I'll just say at high level. First of all, I think the notion that if we were to decide to put U.S. VA into Runoff, that it would create immediate material amounts of capital liberated is not true in our view, number one. And number two, remember that we have other businesses -- the Mutual Fund business, the Life business and the Retirement business -- that are very ratings sensitive, and we would -- if we were able to do that scenario, we would not want to do anything that would destroy their value. Chris, anything you'd add to that?

Christopher John Swift
Chairman & CEO

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No, I think that's well said, particularly on the businesses. I think the only other point on allocating 1/3 of the debt to the holding company. Chris, I think you remember that we believe statutory earnings and capital generation, particularly in the near-term '12, is limited. So allocating almost 2/3 of the holding company debt is probably even aggressive on the surface. But Liam, I think your points are good as far as the impacts of other business if those decisions are taken.

Operator

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

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

Two quick ones. So just to follow-up real quick on Slide 17. I guess my question is, it seems like debt allocation or just debt levels might be an impediment here or might be one of the most meaningful impediments here. So I guess it begs the question, why not spend your excess capital, instead of on share repurchases, on debt paydown, at least to provide some optionality to you?

Christopher John Swift
Chairman & CEO

Yes, John, it's Chris. Thanks for the question, and -- the debt restructuring is a priority for us. I think given how we've defined deployable capital in the past, roughly about $500 million, we've targeted the share buyback as a higher priority, the most accretive to shareholders. But the debt restructuring and its associated impact on earnings and leverage is high on the list, and it's something that we think about very aggressively.

Liam E. McGee
Former Chairman

Well said, Chris and I think it's not only from a flexibility perspective, John, but also just a carrying cost perspective on some of the components of our debt that you're well aware of. So I think the management team is very focused. We're proud of the strengthening we've done on the balance sheet in the first couple of years, but your question is a very appropriate one that Chris and I and the management team are factoring in, things like share repurchase, potential warrant repurchases, etc.

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

And then just a quick one on the Life company capital. Certainly, given strong equity markets in the quarter, I was pleased to see the $300 million improvement in the statutory capital from the VA business. Obviously, interest rates remain a pressure point. Following the moves in the Life company statutory capital and the reserves, where would you estimate the risk-based capital would come in for year end?

Christopher John Swift
Chairman & CEO

Yes, John, it's Chris again. I'd say thanks for noticing the decent recovery in VA. I would also just point out that as we closed out year end, particularly in the life insurance business, so we updated our cash flow testing analysis, and that created a little bit of a headwind for us. But when you put it all together, we wouldn't estimate that our main company is -- RBC is between $415 million and $420 million. Our capital at White River Re is well in excess of $125-basis-point target, and we have approximately $400 million of actual tangible surplus there. In Champlain, we did make a capital contribution to Champlain. $80 million of that was funded by the Life company. So we sent a dividend up to the holding company of $80 million contributed back to Champlain with another $20 million of holding company resources. So Champlain is above our targets and it actually has $265 million of stated surplus, and then you saw the $1.3 billion of surplus in Japan. If you put it all together, we actually feel pretty good about our statutory resources in the various entities.

Operator

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

A. Mark Finkelstein
Evercore ISI, Research Division

Sort of a follow-up to John's question. Chris, you talked about statutory capital flattish sequentially, obviously, markets were up but that had a mark-to-market on the derivatives, which overwhelmed the reserve change. Not to get too technical, but -- I guess what I'm asking is, at what point in the market, if we continue to go up, would you actually see that reversal where you actually start increasing your statutory capital as the reserve changes are more meaningful than the mark-to-market on the derivatives?

Christopher John Swift
Chairman & CEO

Mark, it's Chris, thanks. I would say to just this context, the U.S. equity markets were up nicely. I mean, but the other markets where we are participate in with our Japanese annuity blocks, I would say, were mixed to down. I mean, if you look at interest rates, if you look at Europe, if you look at Japan, the Nikkei was substantially down. So I think the positive impacts on VA carbon reserves in the Life book were offset by the net negatives around the world. That said, I think you're really trying to -- and we've talked about it before, is measured sort of the inflection point of where things start to turn positive from a capital generation side. And I'll just go back to our comments that we do see substantial capital generation in '13 and beyond, obviously, as market levels improve. I don't think there's a precise number I'd give you, but when you're north of 13,070 and approaching those types of levels, I mean, it really does take a lot of pressure off the VA CARVM reserves. As you know, we've talked about somewhat -- those being on a lag. But there's not a precise thing. It's just, I'll call it, continued healing, but there's also, I would say, a lot of continued pressure in the low interest rate environment also. So you could have a medium impact of just looking at one equity market index, and you really got to consider all our indices that go into liability calculation.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. And then just a question on the Variable Annuity business. You're launching some new products. It feels like the products are a little bit more consistent with some of the living benefit guarantees that are out there in the market, so you're kind of -- feels like you're jumping, kind of, into that, kind of, game little bit. And it's a little bit -- feels like a little bit of a different strategy than what it's been, which is kind of pick your spots, very focused on kind of lower risk but some -- obviously, value to the consumer. So I'm just curious about the product that you're selling, how you think it's positioned and, I guess ultimately, how you're making sure that the risk management around it is very robust?

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

So Mark, this is Dave Levenson. Thanks for the question. So as it relates to the new product filing, which is what you're referring to, we are always looking to make improvements in products as part of the normal course of business. So what you saw was clearly a filing for the Annuity business, but as we're in a quiet period with the SEC, I really don't want to comment too much as it relates to the details. Our absolute focus right now is really on growing the business with the product portfolio that we have today. As it relates to your question around profitability and risk, I would say we pay very close attention to this, as you heard Liam say in his comments, with a focus on profitability. The ROE and the product we have today is what I would say, on a fully hedged basis, very close to the cost of capital at scale. And from a risk perspective, we're -- we think the product that we sell today is more than acceptable. So 3 things to add to that. First, we hedged the product fully; second, the NAR of the business that we put on the books is less than 1% of our total sales; and third, the personal protection portfolios, which is a core part of the product, had a volatility last year that was about 1/3 of the level of the S&P. So the issue for us is really a scale issue.

A. Mark Finkelstein
Evercore ISI, Research Division

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Okay. Just one very quick follow up. How are you defining cost of capital in this business?

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

It's the weighted average cost of capital that we hold on a GAAP basis.

Operator

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

Randolph Binner
FBR Capital Markets & Co., Research Division

Just a follow-up on the annuity area and kind of more on the sale side. I think back in the December day, you all had talked about a $3 billion to $5 billion all-in sales goal across annuities. And so I think you also said that the fourth quarter should be somewhat of a litmus test for the new VA product. The run rate's considerably low to achieve $3 billion. So just be interested if there was something that made the fourth quarter not a good litmus test for VA and if you still think that goal is attainable and if indexed annuities might play a big part in that?

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

Randy, it's Dave again. Thanks for the question. So we recognize that the $258 million that we did in the quarter does not get us to our guidance. I'd say that said, we really only had a competitive product in the marketplace for the last 6 months. So we've been essentially out of the market since 2009 and back in since June. The PDF fund, which again is the secret sauce underlying the product, it's very innovative and, frankly, it needed some proof of concept, which I think took a little bit longer than we expected. But with 6 months behind our belt, I feel very good about where that is right now. As it relates to the fourth quarter specifically, as was mentioned earlier in the remarks, 2008 was the first time that we saw our sequential increase in sales, and when you start looking inter-quarter, our story gets a little bit more interesting where December was the best month we had in the year and was up 45% over October. So let me address your question about 2012 and whether or not I still feel like we can achieve it. The answer is yes. Clearly, as Liam mentioned, the market is rationalizing, competitors are raising fees, they're reducing benefits, they're getting out of the business. We think this is all good for us. Our biggest distributor in Wealth Management, added the product just recently, it was the end of October. We are in very good discussions right now to add the product to shelves at 2 of the top 20 firms. The only top 2 -- the only 2 of the 20 firms in the industry that don't carry this product today. We changed our national sales manager in September, and we have much greater discipline, focus and accountability. And as importantly, we're attracting some of the top wholesalers from many of our competitors. But with that backdrop, I think the punchline is that we really know what we have to do with respect to showing sales and sales momentum, and the management team is confident and committed to getting there.

Liam E. McGee
Former Chairman

So Randy, you can see that Dave is managing this business very closely, and I think that reflects the fact that we need to see meaningful, profitable sales progress in the near future, and I think he's doing all the right things to make that happen.

Randolph Binner
FBR Capital Markets & Co., Research Division

That's great. Just a quick follow-up. Indexed annuities, I mean, could those become a material part of this in 2012? Or should we really think of this is as being kind of a VA phenomenon to get to that goal?

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

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So Randy, the FIA product that we launched in '11 was really a table sticks product. It's really going to be the offering that we bring out in the summertime that we think is very innovative combined with WealthVest, which as you know, is our third-party focused distributor on this. So I would say it will contribute, but if it -- it will contribute, but it will be more in the second half of the year where it contributes.

Operator

Your next question comes from the line of Meyer Shields with Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

I want to applaud your candor with discussion -- with discussing the separation of Life and the P&C companies. And I don't want to contradict that with this question, but can you share your thoughts about how this disclosure is actually going to impact the unit's performance in the near term?

Liam E. McGee
Former Chairman

I'm not sure I understand the question.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

We'll I'm -- putting it in probably overly blunt terms, if distributors look at the Life business as being somewhat on the block, is that going to make it harder for them to actually sell the product?

Liam E. McGee
Former Chairman

I think you completely misinterpreted the nature of our discussion. So again, I don't think we said that. We did not say that. I think we commented very specifically and very precisely on questions that we've been asked by shareholders about a potential tax resplit of the P&C company. I think to your -- thank you for recognizing our candor. And I would just go back to what I've said a couple of times, which is as we -- and I, more specifically, went through and then the business leaders went in greater detail, we are managing our company as a portfolio of businesses. We intend to maximize the value of each of those businesses because we do not believe our share price accurately reflects the value of the company and of the enterprise and that we're evaluating strategy and business portfolio for opportunities as a result of that philosophy to deliver greater value for shareholders, and we'll be objective and pragmatic and thorough and rigorous about the best ways to achieve this goal. I just want to be sure that you heard me correctly.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Yes. No, I think I did. If I can shift gears just a little bit. The workers' compensation rate increases that you've talked about, is that impacting retention for other product lines?

Douglas G. Elliot
President

It is not. This is Doug Elliot. It is not impacting our retentions across other lines. It is impacting some of the workers' comp retentions. But at the moment, we are more than pleased with the trade-off we're seeing in that book of business and very encouraged as we finish the year with really strong pricing momentum across those workers' compensation line. Very pleased about the last 3 months. And as Chris noted, incremental progress between October to November to December as we head off into 2012.

Operator

Your next question comes from the line of Lawrence Sarly [ph] with Paulson & Co.

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John Alfred Paulson
Paulson & Co. Inc.

This is John Paulson speaking. Liam, I want to go back to the Slide 17, talking about the potential separating the Life and P&C business. And the -- I know you're doing a strategic review, but there's no slide talking about what the potential would be, just that there's challenges. Goldman Sachs came out with, I think, a very good analysis a few months ago, where they showed this is -- that they estimate the upside to doing a tax-free spinoff of P&C can be over 70% of what the current stock price is trading at. Now I agree that there's going to be challenges, but isn't your job to really overcome those challenges to achieve the maximum value for shareholders? Now I would say that Hartford needs to do something drastic because the stock is the lowest valuation relative to book value of any major insurance company. Last year, Hartford stock was down 38% while the P&C stocks were up 14% and even declined much more than the Life index, which was down 21%. So what I'd like to see you do is not merely come back and say yes, we're looking at strategic options, but there's challenges to achieving them. But what -- first of all, do you agree that you could create as much as 70% value for your shareholders by spinning off -- separating P&C? And secondly, is [indiscernible] incentive to overcome the challenges that it's going to take to spin this off? And how long is -- how long do we have to wait to hear if there's going to be a positive recommendation to separate these 2 businesses?

Liam E. McGee
Former Chairman

Thanks, John, for the question. First of all, the analysis and the intent of the comments was to acknowledge that the challenges are significant, not to say that they could not be overcome. Second of all, our analysis, including the frictional costs, if you will, that are in the third category, would suggest that a split would not create the kind of shareholder value that, that particular report suggested. And third, in addition, I think the -- your sense of urgency about realizing greater value for shareholders is shared by me and by this team. And so I hope I answered your questions succinctly and correctly.

John Alfred Paulson
Paulson & Co. Inc.

Partially, Liam. But if it is -- if you share the interest all shareholders have at increasing shareholder value, I'm surprised that as part of the discussion, you don't talk about how much value could be created by separating the P&C business from the Life business and not the only slide you devote to it talking about that there's some obstacles to overcome. I'm talking about the upside and weighing the upside of the separation against what the obstacles are. And better yet, not just listing as obstacles, but what I'd like to see is how you will overcome those obstacles to result at a more -- a fair valuation for Hartford. Not that there's obstacles, but how are you going to overcome those obstacles? That's what I, as a shareholder, look from you as the management to do.

Liam E. McGee
Former Chairman

Thank you, John. And I -- that is our mindset. Our purpose in the slide was to identify the hurdles. You can -- if you heard our language, we did not say they were not surmountable, number one. We said there were significant costs to surmount them in a number of areas, so we felt we owed shareholders that disclosure. Number two, we do not believe that splitting them in the current environment for the reasons that we cited will create shareholder value. And third, again I'll reiterate, we have an incredible sense of urgency on looking at all ideas to create a shareholder value.

John Alfred Paulson
Paulson & Co. Inc.

Well, I think you need to do a much better job of explaining that because Goldman's report is a very good report on a path to separate the business and create what they estimate is a 70% increase in shareholder value. And then you merely say there's some obstacles and you don't equate what the costs are to the benefit and what value you think could be created. Because right now, with the stock performing as poorly as it has relative to both P&C and Life companies, I think you need a better explanation of what you're

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going to do to enhance shareholder value, merely that you're working hard and you're committed, but there's obstacles. What we need you to do is overcome the obstacles to enhance the valuation for your shareholders, not merely to point out that there's obstacles.

Liam E. McGee
Former Chairman

Hey, John, thank you. I hear you loud and clear.

Operator

Our next question comes from the line of Andrew Kligerman with UBS.

Andrew Kligerman
UBS Investment Bank, Research Division

Why don't I just start off with capital. It looked like you had some improvement in the Life co stat capital and that was a surprise to me. And for the Investor Day, you're going to generate about $800 million in capital a year out of the P&C company. So what I'd like to know is, when you finish up the $500 million buyback, which I think you're saying is early 2Q, it will have been about a year since your last authorization of $500 million. Could you give a little color on the flexibility that you might have to authorize another buyback? And I don't know if you -- just flexibility, amount, timing. I know you can't be overly specific, but a little flexibility commentary would help.

Christopher John Swift
Chairman & CEO

Andrew, it's Chris. Thanks for the comments. I think your comments are right. Again, we finished fourth quarter in decent shape, particularly at the Life company. I would say one point of clarification that we planned to take out $800 million of dividends out of the P&C company, but we do expect the P&C company to generate slightly more in statutory earnings and that the Life group, we're still calling, right now, for flat to slightly down. But a lot of that is path dependence on markets, hedging performance. But directionally, it's still -- I'd like you to take away, it's still a constrained model for 2012. So as we said and as Liam said and I said, we are going to complete the program in early second quarter. At that time, we will evaluate, call it, our deployable capital levels, our capital needs for different initiatives and then determine our future actions and communicate them at that point in time. But as we've said, we see capital and surplus increasing in 2013 at the Life company, so that gives us hope and optimism that we will continue to have flexibility in '13 and beyond, particularly.

Andrew Kligerman
UBS Investment Bank, Research Division

Okay. And possibly in mid '12?

Christopher John Swift
Chairman & CEO

Possibly. Again, Hard to predict. We'd like to finish what we started, do the evaluation, compare, obviously, a lot of different options for our deployable capital and then come up with the best solution at that time.

Andrew Kligerman
UBS Investment Bank, Research Division

Okay. And then just following up on one of the business lines. One of your rationales for being a multi-line company was aligning the Commercial Markets businesses, the Group Benefits along with the Commercial P&C. And I'd like an update on -- well, first off, it looks like AIG actually copied what you did based on some of the things I've been reading about. And secondly, I'd like to get a sense of sales volumes and some of the impact that you're having there.

Douglas G. Elliot
President

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Andrew, this is Doug. We talked about that at the December 8 day in quite some detail, and those discussions continue as we close 2011 and head into 2012. So we had quite a bit of success, greater than $125 million of sales working across our group and P&C space in 2011. We have challenging goals for '12. As I travel -- and 2 weeks ago, I was in Orlando. I spent several hours in the morning with our comp and group people together to talk about issues, to make sure that we're firing on all cylinders and we're looking for opportunities in the marketplace. So absolutely, on a day-to-day basis, those opportunities continue to be chased, and we're looking for more to leverage the breadth of product that we have here at The Hartford.

Andrew Kligerman
UBS Investment Bank, Research Division

And you think that could result in a turnaround negative 3% sales year-over-year?

Douglas G. Elliot
President

The dynamics of the sales process themselves is much more related to our need for margin improvement in group than our margin improvement needs across Middle Market. So when I think about top line, given the scale of those businesses, we're clearly driving rate change at those 2 businesses. As you looked at the bubble chart that Liam took you through in December, we have several businesses that need significant rate, and we are doing everything we can on a day-to-day basis to get that done. And that's more driver relative to top line than this other dynamic.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Andrew. Keesha, we have time for one more question, please.

Operator

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

Robert Ray Glasspiegel
Langen McAlenney

I wanted to zero in on AARP. Chris, you said that you're pleased with the -- where you are and in position to grow. Liam, you sort of said that's a franchise operation, which I totally concur. I'm just confused on where it is in the sort of fixed versus grow mode. With premiums down 4% and the overall auto underwriting at 96, it seems like AARP should be in a position to grow, not being one of the fixed candidates. If it is a franchise as I think and it's in a demographic that's favorable, why is it not growing more?

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

Bob, this is Andy. It's a great question. So I'd kind of take you back 18 months ago, we had profit issues in the division, probably more pronounced in agency than with AARP. But nonetheless, we were taking above market rate increases across all channels and products, so when you grow, it would be impacted. But quite frankly, given the competitive environment that we -- that confronted us in 2010 and '11, it was greater than anticipated, affecting both new business and retention. So since then, we've been working really hard to achieve rate adequacy and restore growth to divisions, especially AARP. It's very much still a work in progress, but as you commented, in AARP Direct we are converging on our combined ratio pricing targets. I actually expect that to happen sometime in 2012. New business has rebounded very nicely, and that will continue to play out as 2012 plays out. The big objective for us right now is to get retention where it needs to be, and until we do that, we expect that to happen in -- throughout '12 and into '13, we'll restore total premium growth to AARP. Still a valuable franchise, extremely important to us strategically, and we're well on our way to getting that back on track.

Robert Ray Glasspiegel

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Langen McAlenney

Where does auto have to be to get your ROE objective? You don't break out AARP, so -- if you could give me AARP's targeted combined ratio to get to the ROE, that would be great. But I don't think auto, in general, would be...

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

Yes, auto, around 95 or so.

Robert Ray Glasspiegel
Langen McAlenney

Okay. We're -- I mean, you're at 96 overall, and AARP is, I assume, better than agency. So why couldn't AARP be growing right now?

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

I think it's just a timing thing. It's the way we -- the rate increase has played out in '09 and '10. Retention was impacted more than we thought it would be. Now we're recovering it.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Bob, and thank you, also, Keesha. We look forward to seeing and talking to you all soon. And as always, we appreciate your interest in and support of The Hartford. Have a good day.

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

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