S&P Global
Market Intelligence

The Hartford Financial Services Group, Inc. NYSE:HIG

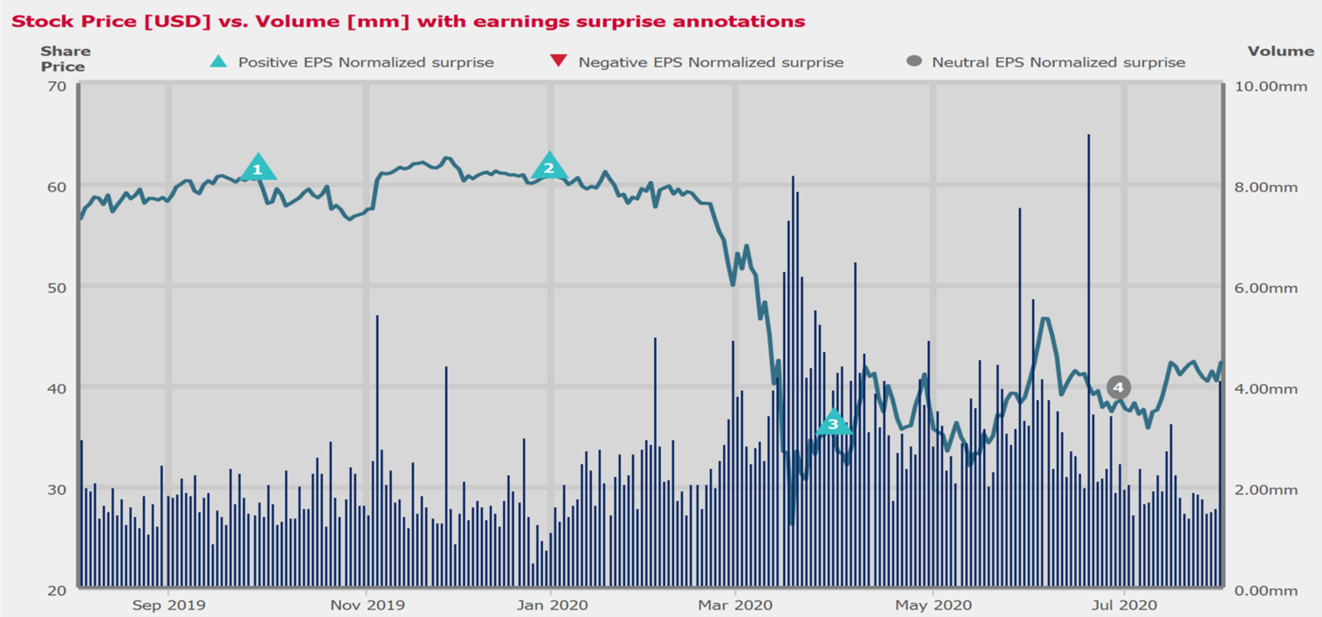
FQ2 2020 Earnings Call Transcripts

Friday, July 31, 2020 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2020-			-FQ3 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.22	1.22	0.00	1.23	4.98	5.19
Revenue (mm)	5080.00	5068.00	(0.24 %)	5125.00	20309.48	20943.93

Currency: USD
Consensus as of Jul-31-2020 12:03 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2019	1.23	1.50	21.95 %
FQ4 2019	1.33	1.43	7.52 %
FQ1 2020	1.33	1.34	0.75 %
FQ2 2020	1.22	1.22	0.00 %

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Presentation

Operator

Good day, and welcome to Second Quarter 2020 The Hartford Financial Results Webcast. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to Susan Spivak, Senior Vice President, Investor Relations, The Hartford. Please go ahead.

Susan Spivak Bernstein
Senior Investor Relations Officer

Thank you, Andrew. Good morning, and thank you for joining us today for our call and webcast on second quarter 2020 earnings. We reported our results yesterday afternoon and posted all earnings related materials on our website.

For the call today, our speakers are Chris Swift, Chairman and CEO of The Hartford; Doug Elliot, President; and Beth Costello, Chief Financial Officer. Following their prepared remarks, we will have a Q&A period.

Just a few comments before Chris begins. Today's call includes forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance, and actual results could be materially different. We do not assume any obligation to update information or forward-looking statements provided on this call. Investors should also consider the risks and uncertainties that could cause actual results to differ from these statements. A detailed description of those risks and uncertainties can be found in our SEC filings.

Our commentary today include non-GAAP financial measures. Explanations and reconciliations of these measures to the comparable GAAP measure are included in our SEC filings as well as in the news release and financial supplement.

Finally, please note that no portion of this conference call may be reproduced or rebroadcast in any form without The Hartford's prior written consent. Replays of this webcast and an official transcript will be available on the Hartford's website for 1 year.

I'll now turn the call over to Chris.

Christopher Jerome Swift
Chairman & CEO

Good morning. Thank you for joining us today. I trust you and your families remain safe and healthy during this pandemic. Our hearts go out to those grieving, ill or confronting economic hardships. Let me begin my remarks with some overarching comments.

When we last spoke at the end of April, we were just weeks into the wave of stay-at-home orders that would eventually affect most of the country and much of the globe, and the market was only beginning to develop a sense of how sweeping the consequences of COVID-19 would be. At that time, there was considerable uncertainty as to the scope, duration and economic impact of the global health crisis. Now as we enter the second half of 2020, I am encouraged by the progress the country has made in a number of areas, although tremendous challenges and a host of unknowns persist.

I want to thank our employees across the United States and around the world as well as our many partners for their extraordinary dedication during these unprecedented times as we have navigated this crisis together. Throughout this crisis, The Hartford has remained focused on serving customers, working closely with distribution partners and taking appropriate steps to safeguard the health and safety of our talented team.

At the same time, we have continued to execute on our original 2020 strategies, including realizing the full potential of our product capabilities and underwriting expertise, becoming an easier company to do business with, and attracting and retaining the talent we need for long-term success.

In support of these strategic goals, we have launched a new transformational program focused on elevating customer needs, simplifying business routines, further leveraging remote work and achieving expense savings of approximately

$500 million in 2022 as measured off our 2019 expense base. While the initial work on this program predates the pandemic, it is all the more applicable and responsive to the current environment.

I am excited about the impact of this initiative, which we refer to as Hartford Next as it represents the next step in our focus to increase competitiveness and drive operational efficiencies while continuing to provide outstanding service to our agents and customers. Beth will provide additional financial details in her commentary.

Now let me turn to our results for the quarter. Despite the many challenges we faced, we delivered strong underlying performance with core earnings of $438 million or $1.22 per diluted share; 3.5% growth in book value per share, excluding AOCI from year end 2019; and a trailing 12-month core earnings ROE of 12.7%. These results demonstrate the fundamental strength of our businesses.

In Property & Casualty, our broader product offerings and expanded distribution are providing more opportunities to leverage positive pricing momentum in the areas of the market that are hardening. Group Benefits results reflect continued favorable incidence trends and solid sales.

The quarter was impacted by a number of unusual items, including incurred losses related to COVID-19 of $251 million, which is based on an exhaustive review of all applicable policies. $213 million of the incurred loss is attributable to our Property & Casualty business and $38 million to Group Benefits.

On the P&C side, COVID-19 incurred losses primarily relate to property, workers' compensation and financial lines. Of the $213 million attributed to P&C, $101 million relate to reserves for a small number of property policies. In particular, within our Middle & Large Commercial and Global Specialty businesses, there are a handful of unique policies which were intended to provide a broader range of coverage for specific business needs such as crisis management or performance disruption.

In addition, we have a small number of highly manuscript policies that do not contain a physical damage requirement. We believe the reserves established appropriately cover claims arising out of our property portfolio.

To put this small group of policies into context, while nearly all of our property policies include coverage for business interruption, 99% of them contain a clear requirement that a direct physical loss or damage to property must occur to trigger coverage. In addition to this requirement, 99% of our property policies with BI coverage also contains standard exclusions that we believe preclude coverage for COVID-19-related claims.

And finally, we also have a specific virus exclusion on the vast majority of these policies. As I've said many times before, responding to customer claims and doing it well is at the heart of who we are. We are in the business of paying covered claims, and that's exactly what we're doing.

Unfortunately, when it comes to business interruption claims resulting from this pandemic, we believe it is self-evident that COVID-19 does not cause direct physical loss or damage to property and that the various stay-at-home orders were issued to reduce community spread, not to prevent property damage. As a result, COVID-19-related claims are outside the scope of our policy terms and conditions and simply are not covered.

We are highly confident in our contract language and coverage positions and have put up $40 million in reserves to cover the estimated legal costs of defending our business interruption policy language.

Excluding the unusual items in the quarter, Commercial Lines' underlying results continue to benefit from underwriting actions to improve profitability and drive efficiencies, along with accelerating premium momentum in what can be characterized as the hardest market in decades.

At the beginning of 2020, I shared my outlook for the pricing cycle, anticipating 18- to 24-month period of significant rate increases. Now through the first 6 months of the year, I have even more conviction that the hardening market in many Commercial Lines is sustainable with ongoing price momentum despite the challenging economic conditions of a slowing economy.

Our core P&C underwriting platform, expanded through the Navigators acquisition, is benefiting from higher prices in Middle Market and Global Specialty with the exception of workers' comp.

Global Specialty results reflect improving risk-adjusted returns in the business acquired driven by underwriting actions taken as we integrated the business and robust renewal rate increases. With the significant pricing momentum in these lines, we are on track to meet or exceed our targeted earnings and margin goals.

While the largest rate increases are in lines within our Global Specialty segment, renewal pricing in our Standard Commercial Lines also continues to be strong. Doug will provide additional detail in his commentary.

Turning to Group Benefits. I am pleased with the operational execution and financial performance of the business, reflecting our strong underwriting and risk management discipline. Group Benefits posted solid results for the quarter with core earnings of $102 million and a 6.9% margin. Earnings were down versus prior year due to $38 million before tax of COVID-19-related losses as previously mentioned; a $14 million before tax increase in the allowance for uncollectible premium; and lower net investment income, partially offset by excellent disability results. The disability loss ratio was 62.6, improved 10.3 points versus prior year driven by higher recoveries and continued favorable incident trends.

We also updated our year-to-date COVID-19 short-term disability assumptions, resulting in a favorable adjustment of $5 million pretax. The life loss ratio was 85.9% increasing 8.1 points from the second quarter of 2019 driven by COVID-related losses of $43 million. On the top line, book persistency remained solid at approximately 90%. And new fully insured sales were $149 million, up from prior year driven by National Accounts.

With the recent spikes in COVID-19 across the country, states are continuing to evaluate their respective policies pertaining to social gatherings and stay-at-home orders. These impacts could continue to affect revenue and results in the quarters ahead.

As a market leader, our Group Benefits business is well positioned operationally to respond to the challenges of the pandemic and the economic recession while continuing to meet the needs of our customers.

Let me now close with a few comments about 3 public policy issues important to the economy and our industry. First, as states reopen and we reignite the nation's economy, millions of Americans will need to safely transition back to work and back to the office. We must ensure that obstacles to this critical transition are appropriately addressed. To be specific, I believe federal legislation creating a timely, targeted and temporary safe harbor against frivolous lawsuits related to COVID-19 is critical to providing businesses of all sizes the confidence they need to reopen.

Second. Much debate has occurred around workers' compensation presumptions. While we value and appreciate the services and sacrifices of essential workers, it is important to note that the current workers' compensation system has been an American success story for over 100 years. We accept the decision by some states to impose a limited presumption for those who come into close contact with those suffering from the COVID-19 virus in the course of providing them medical aid and treatment, but we are troubled by efforts to alter well-established principles of the current system.

The significant cost of expansive presumptions will ultimately be borne by the municipalities and businesses at a time when they are all struggling to recover. In addition, any measures that impede the ability of insurers to appropriately account for an increase in the cost of claims in future rates would represent a unfair tax on the industry.

Third and finally, the devastation caused by this pandemic is unlike anything we've experienced before. Since the outbreak of COVID-19, we have seen governments at all levels take extraordinary action to contain the virus, protect lives and safeguard the economy. These events and the magnitude of the interventions have made it clear that pandemics and other widespread viral outbreaks are fundamentally uninsurable.

That said, we understand the insurance industry has unique knowledge, expertise and capabilities that can and should be brought to bear to help develop solutions to address future pandemics. We believe a federal response is critical, both from a coordination and funding perspective. In short, a robust public sector-based solution is necessary and we are working closely with our industry trade association and the agent and broker community to support the recently released Business Continuity Protection Program or BCPP. This program would provide immediate relief to businesses in the form of revenue replacement assistance for payroll and employee benefits and other operating expenses in the event of a future pandemic. Any federal solution designed to protect against future pandemics should provide timely, effective and affordable relief to businesses across the country. I believe the BCPP provides such a solution.

To recap, The Hartford's second quarter results demonstrate solid execution as we adopted -- adapted to the next normal. Despite the challenges of COVID-19 and the resulting uncertainty of the future, we remain focused on investing in the business for growth and efficiencies while producing top-quartile returns on equity for shareholders. I remain confident our company will manage through the crisis and emerge well positioned to continue to achieve our strategic goals.

Now I'll turn the call over to Doug.

Douglas Graham Elliot
President

Thank you, Chris, and good morning, everyone. I can't agree more that the challenges are unprecedented and certainly contributed to many of the financial impacts in the quarter.

Overall, Property & Casualty core earnings were $309 million, and written premium was flat to prior year at $2.9 billion. The underlying combined ratio of 97.6 was quite good considering COVID charges of $243 million. COVID charges consist of underwriting losses of $213 million or 7.5 points and a $30 million increase or 1.1 points in the allowance for credit losses on premiums receivable. I also continue to be pleased with the strong pricing in our nonworkers' compensation Commercial Lines.

Before I get into the segment details, let me summarize the actions we took this quarter with respect to COVID-19, CATs and prior year reserve development. Recognizing the economic impact of the pandemic on our customers during the quarter, we responded with several actions, 3 of which I'll highlight.

First, we endorsed nearly 250,000 policies to adjust for changes in risk, returning over $35 million in premium to our commercial customers since the middle of March, reflecting lower payroll and other exposures. In a related action, we also reduced expected audit premium, leading to a $100 million reduction in our audit premium receivable. When netted with losses and commissions, this led to a $34 million reduction in underwriting results.

Second, we delivered personal auto refunds of $81 million or 15% of the second quarter premium, reflecting favorable frequency trends in the quarter.

And third, we extended billing grace periods through May 31 on all policies while waiving late fees that would otherwise apply. The extension drove second quarter Personal Lines and Small Commercial policy count retention 4 to 5 points higher than the historical run rate and increased Property & Casualty allowance for credit losses on premiums receivable by $30 million or 1.1 points.

In Commercial Lines, COVID underwriting losses, the majority of which relate to IBNR reserves, were $213 million for the quarter or 9.9 points. Property losses were $141 million, including a $40 million provision to defend the company in litigation, challenging certain business interruption denials.

Gross workers' compensation losses were $75 million, including a provision for those states that enacted presumptive legislation. Offsetting the gross loss was COVID-related favorable frequency in the quarter of $40 million, driving a net impact of $35 million. Financial lines and other losses were $37 million primarily for D&O, E&O and surety claims.

Turning to catastrophes. Property & Casualty recorded losses of $248 million, including $110 million for civil unrest. The remaining losses for wind and hailstorms were less severe than a typical second quarter.

Net favorable prior year development for the quarter was $268 million and contained a number of reserve actions, including: $400 million of favorable catastrophe reserve development driven primarily by a reduction in net loss estimates for the 2017 and 2018 California wildfires, which included a $289 million subrogation benefit from PG&E; continued favorable development in Personal Lines auto and workers' compensation; bond reserve development was also favorable in the quarter while we strengthened commercial auto; reserve strengthening of $102 million for sexual molestation and abuse claims; and finally, net unfavorable ex-CAT reserve development of $49 million on Navigator reserves primarily in the Lloyd's syndicate D&O and domestic general liability lines. $54 million of the total development was from accident years 2018 and prior and, therefore, economically covered by the adverse development cover.

Turning now to our business line results. The Commercial Lines underlying combined ratio was 102.9, increasing 9.7 points over prior year, including 11.1 points for COVID charges. The remaining variance was primarily due to a lower expense ratio from reduced travel and incentive compensation costs and some modest early wins from our transformation program, and improved inland marine losses from a year ago.

As a pivot to pricing, the industry continues to achieve much needed pricing gains as another positive quarter contributes to a strong 6 months. This is particularly evident in auto, specialty and excess casualty lines. For the quarter, renewal written pricing in Standard Commercial Lines was 3.6%, down 70 basis points from quarter 1. However, excluding workers' compensation, which was negative 1.3%, pricing was up 7.8%, slightly ahead of our strong first quarter. These results continue to demonstrate our ability to achieve rate increases across each of our nonworkers' compensation Commercial Lines.

I would remind you that the 7.8% is Standard Lines only. Adding core Global Specialty lines would move this pricing measure higher.

In Middle Market, renewal written pricing in the U.S., excluding workers' compensation, increased 9.3%, down slightly from the first quarter but still a very strong result and 520 basis points better than the second quarter of 2019. Property and general liability pricing are each in the high single digits, and auto is now in the low teens.

I'm also pleased with the continued pricing momentum and reshaping in Global Specialty. Strong pricing gains continue in both our U.S. wholesale book as well as the international portfolio, which is primarily written in Lloyd's. The U.S. wholesale book achieved 24 points of rate in the second quarter, nearly 5 points better than quarter 1. Auto and property lines are strong in the high teens, while excess casualty eclipsed 30% in the second quarter, up over 9 points from quarter 1.

U.S. financial lines also had a particularly strong quarter, achieving pricing of 17%, more than doubling the first quarter results. Pricing gains in the international portfolio continued their upward trend with very strong results in professional lines, energy and cargo.

Let me share a few more details on our commercial businesses, beginning with Small Commercial, which posted an underlying combined ratio of 92.9, 5.1 points higher than the second quarter of 2019, including 5.8 points from COVID charges. Small Commercial written premium was down 9% versus prior year driven by several factors. New business declined 24%, excluding the 2019 Foremost renewal rights transaction. Top line was also impacted by a reduction in audit premiums and negative exposure endorsements, partially offset by strong retention.

With that said, I'm encouraged with our Spectrum new business flow in June and July. July quotes are up 6%, and new business is expected to exceed 2019 ex Foremost.

Middle & Large commercial reported an underlying combined ratio of 112.9 in the second quarter, an increase of 12 points over the prior year period, including 16 points from COVID charges.

A favorable expense ratio and lower inland marine losses contributed to the ex-COVID improvement. Written premium declined 10% in the quarter, largely driven by lower new business and expected declines in retention due to our underwriting and strong pricing actions. Our re-underwriting is intended to improve profitability levels in portions of our book. To that end, I am confident the underlying business is improving as expected.

The decline in new business within Middle & Large Commercial, however, is larger than I expected, causing us to look hard at those levels across lines, classes and geographies. I sense we're not alone in experiencing compressed new business levels during the COVID crisis. I also see increasingly competitive workers' compensation marketplace. However, there is sequential progress with new business from an April low through our current view of July.

Moving to Global Specialty. The underlying combined ratio was 105.5, increasing 14.8 points from the second quarter of 2019, including 13.4 points from COVID charges. We continue to be pleased with the Navigators acquisition. The acquired diversification of product offerings has put us in a much better position to take full advantage of this hard market.

Additionally, considerable portfolio reshaping continues including shifting industry and geographic mix, raising attachment points and reducing policy limits. Combining these actions with our sustained pricing work, I'm pleased with the improving risk adjusted returns of Global Specialty.

The early returns are positive. Year-to-date, the underlying combined ratio for Global Specialty was 101, including 6.8 points for COVID charges. Considering the impact of the COVID charges and that the underlying combined ratio for Global Specialty was 98.5 in the second half of 2019, we've seen significant improvement almost entirely coming from the Navigators book.

Shifting over to Personal Lines. Let me first say how pleased we were to announce a 10-year renewal with AARP in May. We also had strong underwriting results in the quarter. We do, however, appreciate that the shelter-in-place guidelines resulting from the COVID environment favorably impacted the strong performance and led to the aforementioned auto premium refund of $81 million. The underlying combined ratio of 80.7 improved 10.3 points from a year ago.

In Personal Lines auto, the underlying combined ratio of 86.3 was 10.4 points better than 2019. Frequency was down significantly during the first 2 months of the quarter and increasingly less favorable during June as the number of drivers and the corresponding miles driven increased with the lifting of shelter-in-place orders. Claim severity was consistent with what we expected in the quarter.

In homeowners, the underlying combined ratio of 70.1 was 9.1 points better than prior year driven predominantly by a favorable non-CAT weather in the quarter. We've had a strong 6 months of non-CAT loss performance in our homeowners book.

Let me now step back from our business results and reflect on what we might expect for the second half of the year. As we've seen, predicting the course of this pandemic and its economic impact can be incredibly difficult. The status of state reopening plans are constantly changing as new virus hotspots appear across the country. Within Small Commercial and Middle & Large Commercial, third quarter total written premium could be down moderately versus prior year. I expect renewal pricing for Specialty and nonworkers' compensation lines will remain strong and mitigate lower new business levels.

While there have been encouraging signs in June and July with respect to new business, endorsements and premium cash collections, the actual results for the quarter will also depend upon the success of gradual reopening and macroeconomic conditions.

In closing, the second quarter has certainly been extraordinary. Yet as I look through the impacts of COVID-19 on our business, the foundation is solid and diversified. The work we have done over the past 5 years with our insurance and risk management platform will drive new business growth and strong underwriting results. And our talent is poised to be responsive yet thoughtful to capitalize on risk opportunities in a dynamic market.

Let me now turn the call over to Beth.

Beth A. Costello
Executive VP & CFO

Thank you, Doug. Before I review the results for investment, Hartford Funds and Corporate, I would like to take a moment and discuss further our process for establishing loss reserves. Our objective is always to establish appropriate loss reserves to cover the expected ultimate cost of claims incurred to date. We rely upon multiple actuarial techniques to formulate our views, considering estimates for both reported claims and those incurred but not yet reported. Typically, these techniques project reserve estimates by looking at historical patterns and trends and establishing a view of how claims will develop over time.

Obviously, the COVID-19 pandemic is an unprecedented event. Given the lack of historical claim data on which to base loss reserve estimates, there's a higher degree of uncertainty in developing reserve associated with COVID-19. We took this into account in determining our loss reserve estimates for the quarter.

For example, IBNR reserves represent over 80% of our estimate, which is higher than usual, as we expect more extended claim reporting patterns given the economic disruption created by the pandemic. Additionally, D&O, E&O and employment practices liability policies are written on a claims-made basis, and our loss reserve estimate is based on claims reported or noticed through June 30.

In the quarter, we also increased our allowance for credit losses on premiums receivable by $44 million before tax, including $30 million in P&C and $14 million in Group Benefits, reflecting a higher amount of aged receivables and the effects of the economic strain on expected collection of premiums.

Now turning to investments. Net investment income was $339 million for the quarter, down $149 million from the second quarter of 2019, primarily driven by a loss on limited partnerships. As a reminder, results for LPs and other alternative investments are reported on a quarter lag. So the second quarter loss reflects the decline in underlying fund valuations in the first quarter.

While equity markets have improved, we are expecting LP results to be better but still at a loss in the third quarter. This reflects the deterioration in business fundamentals during the second quarter, a more muted recovery in valuation multiples given continued economic uncertainty and relatively low public equity market exposure in the underlying funds.

The current investment yield before tax, excluding limited partnerships, was 3.4%, down from 3.8% a year earlier and up from 3.3% in the first quarter. We expect the before-tax investment yield, excluding LPs, over the remainder of 2020 to be about 20 basis points lower than the 3.4% earned in the second quarter.

The portfolio yield has been impacted by lower reinvestment rates and lower short-term rates. Our yields have also been impacted by our efforts to increase liquidity. Last quarter, I mentioned that we were carrying more liquid assets than our normal benchmarks, and that continued in the second quarter. We ended the quarter with almost 7% of our investments in liquid assets. Given improved views for operating cash flow, we would expect to reduce that to roughly 5.5% in the third quarter.

The net unrealized gain position of $2 billion after tax on fixed maturities increased by $371 million from year-end driven by a decline in interest rates, partially offset by wider credit spreads. Unrealized and realized gains on equity securities, which are recorded within net realized capital gains in the income statement, were $75 million before tax in the quarter, reflecting an increase in valuations due to higher equity market levels.

During the quarter, we recorded credit losses of $42 million pretax on our investment portfolio, consisting of a $20 million increase in the allowance for credit losses on fixed maturities available for sale, and a $22 million increase in the allowance for credit losses on our commercial mortgage loan portfolio based on revised economic forecast and updated property values. Our fixed maturity investment portfolio is broadly diversified and high quality with an overall average credit rating of A+. 96% of the portfolio is investment-grade with nearly 3/4 of that rated A or better.

Turning to Hartford Funds. Core earnings of $33 million were down 13% from second quarter of 2019, resulting from a decrease in fee income driven primarily by lower average daily AUM, partially offset by lower variable operating expenses. Hartford Funds assets under management were up 15% compared to the first quarter. However, they were still down 3% year-over-year. Net outflows were $675 million in the quarter compared with net outflows of $105 million in the second quarter of 2019, reflecting the movement in funds driven by the economic effects of COVID-19.

The Corporate core loss was $6 million in the quarter compared to a core loss of $35 million in the second quarter of 2019. The retained equity interest in Talcott, which is reported on a 1-quarter lag, was the biggest driver and contributed income of $68 million before tax compared with $3 million of income in second quarter 2019. The increased income from the Talcott investment largely reflects the result of Talcott's hedging program. Given how equity markets increased during the second quarter, we would expect to give back about 1/3 of that gain in our third quarter reporting.

Moving on to capital management. As you know, we paused our share repurchase activity in March. We have not resumed share repurchases and will continue to monitor the economic and other impacts of COVID-19.

Book value per diluted share, excluding AOCI, was $45.25, representing a year-over-year increase of 8.9% and an increase of 3.5% from year end 2019. The 12-month core earnings ROE was 12.7%. As Chris indicated, we have initiated a program to improve our overall efficiency, which will achieve annual operating expense savings of approximately $500 million in 2022 and contribute to our goal of reducing our P&C expense ratio by 2 to 2.5 points; our Group Benefits expense ratio by 1.5 to 2 points; and our claim expense ratio by 0.5 point. To achieve these savings, we expect to spend approximately $360 million with $320 million expensed through 2022, of which $130 million will be classified as restructuring costs and will not be included in core earnings.

We have included a summary table in the earnings slides, which provides a more detailed breakout by year of the estimated expense reductions and related costs. In the coming quarters, we look forward to updating you on our progress.

As we look to the second half of 2020, it is difficult to forecast the business climate going forward given the recent rise in COVID-19 infections in many states of the country and uncertainties surrounding the economic recovery. States that had relaxed restrictions on businesses and lessened stay-at-home guidelines are now putting restrictions back into place. As such, there is a range of scenarios in terms of impacts to our top line, particularly in Commercial Lines, and the amount of COVID-19 losses we might expect to see in future periods. As Doug noted, written premiums could be down moderately.

From a loss perspective, we will see additional COVID losses due to new incidents in areas like workers' compensation and Group Benefits. We will continue to monitor claims within financial lines related to the economic strain created by the pandemic. Additionally, we could see impacts to the frequency trends experienced in affected lines.

The magnitude of all these items will be impacted by how the virus progresses and the actions that are taken to reduce the impact of the virus and the effectiveness of the economic stimulus from the Federal government.

While there is uncertainty as to the full impact of the virus, The Hartford is well positioned to weather this pandemic with strong underlying performance as well as a strong balance sheet with ample liquidity as we continue to invest in our businesses and achieve our strategic objectives.

I'll now turn the call over to Susan, so we can begin the Q&A session.

Susan Spivak Bernstein
Senior Investor Relations Officer
Thank you, Beth. Andrew, we'll take the first question.

Question and Answer

Operator

[Operator Instructions] The first question comes from David Motemaden of Evercore ISI.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Just a question for Doug. If I look at the accident year loss ratio, ex CAT, in Commercial Lines and I take out the COVID charges of roughly 10 points, I get to around a 58% accident year loss ratio, ex CAT. That's better than it's been over the last few quarters since you closed the Navigators deal of 59% to 60%. So I guess I'm just wondering what was driving that improvement and if there's any benefit from lower non-COVID attritional losses that's flowing through that.

Douglas Graham Elliot
President

David, on our casualty lines, we essentially did not move our picks in the quarter. The year is still very immature. We did share with you in our workers' comp COVID charge that we had a favorable frequency that we did recognize. So I'd ask you to make sure you've made that adjustment in your ex CAT numbers. But essentially, it was our ongoing loss trends. We still feel like the loss trends that we had talked to you about expected for 2020 are essentially right where we see them today, ex COVID. And so no, no material changes.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Okay. Great. And then if I could just ask a question on the cost save program and I guess just -- if I think about the 2 to 2.5 points in P&C of expense ratio improvement and 1.5 to 2 points in Group Benefits by '22, just wondering, I guess, what is the view on top line levels within that expectation for the reduction? Or should I think about the potential for greater than $500 million of cost saves in order to get to the 2 to 2.5 points in P&C and 1.5 to 2 points in Group Benefits by 2022?

Christopher Jerome Swift
Chairman & CEO

David, it's Chris. Thank you for joining, and the question. It's a combination, right? As we outlined, we are looking to extract $500 million of what we would consider fixed cost savings in '22. But we're also cognizant of the fact that premium volumes may fluctuate up or down from where we closed out 2019, which is the measurement base.

So as we go through, I'll call it, the next couple of years, we'll have to make any appropriate adjustments. Because at the end of the day, we want to get closer to all-in expense ratio that, at least in commercial, is close to that 30% mark. And if premiums are greater, it means we'll have a lower ratio. But if premiums are less, we'll look to other fixed and other variable costs to take out to achieve our results.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Great. So more anchored in terms of the expense ratio than the dollar amount of cost saves. That's helpful.

Operator

The next question comes from Ryan Tunis of Autonomous Research.

Ryan James Tunis
Autonomous Research LLP

So just on the Hartford Next, I think couple questions on that. I think, first of all, Chris, if you could just give us a little bit more perspective on the genesis of this. I guess sort of like, what's the long game here? Is it longer term the view is that you can offer more affordable policies? Or is this purely a driver to enhance your ROE over time? That's the first part. And then, I mean, just along with that, $500 million is clearly quite a bit of cost. What are the offsets we should be thinking about when we think about what might ultimately fall to the bottom line in 2022?

Christopher Jerome Swift
Chairman & CEO

Sure. I think the genesis question is, if you look back over the last 5 years, I mean, we've been investing in the platform, I think, quite significantly and appropriately, whether it be in product, whether it be in underwriting, whether it be in IT platforms, digital, our data and analytics capabilities, robotics and how we could continue to just be more productive. So I think it's just a culmination of those years of investing and stepping back and saying, we probably need to harvest more gains than we have to date and rally everyone. And this is a company-wide effort. Everyone's involved, all businesses, all shared services. And we want to harvest the gains.

I think our initial point of view right now is to drop the majority to the bottom line. But I do want to think about growth, organic growth particularly, and what we might be able to do in either new areas or existing areas potentially to capture more share. But initial thinking right now is more dropping to the bottom line.

And I would say the timing of all this, it was fortuitous, at least in my judgment. We had had a small team thinking about this in the fourth quarter, doing our benchmarking. And then really, first and second quarters, I would say Beth, and Beth could add her color, we developed the specific action plan on a really, really detailed basis so that we felt comfortable, obviously, announcing it here today with the appropriate investments that are needed.

And when you look at the cost, think of -- in essence, the separation cost is separate, but there are also investments that we're still going to make in our platform primarily in the technology side to wring out structural savings over the long term. So that's what I would share with you, Ryan. And Beth, I don't know if you would add anything.

Beth A. Costello
Executive VP & CFO

Yes. Thanks, Chris. The only thing I'd add, just to pick up on a comment that Chris made, is we have been working on the efforts for planning for this over the course of the first and second quarters. So we have very detailed plans that we are tracking to that will achieve these benefits over the next couple of years, well over 600 individual initiatives. And as Chris said, it's across all aspects of the business. But we really are now in execution mode. This isn't as if we're planning to determine how to reduce our costs. We have detailed plans, and we will be executing to them. And as I said, we will update you on our progress as we go.

Ryan James Tunis
Autonomous Research LLP

And then a follow-up. This is probably, I'm guessing, for Beth. But the defense cost portion of the BI charge that you took, how do we think about that? Is that mostly -- is that your view of what this is ultimately going to cost you? Or how -- I guess how encompassing is -- I think it was $40 million or $50 million, how encompassing is that charge?

Christopher Jerome Swift
Chairman & CEO

Ryan, it's very encompassing. We're very thoughtful about it, working in conjunction with our legal team, our General Counsel, recognizing that this isn't going to go away overnight. I mean this is going to be an extended period of time where there's going to be litigation, disputes, and it's a multi-year view of what we think we are going to spend to vigorously defend our policy terms and conditions.

Operator

The next question comes from Elyse Greenspan of Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question, if we back out that 11.1 points, that's the commercial COVID impact from your underlying, that's about 150 basis points of year-over-year improvement. So just tying together some of the earlier comments, it sounds like there was nothing kind of one-off, I guess, away from COVID in the quarter. So is that the right level of kind of underlying margin improvement we could think about for the balance of the year just given kind of what you know now?

Douglas Graham Elliot

President

Elyse, just couple of points to respond to that. First thing is some of that variance was expense-related. So we had a good quarter on the expense side, and you see that in our printed numbers. I'd also remind you that in addition to the allowance for doubtful account charge, we also took in the quarter -- you could adjust the quarterly number for what we gave you in terms of the $30 million bad debt change.

Secondly, we did talk about inland marine losses being better in Middle Commercial in the quarter. So there is some good news on the property side in Middle. But essentially, yes, I think you have it well laid out.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then my second question, we've been hearing some color about how the workers' compensation market might be bottoming. Do you guys have some thoughts there? And as we think about a time frame when we kind of might get to flat and potentially could start to see some positive rate in that market.

Douglas Graham Elliot
President

Sure. Let me start. And if Chris and Beth want to add any color, that would be great. We would agree that we think we're seeing some bottoming in the workers' comp pricing. That's good news. And obviously, it matters deeply to our company.

I would add that if you just isolate factors, the one factor that will now be joining all the new filings going forward is a very different yield curve assumption in all our filings. In fact, if you look at the 10-year over the last 12 months, just go year-to-year our filing today versus 12 months ago, we're probably talking about 150 basis points, plus or minus, and maybe up to 3 to 5 points of change just on rate need alone for yield curve. So the yield curve will be one of the stimulants. And then as the experience works its way through the process, we expect to see more recovery. But I think a flattening and maybe a slightly upward trend is fair to look at that scenario. Chris?

Christopher Jerome Swift
Chairman & CEO

Yes. I think it's well said, Doug. I'd just look at some aggregate numbers, maybe at various states, California and New York. I mean we're approaching 100% combined ratio today. So the pressure is only going to get more intense, particularly, as you said, as far as interest rates. Although frequencies continue to behave very well, at least in our point of view, but I think it all points to -- you could foreshadow 4 to 6 quarters out that there really is a beginning of an inflection point.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. That's helpful. And one last quick number question on the savings program. Do the core expenses or the charges that you laid out, do those hit the segments or that just run through your Corporate segment?

Beth A. Costello
Executive VP & CFO

Yes. So the expenses that are considered core, those would run through the business segments. Really, the restructuring costs would run in the Corporate segments.

Operator

The next question comes from Jimmy Bhullar of JPMorgan.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

First, I had a question about just your expectations on claims trends in the disability business. There're concerns among investors that as the economy weakens, claims will go up. And wondering how you see the interplay of the weaker economy versus sort of the work-from-home environment. And net-net, do you see disability margins potentially improving despite the weaker economy? Or do you expect them to get worse?

Christopher Jerome Swift
Chairman & CEO

Yes. Jimmy, it's clearly a watch area as historically, when unemployment rises, disability claims tend to go up. I would tell you that our data, both on the short-term and long-term side, does not show any pressure. But remember, long-term disability usually has a 180-day elimination period. So it does take some time before you would see new incidences that could translate into more claims over a longer period of time. So our incidence trends in '20 continue to be, again, at very low levels, all-time low levels, although there might be some modest tick-ups in certain segments. So it's clearly a watch item, but it's not emerging in our data yet.

But as we make 3-year rate guarantees, particularly we're in the 1/1/21 season right now, we're taking this all into consideration to provide ourselves an additional margin or additional buffer for potentially more incidences and obviously a lower interest rate environment.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

And on workers' comp, you mentioned pricing potentially increasing given sort of the uptick in the combined ratio industry-wide. Your margins in the business have been pretty good. If pricing does sort of stabilize to improve, do you think your margins could sustain where they are or even potentially improve from recent levels, which have been really good?

Douglas Graham Elliot
President

I think that's a bit premature. And now you're out into a '21-'22 conversation, which we're not prepared to have right now. We've talked about the 2020 year. Our Small Commercial book is experiencing some compression in workers' comp margins. That's where we are relative to those prices being negative.

So we will continue to update you. But I think it's a little premature to talk about improved margins in workers' comp today.

Christopher Jerome Swift
Chairman & CEO

Jimmy, I would add, just -- again, my comments were geared more at accident year results, not calendar year. So I'm not sure what your comment was geared at, but mine were clearly accident year-based.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Yes. It was accident year as well. And I was thinking more about next year and year beyond and 2022 as opposed to this year. On LPs, you had a loss obviously because of the lag effect of the weak equity market in 1Q. I was assuming that in 3Q, given that the market had recovered, you would actually see gains, maybe not all of the losses reverse but at least part of them. But I think Beth implied that your marks will still be negative. Am I -- did I hear that correctly?

Beth A. Costello
Executive VP & CFO

Yes. You did hear that correctly, Jimmy. When we look at it, we don't expect it to be as large of a loss as we had in Q2. But again, the valuations are not just based on equity market. Some of them is also based on forward look of earnings and so forth. So again, given some of the items that I referenced, we would expect potentially to see still a little bit of a loss there as we go into Q3.

Operator

The next question comes from Mike Zaremski of Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

If we can talk about the workers' comp presumption issue and changes, is -- are the presumption changes largely only focusing on COVID-19? So when this pandemic is hopefully over, it'll kind of be a -- this will be behind us? Or are the presumption changes also kind of permanent regarding kind of any virus or sickness going forward? And so we should be thinking about this maybe a different claims rate in the future even when the pandemic is over.

Douglas Graham Elliot
President

Mike, let's parse that apart. I would say, in general, the presumption by state new guidelines are targeted at COVID. And most of them have sunset clauses on the backside. So we are paying a lot of attention to that particular state by state. I think as of June 30, there were 14 states, and several of them were very important big states for us. So think about it in the context of COVID, and we're working with trades and our teams here to make sure we understand all the nuances. And it's an ongoing matter because there are certainly ongoing discussions in various states today that continue to be important as we think about our workers' compensation line.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. Got it. That's helpful. And lastly, thanks for the disclosure in the 10-Q on business interruption. I think you kind of talk to more than 150 cases. It seems like based on the data out there that Hartford is kind of involved in a somewhat disproportionate number of business interruption cases versus the overall pool. Is there anything -- like any reason why that's the case? Or anything we should be thinking about? I mean, clearly, you gave good color on the IBNR levels and whatnot, but it seems like there's just lawyers poking at you guys a little bit more than others.

Christopher Jerome Swift
Chairman & CEO

Yes. Mike, I think I've seen your report on that. I don't know if I agree with it completely just given how are things you might have been counting. But I'm not going to comment upon any specific litigation. But I wouldn't draw any conclusion to us being picked on by counsel. I think it's fair game for everyone. I think there's a lot of equal opportunity to get sued in these areas these days with some of our peers.

So -- but bottom line, as I said in my prepared remarks, I mean, we are highly confident in our policy language terms, conditions and are going to have to defend it over an extended period of time.

Michael David Zaremski
Crédit Suisse AG, Research Division

Understood. And I think all investors have been happy to see that so far the courts have sided with the industry.

Operator

The next question comes from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Two questions. First one, I hope we talk a little bit, Doug, about some of the reserving actions in the quarter. First, still a little surprised we're seeing auto liability, commercial auto liability adverse development. What's going on there? And then also just the Navigators, I know it's going to be stop-loss cover but still a fair amount of development there. Is that kind of well above expectations? And where is that coming from? Does it have any effect on loss picks currently?

Douglas Graham Elliot
President

So I'll start with auto liability. Our 2019, 2018 -- I'm sorry, 2018 pick was just a little light. So we felt like we had to top that up, Brian. Commercial auto liability has been a frustrating area for us over the last 5 to 7 years. We have, I think, done a lot of underwriting work. We have priced aggressively. Obviously, we haven't caught all of the trends. I think we're on top of it. As I mentioned in my script, our pricing now is in the teens in our Middle Market book and even stronger in our Global Specialty book.

So if we understand it, I think we're in a better reserve position. And yes, it's been a little bit of a nagging issue that Beth and I just want to get on top of.

Relative to Navigators, I would describe the international D&O as specific situations that we had to make adjustments for in our reserves. There were certain cases that we just felt like our case reserves were not adequate.

And then in the U.S. book, I talk about general liability. We just strengthened our tail factors on the backside of some of our curves. So those are the 2 areas that in NAV, I think, we made the appropriate adjustments with. Again, we understand that book more deeply today than we certainly did the day we purchased it, and I feel good about where we are.

Beth A. Costello
Executive VP & CFO

And I just would add that, to your other question, Brian, it does not change our view of our current accident year picks. We feel very good about how that book is performing. I feel very good with the progress that we're making on improving the profitability associated with that. So from that standpoint, no change there.

Christopher Jerome Swift
Chairman & CEO

Brian, I'd just add one other comment just on the overall deal. I continue to be really pleased with the overall performance of the acquisition, the team, the talent that we talked about. Modestly, I think our timing was really, really good. I didn't know that we're going to go through a hard market, but we'll take a little tailwind at our side.

And again, if you really -- remember, when we announced this transaction, we purchased an ADC cover because we knew their reserves were short. We were willing to absorb, obviously, call it, a loss layer of that, the first $100 million. But then we did transact with a third party to transfer all that risk from there. So we knew they were short. That's why we did the ADC. Honestly, it's not surprising to see where they're at right now. But that's the context of how we're thinking about the deal and specifically the ADC.

Douglas Graham Elliot
President

And I would just close, Brian, on the liability pieces that we've talked about this publicly. We wanted more general liability expertise in our portfolio. It was an area that we've been working on organically. And so as we acquire the Navigator, which is a core fundamental throughout their product family, we do that in a time of increased loss trend. We understand that. And we've had to make some adjustments along the way. So I think that all sets up what happened in Q2 and over the last couple of quarters.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then second question, Chris, just going back to some of your initial comments about the safe harbors and the Federal stimulus that the industry needs. I'm just curious, as you think about this going forward, what does it mean if we don't get it? Is that something that you kind of contemplate in your kind of current casualty picks that maybe we do see a pickup in litigious activity? I mean there's an article in the journal about it today. And is there any way that you can protect yourself as a commercial carrier with policy wording or anything? Are you doing that from some potential pickup in lawsuits?

Christopher Jerome Swift
Chairman & CEO

Yes. It's a great point, Brian. I think it would add only to the -- impact the social inflation that we're experiencing today that everyone is talking about. So yes, I would say it's bad now, and it could get worse going forward if there isn't, as I said, temporary relief, right? I mean we want people to try to go back to work and reopen the economy. And as long as there isn't, call it, gross negligence or just bad behavior that employers -- I think vast majority would know better. But there still needs to be a level of protection.

I don't know what's feasible as far as litigation going forward. I hear more and more litigation each day that is happening as people think about returning to work and/or wrongful death claims this morning.

I think really what it means is, particularly in all our policies -- and we take a proactive stance in looking at policy terms and conditions and appropriate communicable disease exclusions are already in a lot of our general liability policies. But we'll continue to just be thoughtful and take necessary action where appropriate with policy terms and conditions.

Operator

The next question comes from Yaron Kinar of Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group, Inc., Research Division

Just couple of questions. One, looking at Small Commercial, I think you call out couple of COVID items that impacted year-over-year results. I think if we strip those out, we still get to some year-over-year improvement. So wanted to hear what the favorable offsets were. Doug, I think earlier in response to another question, you talked about potential expense ratio improvements. But any color you can offer in Small Commercial would be appreciated.

Douglas Graham Elliot
President

So when I think about Small Commercial, and I'm assuming you're looking at margin and [FX] , essentially when you adjust our quarterly underlying for COVID, you get an 87.1, which is, I think, a really competitive, terrific answer for their business. I have commented that we were impacted by COVID-19 relative to production. I've commented we expected that in the quarter. We've watched that. I also will share with you that or on-the-glass underwriting tool, early March, when we saw this thing coming, we made adjustments on the glass for referrals to underwriters in certain classes that we just wanted extra sets of eyes. And I'm sure that influenced a bit of the flow during the first 60 days.

So there are a lot of subtle factors that go into how we run that business, but I feel very good about our underlying margins, the adjustments we've made and our go-forward prospects.

With all that said, we have to understand that we're watching carefully the reopening across the country. And we can't do this all ourselves. We have to participate in the economy in large.

Yaron Joseph Kinar
Goldman Sachs Group, Inc., Research Division

Doug, what I was trying to get at is, I think once you take out the COVID losses, the margin -- the underlying margin actually improved in Small Commercial. And since you had called out some of the negatives, I was just curious as to what some of the favorable offsets were?

Douglas Graham Elliot
President

Well, there's a little bit of good news on the expense side, and I would say largely on the loss side we didn't adjust many of the other picks. So we commented on the workers' comp news relative to COVID, and quite a bit of that would be Small Commercial. But I don't think, Yaron, there's much else to talk about at this point. We're talking about tenths as opposed to significant points.

Yaron Joseph Kinar
Goldman Sachs Group, Inc., Research Division

Okay. Okay. And then my second question, I'll just start off by saying I thought the disclosures around COVID were really excellent this quarter. So thank you for that. But I'm greedy in nature, so always looking for a little more. And I was just curious with regards to the $100 million property COVID loss, specifically that -- the portion that came from physical -- the policies without a physical damage trigger, were you taking kind of full limit losses there? And also just curious as why you're taking a quantitative approach on the -- on those policies that have physical damage triggers, saying they're 99% of policies, yet you're keeping the disclosure around virus more qualitative just in vast majority. Just wondering what the thought process around the differentiating between the 2 was.

Christopher Jerome Swift
Chairman & CEO

Yes. Yaron, it's Chris. So what I would share with you on, call it, the 99%, it's basically to sort of reinforce that business interruption is standard in most policies but it does have a physical loss requirement.

The second point that we were -- we have been making to the people that will listen is that besides the direct physical loss requirement, we also have broad pollutants and contamination exclusions in, again, 99% of the policies. And those exclusions really bar coverage for any material that threatens human health or welfare.

And then the third layer is, like we said, virus -- the virus exclusion, which is on the vast majority of our policies. And that's how we think about sort of how policies are constructed and sort of the terms and conditions and how it really works. And I almost think of it as a waterfall. So you don't even get to virus, if you don't have direct physical loss. And that's why I sort of put it last in the waterfall.

As far as the $101 million, any additional detail at that point in time as far as policy limits and things like that, I'm just not going to comment upon. I mean we looked at it in aggregate. We know what the policy limits are. We know what claims have come in in for. We did an exposure analysis on future claim activity that might come in. And that's our number, and that's all I'm going to say.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Susan Spivak for any closing remarks.

Susan Spivak Bernstein
Senior Investor Relations Officer

Thank you. We appreciate you all joining us today. If we didn't get to your question on the call, please contact me, and we are happy to follow up. Talk to you again next quarter.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.