S&P Capital IQ

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The Hartford Financial Services Group, Inc. NYSE:HIG

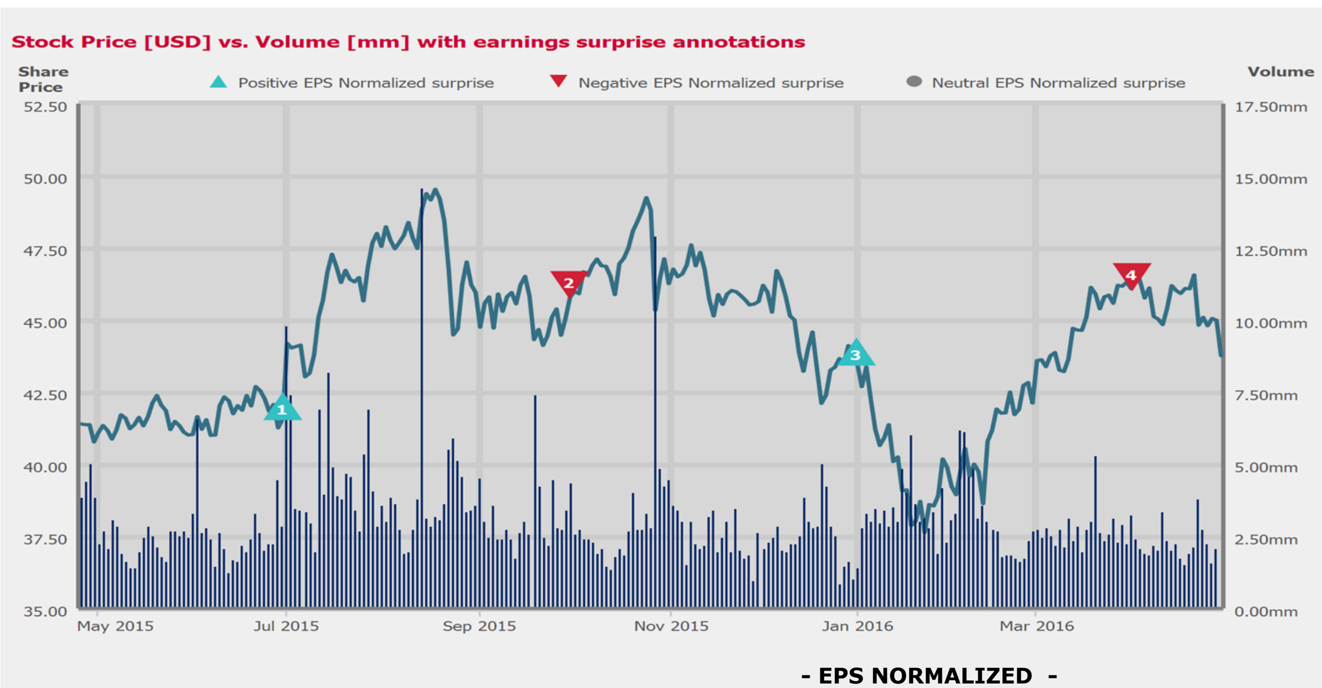
FQ2 2016 Earnings Call Transcripts

Friday, July 29, 2016 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2016-			-FQ3 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.80	0.31	(61.25 %)	0.93	3.52	4.28
Revenue (mm)	4853.00	4677.00	(3.63 %)	4883.00	19045.00	19384.00

Currency: USD
Consensus as of Jul-29-2016 12:07 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2015	0.77	0.91	18.18 %
FQ3 2015	0.99	0.86	(13.13 %)
FQ4 2015	0.98	1.07	9.18 %

FQ1 2016	1.01	0.95	(5.94 %)

Call Participants

EXECUTIVES

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

Douglas G. Elliot
President

Sabra R. Purtill
Senior Vice President of Investor Relations

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Evercore ISI, Research Division

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Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Randy Binner
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Presentation

Operator

Good morning. My name is Scott, and I will be your conference operator today. At this time, I would like to welcome everyone to the Hartford's Second Quarter 2016 Financial Results Conference Call. [Operator Instructions] Sabra Purtill, Head of Investor Relations, you may begin your conference.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you. Good morning, and welcome to the Hartford's webcast for second quarter 2016 financial results. The news release, investor financial supplement, slides and 10-Q for this quarter were all released yesterday afternoon and are posted on our website.

Our speakers today include Chris Swift, Chairman and CEO of the Hartford; Doug Elliot, President; and Beth Bombara, CFO.

Following their prepared remarks, we will have about 30 minutes for Q&A.

Just a few notes 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 forward-looking statements, and investors should consider the risks and uncertainties that could cause actual results to differ from these statements. A detailed description of these risks and uncertainties can be found in our SEC filings, which are available on our website.

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

I'll now turn the call over to Chris.

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

Thanks, Sabra. Good morning, everyone, and thank you for joining us today.

From a bottom-line perspective, second quarter results were disappointing. Higher prior year development, including A&E, lower current accident year personal auto results, lower net investment income and higher catastrophe losses led to a decline in our core earnings.

However, I am pleased that our Commercial Lines and Group Benefits businesses continued to generate solid underwriting results. And book value per share, excluding AOCI, grew 5% over the prior year and 2% since year end. You all are aware of the challenges our industry is facing due to greater commercial lines competition, unfavorable auto loss cost trends and significantly lower interest rates.

In Commercial Lines, competition is becoming more aggressive, especially in National Accounts and Middle Market. Some companies are expanding into new markets, while other long-standing competitors are now willing to accept lower pricing or weaker terms and conditions. Renewal rate increases are hovering near short-term loss cost trends in most lines, so expanding margins from here will be difficult.

While we've continued to deliver good Commercial Lines results by focusing on underwriting discipline, retention and maintaining underlying margins, we see fewer opportunities to grow the top line in middle and larger account markets over the next several quarters. We will continue to pick our spots prudently.

In Personal Lines, increased vehicle miles driven as well as distracted driving have continued to put pressure on auto loss cost trends. Based on our analysis of the deterioration in frequency and severity, we strengthened reserves for accident year 2015 and increased our loss ratio estimate for accident year 2016. In hindsight, I'm disappointed we didn't recognize earlier the magnitude of the changing trends. Doug will update you on the pricing, underwriting and agency management actions we are taking to get margins back to our targets.

Personal Lines is a core business for us, and our 30-plus year relationship with AARP provides a solid foundation for long-term growth opportunities. While it will take time to fully restore profitability to target levels, I'm confident we will begin to see improved margins in this book in early 2017.

Another issue confronting our industry is the macroeconomic environment, especially the decline in interest rates, in part due to Brexit. As it relates to Brexit, I'm confident that the global insurance markets, which have been managing insurance risk freely across borders for centuries, will make the necessary changes to adapt. In the meantime, sustained low rates will continue to put pressure on net investment income and place greater emphasis on underwriting results. Our investment team has carefully steered our portfolio through many challenges over the past few years, including the European debt crisis and the collapse of energy prices. We will remain vigilant on the evolving macroeconomic environment and emerging risk.

I'd also highlight our strong risk management capabilities as our hedge programs have performed as expected in this period of heightened market volatility.

During the quarter, we maintained our pace of capital return to shareholders, with over $430 million of share repurchases and common dividends. Year-to-date, we have returned significant capital from Talcott Resolution to the holding company, which Beth will discuss. We expect to complete our current capital management plan of 4.4 billion of common equity repurchases by the end of 2016. Later this year, we will finalize our plans for 2017.

Before turning the call over to Doug, I'd like to note that based on first half results, we now expect the 2016 Personal Lines underlying combined ratio to be in the 93 to 94 range. This reflects favorable homeowners results year-to-date, with an approximate 5-point deterioration in the auto underlying combined ratio compared to our original outlook.

That said, I'm confident in our approach to the current market conditions. We are taking the right steps to restore personal auto profitability, and we have the discipline to navigate the competitive Commercial Lines and Group Benefits environments. We will continue to build upon our strong franchise and invest for the future, including opportunities like the acquisition of Maxum, which is expected to close today. We will improve our operating capability and maximize efficiency while redeploying excess capital to support long-term shareholder value creation.

Now I'll turn the call over to Doug.

Douglas G. Elliot
President

Thank you, Chris, and good morning, everyone.

Commercial Lines and Group Benefits posted a solid quarter even as market headwinds have intensified. In Personal Lines, results were disappointing as loss trends in accident year 2015 continued to emerge adversely to our expectations, driving both unfavorable prior development and a deterioration in our estimates for accident year 2016.

Let me get right into Personal Lines, which posted a core loss of $55 million for the quarter, down from core earnings of $42 million last year. The underlying combined ratio, which excludes catastrophes and prior-period development, was 94.2, increasing 5.1 points versus last year. This is primarily due to higher auto liability loss costs, which I will discuss in a minute, partially offset by a decrease in direct marketing expenses.

Homeowners performance continues to be excellent. We experienced a slight uptick in fire-related losses, but this is compared to a very favorable second quarter 2015.

CAT losses in the quarter were $104 million, $7 million higher than second quarter 2015, but generally in line with our expectations. Overall, we were pleased with the trends of our Homeowners book.

Included in the Personal Lines underwriting loss this quarter is $75 million pretax of adverse auto liability development primarily related to accident year 2015. The factors behind this adverse development remain consistent with those we described in the first quarter, which are related to higher employment, resulting in more people on the road. As a consequence, we're seeing both increased frequency and severity of bodily injury claims, which generally have the longest reporting lag and highest severity. Despite our first quarter reserve action, losses from the 2015 accident year emerged well above our previous expectations during the second quarter.

Due to the deterioration in these trends for the 2015 accident year, we also raised our 2016 accident year auto liability loss estimates, essentially carrying forward the 2015 experience. Based on our latest call, we do not expect to achieve the full year Personal Lines underlying combined ratio of 90 to 92 that we provided in February. This included homeowners at 77 to 79 and auto at 96 to 98. As I noted earlier, Homeowners results have been strong, coming in favorable to our expectations. Auto, on the other hand, is running approximately 5 points adverse to our full year expectations. We now expect the Personal Lines underlying combined ratio to be in the range of 93 to 94. This incorporates our view that the rate of change in auto frequency will moderate for the second half of this year based on the elevated levels that began in the second half of 2015, and that the rate of change in auto severity will continue to hover in the low single-digit range.

The actions we described last quarter to address the adverse auto liability trends are intensifying. These include a substantial increase in the number of rate filings versus prior year; aggressive non-rate actions to improve our profitability, such as terminating unproductive agency relationships, de-authorizing certain agents from the AARP program, and rolling out a new compensation structure focused on key partner agents. On the direct side, our marketing efforts are targeted toward preferred customer segments, and we continue to address underperforming business with targeted pricing and underwriting adjustments.

Our 2016 rate actions continue to accelerate, equating to over 200 million of premium on the auto line. The earned premium impact of this rate will follow and, ultimately, is based on the customers we actually renew. We expect the combination of rate increases and mix change in the book of business to drive auto margin improvement in 2017.

As a result of our profit improvement steps, AARP Direct and AARP Agency written premium was up only modestly at 1% and 3%, respectively, for the second quarter of 2016. Other agency was down 17%, consistent with our strategy to shift our business mix towards AARP members and our more highly partnered agents.

When I step back and reflect on the first quarter of 2016 for Personal Lines, there's no hiding our disappointment in the results. However, encouraging signs are emerging from our various auto initiatives, and I'm confident that we're moving in the right direction to restore profitability in this business.

Now let's shift over to Commercial Lines, where we had a solid quarter with core earnings of $224 million, down $40 million from second quarter 2015. The combined ratio was 95, an increase of 2.8 points versus prior year, primarily due to higher CAT losses and lower current accident year margins in Small Commercial and Middle Market, offset by improved margins in Specialty. Renewal written pricing and Standard Commercial Lines was 2% for the quarter, flat to first quarter 2016.

In Small Commercial, we had another excellent quarter, with strong retentions and margins. The underlying combined ratio of 86.9 was 1.8 points higher than last year. The increase is largely due to lower margins on package business, resulting from higher non-catastrophe property and general liability losses, offset by a modest improvement in workers' compensation margins. Recall that property losses were very low a year ago, making this quarter a tough comparison.

Small Commercial written premium was up 2% in the quarter, reflecting strong retention, while new business was off 1% as competitive conditions intensified. We continue to advance our capabilities with initiatives in distribution, product, digital technology and analytics, all of which are crucial in the small commercial market and are helping us maintain our leadership position despite the increasing competition.

Moving to Middle Market. We posted an underlying combined ratio of 91.9, up 2.6 points from second quarter 2015. This was primarily due to less favorable property losses and an increase in expenses. Similar to Small Commercial, second quarter 2015 benefited from particularly favorable property losses. Middle Market written premium in the quarter was flat compared to prior year. New business of $124 million increased $5 million over last year, due mainly to solid performance in our industry verticals, which we have been building in recent years as part of our strategy to become a broader and deeper risk player. In other areas of Middle Market, we experienced a slight decline in both retention and new business for the quarter. This is the result of our disciplined pricing and underwriting stance in the market, with our primary objective centered on maintaining profitability.

Specialty Commercial had a very strong quarter. The underlying combined ratio of 95.4 improved 3.4 points versus prior year, driven by strong margins in National Accounts and the continued favorable margins in Bond and Financial Products. Specialty Commercial premium was down 2% compared to second quarter '15, reflecting the competitive environment in National Accounts. I'm very pleased with how we're navigating these markets and the pricing discipline we continue to exhibit.

I'd describe the marketplace for both Middle Market and National Accounts as increasingly aggressive, particularly for new business. We're seeing relative newcomers, some reemerging incumbents as well as the traditional players offering very competitive pricing. Although we continue to win new business and renew existing accounts at pricing that's both competitive and profitable, we expect that achieving total written premium growth in the near term will be challenging.

Moving on to Group Benefits. Although core earnings is down from last year, the business continues to perform well and is operating from a strong market position with solid returns. Second quarter 2016 core earnings of $46 million was down $10 million, producing a core earnings margin of 5.1%. The decline in core earnings was driven primarily by lower net investment income and higher group life mortality claims.

The group life loss ratio increased 1.9 points to 78.1 for second quarter 2016. This was primarily due to higher claims severity, which can be volatile from quarter-to-quarter.

Mortality trends remain in line with our expectations.

On the top line, fully insured ongoing premium was up 1% for the quarter. Overall, book persistency on our employer group block of business continues to hold around 90%. Fully insured ongoing sales were $80 million for the quarter, a 38% increase over second quarter 2015. We feel competitor pressures in this business, too, particularly in long-term disability, but had strong sales this quarter due to a large new account.

In summary, our Commercial Lines and Group Benefits businesses are operating effectively in competitive market conditions, and we remain focused on business retention and margins. Consistent with our philosophy across the enterprise, we are diligently pricing and underwriting, prepared to pass on the business that does not meet our return thresholds.

In Personal Lines, we have hit a difficult stretch, but are taking numerous actions to address elevated loss cost and restore underwriting profitability in personal auto.

Let me now turn the call over to Beth.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Thank you, Doug. I'm going to covered the Other segments, the investment portfolio and capital management before we turn the call over for questions.

This quarter, in P&C Other operations, we completed our annual asbestos and environmental reserve study. As a result of this study, we added $197 million before tax asbestos reserves and $71 million before tax to environmental reserves. The increase in the asbestos reserves was due to mesothelioma claims not decreasing, as expected, over the past year for a small subset of peripheral defendants in adverse jurisdictions. The environmental charge reflects higher claim severity, including for additional properties tendered during settlement discussion and increased legal defense and cleanup costs. After tax, the A&E development increased $40 million from second quarter 2015, resulting in core losses for the segment of $154 million compared with $113 million in second quarter 2015.

We are disappointed with the development on this book. And as we have said before, we continue to evaluate options for these exposures, taking into account factors such as the value we add by managing these claims ourselves, the loss of investment income versus the cost of a transaction, as well as whether it is a partial or permanent transfer of risk.

Earlier this week, we were pleased to announce a definitive agreement to sell our U.K. run-off P&C book to Catalina. This agreement provides for a permanent transfer of these liabilities and is not expected to have a material impact on our financials.

Mutual Funds core earnings were down $2 million from second quarter 2015 due to lower fees as a result of lower assets under management. Total AUM was down about 4% from a year ago, consisting of a 2% decline in Mutual Fund AUM, principally due to lower market values over the past 12 months; and a 15% decline in Talcott variable annuity AUM, primarily reflecting surrender activity.

Fund performance remains solid, with 62% of all funds and 70% of equity funds outperforming peers over the last 5 years.

Mutual Fund net flows were a negative $419 million as positive net flows in multi-strategy investments were more than offset by negative flows in equity and fixed income. Over the last 12 months, net flows were a positive $107 million.

Talcott's core earnings declined to $91 million, from $171 million in second quarter of 2015, which included a $48 million tax benefit in higher limited partnership income. Compared to the first quarter of 2016, full surrender activity increased slightly to 7.7% for variable annuities and to 5.1% for fixed annuities. Surrender activity in the quarter reflects normal run-off as there are no current contract holder initiative. VA surrender activity decreased from second quarter 2015, reflecting the age of the block and is largely consistent with our assumptions.

We recently received approval from the Connecticut Department of Insurance for the $250 million extraordinary dividend that we had expected from Talcott in the second half of 2016, and this amount was received by the holding company in July. Combined with the $500 million we received in January, Talcott has provided $750 million of capital to the holding company during 2016, as planned.

We continue to evaluate Talcott's capital generation outlook for 2016, which has been negatively impacted by lower interest rates. As you may recall, we had a 2016 outlook for $200 million to $300 million of capital generation, which was dependent on markets and the run-off of the book, among other things. Compared to the beginning of the year, equity markets remain high, which supports fee income and earnings. However, as interest rates remain at current levels, we would most likely need to record additional cash flow testing reserves at year-end, which would reduce or eliminate 2016 capital generation at Talcott. While we have a ways to go until year end and a lot of things can change, this will be a factor for us to consider as we determine dividends for Talcott in 2017.

I want to emphasize that even at current interest rates, Talcott's base case capital margin remains very strong, and its stress scenario capital margin, while lower than what we calculated in February, is still above our minimum. In short, the low interest rate averment has not changed Talcott's ability to remain capital self-sufficient in a stress scenario.

Turning to investments. Our limited partnership returns totaled $40 million in the second quarter, which is in line with our 6% annualized outlook. All 3 asset classes had positive returns this quarter as contrasted with first quarter 2016 losses in hedge funds and real estate. However, compared with second quarter 2015, limited partnership income was down 57% year-over-year. In second quarter last year, we had especially strong returns in real estate and private equity, resulting in a very difficult comparison.

Excluding limited partnerships, our before tax annualized portfolio yield was 4.1% this quarter, relatively consistent with the last year. However, we expect the portfolio yield and net investment income to decrease as new money yields remain below the book yields.

While our current projections for full year P&C net investment income, excluding partnerships, is still in line with our original outlook, the P&C portfolio yield, excluding limited partnership, declined this quarter to 3.8% from 3.9% in second quarter 2015. In addition, year-to-date results include some make-whole premiums and other nonroutine items that to the extent they do not continue at the same levels, will put additional pressure on second half 2016 and full year 2017 net investment income and portfolio yields.

Turning to credit performance. Our investment portfolio remains highly rated and well-diversified. Credit experience was good during the quarter, with total impairments and mortgage loan valuation reserve charges of only $7 million before tax.

To conclude on earnings, second quarter core earnings per diluted share were $0.31, down 66% from second quarter 2015. Excluding prior year development and other items listed on the segment results table in the news release, results were down about $0.15 per share, or 15%, due to higher catastrophe losses and current accident year personal auto results.

Turning to shareholders' equity. Book value per diluted share, excluding AOCI, rose 5.5% from a year ago, resulting in total shareholder value creation, including dividends, over the last 12 months of 7.4% versus our target of 9% over time. The 12-month core earnings ROE, excluding Talcott but including the A&E charge, was 8.9%, while P&C core earnings ROE, which also includes the A&E charge, was 10.3%.

During the quarter, we repurchased $350 million of common equity. During July, we have repurchased 2 million shares for $89 million, leaving $541 million under -- remaining under the authorization. As you know, we tend to be consistent in our approach to repurchases and expect to use the remaining authorization over the balance of the year.

To conclude, this quarter's results were disappointing, largely due to personal auto. As Doug discussed, we have many initiatives under way to improve Personal Lines margins, and we look forward to updating you on our progress.

Aside from Personal Lines, underwriting -- underlying results in the other segments remain strong. In addition, we were pleased to see limited partnership returns back up to our 6% outlook after 3 quarters of low returns.

While the environment remains challenging, we continue to generate capital and effectively manage the run-off of Talcott. As Chris mentioned, we expect to complete our current capital management plans by year-end and will finalize our capital management plans for 2017 by year-end.

I will now turn the call over to Sabra so we can begin the Q&A session.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Beth. Just a reminder that we have about 30 minutes for Q&A. If you have to drop off or if we run out of time before we get to your question, please email or call the IR team and we'll follow up with you as soon as possible today.
Scott, could you please repeat the instructions for Q&A?

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Thomas Gallagher from Evercore ISI.

Alex Scott
Evercore ISI, Research Division

This is Alex Scott, standing in for Tom. Quick question on the A&E. Did the sale of the U.K. runoff business impact the A&E charge this quarter? In other words, is there an element of this charge that's some kind of true-up ahead of the transaction?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Thanks for the question. This is Beth. The A&E charge that we took this quarter was not impacted by the U.K. sale at all.

Alex Scott
Evercore ISI, Research Division

Got it. And just thinking about the lower reserves pro forma the transaction, would that be expected to reduce future charges? Or do you think sort of the underlying experience you're seeing more than offsets this?

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

Alex, it's Chris. It's going to be hard, obviously, to predict the future. And we try to make our best estimates every year with our ground-up study. There are a concentration of accounts that seem to be getting picked on year-after-year, but, I mean, it's really hard to predict what's going to happen in the future. I think what the transaction should tell you is we are proactively looking at our legacy books, whether it be the Life or P&C side, and seeing if there are better owners for those books over a longer period of time than holding them. So we'll continue to challenge ourselves on the U.S. block, but we'll make our best estimates every year. But, Beth, would you add anything else?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Just the only thing I would add is if you look over the last couple of years and just the prior year development that we've experienced on the claims that we will be transferring as part of the sale, it's been anywhere from $25 million to $55 million of prior development that we've recorded in that book. So obviously, that level of reserve increases going forward would obviously not be there.

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

And we typically have done historically the U.K. operation in the fourth quarter reserve studies?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

There's a variety of reserve studies that impact the book of business that we just sold. But the largest amount of prior development that we've experienced has typically been in the fourth quarter when we looked at non-U.S. asbestos and environmental reserves that were in that book of business.

Operator

Your next question comes from the line of Brian Meredith from UBS.

Brian Meredith
UBS Investment Bank, Research Division

A couple of questions here related to the Personal Lines. First, Doug, can you talk a little bit about why this took you all probably longer than the rest of the industry to kind of identify some of these trends? And maybe the kind of lag in reporting, anything related to ACA? Or what do you think is causing that?

Douglas G. Elliot
President

Brian, let me take a shot at that. Let me try to separate it in a few components. Number one, I think you know, and we should just state it, there has been pressure across the industry the last couple of years, right? So if you look at accident year '15 versus accident year '14, we do see that pressure point. At the heart of your question is why were we late on it. I would say this, number one, our physical damage frequency estimates at year-end for accident year '15 are still holding. So the number of collisions we predicted for that accident year book still look very solid. Didn't change much in the first quarter and have not changed in the second quarter. Second piece, which we talked quite a bit in the first quarter and also have developed in the second quarter, the number of bodies that are injured in those crashes during accident year '15, we're seeing more people injured and we're seeing more coverages influence. So the frequency of components of loss has grown in our 2000 -- accident year '15 book. And the third piece, which ties into that last statement, our bodily injury severity across the book has had pressure, and that pressure was evident in the first quarter if we look back on '15. And we've seen another 1 to 1.5 point of pressure in the second quarter. So that really forms the basis for why the changes. We are disappointed that we didn't see all of it, but we've gone back. And it's not like we missed the number of actions in our book. We look -- we are missing the features around them and have made pretty significant changes to make sure not only are we on top of '15, but we've adjusted for '16 moving ahead.

Brian Meredith
UBS Investment Bank, Research Division

Great. This is a quick follow up there. My recollection is that most of your business is annual business. So how quick -- how long is it going to take to get back to kind of where you want to be on auto profitability?

Douglas G. Elliot
President

When you look at our auto book, and we shared the numbers XX, we've got 5, 6, 7 points that we need to get back at, right? And that's probably not doable in a 12-month period. But Ray and Chris and Beth and I and the team, we are driven, over the next couple of years, to see incremental progress quarter-by-quarter. And certainly by '18, we feel like we're going to be in a much healthier spot relative to long-term targets.

Operator

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

Randy Binner
FBR Capital Markets & Co., Research Division

I wanted to jump to some of the comments that Beth made around Talcott. And I guess in particular, it sounded like -- you said there was a potential that the low-rate environment could eliminate cash flow up from Talcott in 2017? I just want to make sure I heard that right. And if so, is there any change to the stress scenario you had in your 4Q '15 presentation around low rates? Because I guess our view had been that there was enough market good guy in that test to offset the bad guy of low rates, if you will. So just trying to understand that comment better. And if the rate impact has changed in that analysis.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. Thank you for the questions. Let me clarify. What I was referring to is that when we look at surplus generation in Talcott for 2016 with the potential to have the need to increase cash flow testing reserves at the end of the year, that surplus generation of $200 million to $300 million we could see decrease or be eliminated. I do expect that we will have dividends from Talcott in 2017. What the amount of dividend will be, will be dependent on kind of where we end the year at. As we look at our stress scenarios, we feel very comfortable with the amount of capital that we have, and we have updated those scenarios for a steeper decline in interest rates. So when we did those scenarios at year-end, we were assuming that the 10-year at the end of '17 would be at 1.61%. And now, when we stress that, we're looking at a 10-year of 1.15%. And so with that, our stress margin capital that we shared with you in December would come down and probably be slightly under $1 billion. But I think that still gives us capacity in 2017 to take dividends from Talcott.

Randy Binner
FBR Capital Markets & Co., Research Division

So the stress margin capital of a little under $1.0 billion, you just said. Would that compare to the $1.6 billion that you initially had in that presentation?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. And that, again, takes into consideration the fact that we were taking $750 million of dividends out in '16, which we have done.

Operator

Your next question comes from the line of Michael Nannizzi from Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I guess, Doug, a couple of questions back to Personal Lines. Sort of looking at now what we've seen manifest here, you've had continued challenges in what appears to be getting our arms around the issue there. But when I look at the supplement and look at rate-taking activity there, it looks like you've gone from 5% before anything manifested to about 7% now. So I'd like to square that to your comment about significant rate taking. But your policy count retention is flat and new business has come off modestly. So I'm just trying to square all of those things. Like how is it that with everything that's taken place, that we're not seeing the foot come off the gas entirely? Why is new -- why is there any new business? And why isn't retention coming down further?

Douglas G. Elliot
President

By saying that our performance in AARP versus our agency book do have different profiles over time, so there is a management of our different customer segments that just underlies all I'm talking about. But I think with that, it's important just to set the stage, right? Over the last couple of years, starting in April of '14, we started rolling out a new class plan designed to improve our competitiveness, particularly in under-penetrated segments. We also expanded our agency distribution around that, appointing some firms, which had no prior relationships with us. And those changes were going on at a time when the industry was starting to lean into higher frequency and some severity news. So probably not the best time to be rolling out a new class plan. I want to give you some evidence of what we've been working on. The last state in that class plan was rolled out in August of last year, August of '15. That was Florida. We now have the third fine-tuning or iteration of those class plans going into effect across the country. So we've been tuning those plans over this 2-year period. We're also leaning into rates. So our achievement of rate today is greater than we expected the plan to need 6 months ago. And I would say that we're leaning in harder the second half of the year, subject to our work with the various states. So the disappointment is we've leaned into a growth mode over the last couple of years at a very difficult time. Further, some of that growth was more pronounced in several states with higher overall loss costs, such as Florida. When you think about Florida, we've get a lot of retirees in certain pockets of the country. Florida, at times, can be one of the more challenging environments, and so we've had to go back and adjust our rate plan and open road plan in some of these states aggressively. The last thing I would say to you is that, and Florida is an example, we've seen across the states an emergence of a little bit more pressure in uninsured and underinsured motorists. These claims are the slowest to emerge and have the highest ultimate severity. So this pattern has shifted, with these UM claims emerging more slowly over time, and I think our severity dynamic has tied into the emergence of some pressure with UM. So I'm not making any excuses. We are tackling hard. We're tackling with pricing. We're working the product and the segmentation as hard as ever. We've made pretty material changes to distribution management, both our targeted plans and also our agency partners. And we're working across our claim operation across the country, making sure that we're on every bit of our operating strategy. So, Mike, I expect to see brighter days ahead. I will tell you in the last 45 days, we're seeing signs of this progress. Feel very good about July. But July does not make a year, and certainly doesn't make a quarter. So we'll talk more about that in the coming quarters.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

So should we expect then in the third quarter that we're going to see new business -- we're not getting to see any new business -- we're not going to see retention levels down? I mean, like when are we going to see those metrics? Because just -- we've talked now the last few calls about this. And it just feels like, on the one hand, we've got issues still trying to understand why they continue to change relative to expectations. But then on top of that, what you're doing in the field as far as new business, I hear everything you're saying, but when do we expect that we're going to see what should be a natural decline in retention as you take aggressive rate action and just a complete drop-off of new business and advertising?

Douglas G. Elliot
President

So let me share a few numbers of new business in the second quarter just to stage the answer. Our AARP Direct was off 8% in the quarter. Our other agency was off 37% and our overall auto new business was off 14%. So that's a demonstration of some of the moves we've made. On the pricing side, we look at the adjustments we're making and -- there's still big chunks of our book that are, with the pricing we're putting in place, we want to retain those customers. So the numbers I shared on new are more reflection of how we're moving into these territories and the customers we're seeking to add and build to our book. But the retention strategies are tied into a rate adequacy, and in some places, we're very rate-adequate, and other places need a lot of work. And the numbers you're looking at are averages. So the span around those averages, between most distressed and well under control, do vary widely.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Do you think you'll be able to provide some more granularity so that we can evaluate how you're progressing in these stressed and non-stressed books in the future? Because it sounds like -- yes, it sounds like there's a big gap between what you're reporting in these numbers and what you're doing strategically, but we just don't have the information to see that. And just given the time lag that this has been going on now, I would hope that we could see a little bit more information on exactly what tactics you're pursuing and what effectiveness those tactics are having.

Douglas G. Elliot
President

That's fair. Let us take that back, discuss it with ourselves and see if we can't address the gap there.

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

Michael, it's Chris. I appreciate your feedback and, hopefully, you get a sense, from Doug's tone and my tone, that we are equally as frustrated as you are. And if a little more data helps, that's great. But I think the overall message here, too, is we have been reacting. We have been pushing ourselves since year-end to look harder at things. But as I mentioned before, we're balancing this with a partner, a 30-year partner, where I've looked at history and how we've worked together, how we've grown this book, how we've produced strong returns over a longer period of time, and we need to balance a level of stability with AARP and its members while we're taking these aggressive actions. So as Doug said, the later half of '15 is when we rolled out our last state with our new class plan. We've been tuning, as we say, as we've gone along, but there are still things that have surprised us. And as Doug said, some of it was industry related, some of it was our own self-inflected actions and we have to take full accountability for that, and we do. But we are working. And I think you will begin to see progress, particularly as we head into '17. And we'll look closely at the metrics that we could share with you that are appropriate so that you could gauge our progress.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

What do you expect your advertising budget will be in auto for the rest of the year relative either to the first half or to the last half of last year?

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

We've already cut 25%, 30% of our budget on direct advertising and activities along those lines. We'll continue to push ourselves. But there are areas in the country, and again, given the relationship, where we still want to produce business that we think will generate adequate returns over its lifetime. So it's a balancing act. And those areas that are on fire and that require a lot of attention, we're not afraid to make those calls. On the other side, we want to be balanced, particularly with our AARP members.

Operator

Your next question comes from the line of Meyer Shields from KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

This is a little bit of an unfair question. And I don't mean it to be hostile, but when we look at, I guess, the auto deterioration and the asbestos issue and maybe the fact that the interest rate environment in Talcott or that Talcott is facing is worse than you had anticipated, does there need to be maybe more skepticism culturally in how you're managing the business?

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

Meyer, it's Chris. I don't know what you mean by skepticism. I mean, we challenge ourselves to perform every day at high standards. We're investing in the organization for the future. Our employees are world-class and willing to go the extra mile. But I do know that, as I said in my opening comments, I mean, we're in a challenging period of time, but I think we have the ability to manage all elements of our business and make the right judgments and right estimates for accounting purposes and make our best estimates on loss picks and, hopefully, have a bias towards being conservative that gives us a margin of error to deal with in case anything goes wrong. So that's what I would say. So what do you mean by skepticism?

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

So let me use asbestos as an example of that. Because I'm not, in any way, questioning the competence. But we've -- over the past few years, we've had adverse development, and the question was whether maybe you should take a bigger slug. And clearly, you were expecting a smaller -- or you were expecting claims to decline. And I'm wondering whether maybe that approach -- I mean, in retrospect, obviously, that approach didn't capture everything. But I'm wondering whether there's something in the, I guess, the outlook or the underlying culture that -- culture's a wrong word, but just the approach, that should maybe say, okay, instead of expecting things to work out more favorably, maybe they won't.

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

Yes. That is a unique set of facts. So I take your point. And as I said before in one of the questions, I mean, you ought to take away the real message from the U.K. transaction is we put a piece of legacy P&C runoff behind us that we're always challenging ourselves of how we can continue to take some of the noise out of our results. But on an economic basis, right, we've always talked about balancing the economics and noise, and this is a tough issue from a litigation perspective, of how people attack the exposures that our customers have had related to asbestos. So we'll always challenge our assumptions and make our best views. And I know we haven't had a stellar track record there, but we'll continue to challenge ourselves, Meyer.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. No, that's helpful and I appreciate it. On a more sort of granular basis, can we get the current accident -- the original and the current accident year auto picks for 2015 for the back half of the year?

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

Well, let us look for them and see if we have them in -- for 2015, you said?

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Right. Just so we can sort of model the year-over-year change in the back half of this year.

Sabra R. Purtill
Senior Vice President of Investor Relations

So, Meyer, with the reserve additions that we made in the first quarter and the second quarter, the 2015 auto combined ratio, excluding CATs and prior year development, is 103.5. And I think Jonathan [ph] may have the original one for the full year. I believe it was 99.0 for full year '15, at the end of '15. So it's been about 4.5 points of deterioration during the first half of this year. I would also note that given the actions we took in first quarter, the '14 accident year was -- well, at the end of '15, it was 97.1, and that deteriorated 1.5 points during '16, so that's now 98.6.

Operator

[Operator Instructions] Your next question comes in the line of Ian Gutterman from Balyasny.

Ian Gutterman
Balyasny Asset Management L.P.

I guess I have an auto question. But just first, another sort of big topic that's come up recently, Chris, is do these sort of incessant, every-few-months M&A rumors -- and I know you've talked about it before, so I'm not going to ask you to sort of rehash what you said in the past. But from a practical standpoint, is it having an impact on your business? I guess that's what my concern is. Like are you getting too many questions from agents or clients wondering what the company's future is? Is that a distraction at all or not an issue?

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

It really is not, Ian. So we can't control rumors, but it is not distracting us at all.

Ian Gutterman
Balyasny Asset Management L.P.

Okay, good. So that was my main concern. On the auto, to sort of follow up a little bit what Mike was asking a few minutes ago. I feel like agency auto, specifically the agency side, has been struggling ever since I've known the company, which unfortunately, is a long time. And I feel every few years, we talk about sort of what do you need to see to affirm your commitment to that business. And I guess I still struggle with -- again, the AARP business is a great business, but the pure agency side, does it feel like you're being adversely selected because you don't have the same sort of scale or systems that other people do? And we've seen, obviously, one competitor that's made a lot of improvements in their cost structure to be able to lower pricing, and others who have focused a lot on the rating systems and to do better in that and things like -- it just feels like the business isn't necessarily at the scale it needs to be to keep up with the top players. And at what point do you need to maybe take a harder look at whether it's best in someone else's hands and you can redeploy that capital into growing things like Middle Market, where that may be your better fit?

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

Ian, it's Chris. Let me frame the issue and then ask Doug for his perspective, too. Yes, you're right. And we see the same trends as far as performance. And I would say what the real strategy is right now is, look, we are committed to our independent agents for all aspects of our business, while we, obviously, market to AARP members on a direct basis. I think what Ray and his team are really focused on right now is finding those independent agents that are aligned to our value proposition over the longer term. And our value proposition is really -- my simple way of thinking about it is a product that offers real benefits to its -- to the insureds that is appropriately priced and that we just don't want to be spreadsheet-ed against the lowest carriers. So very proud in what our brand stands for, our claims capabilities, our empathy, particularly in the mature segment, because I think we've earned the right to be a carrier in that segment. I think what it really means, though, is how do we transition to that as quickly as possible. And you've heard the litany of activities that Doug and team are focused on, whether it be commission actions, whether it be appointments. So we are pruning the agents that are aligned to our value structure. We want to support them. We want to grow with them. So I think that is a more tailored strategy, particularly in the mature market that we're executing right now.

Douglas G. Elliot
President

Chris, I think you've done a good job. I mean, we've shared the numbers in the past. And, Ian, I don't disagree with the question, but we feel like we've taken pretty significant action, I think, about our core preferred agency group now, kind of focused around 2,000 to 2,500 agents. That's a very different number than we were trying to manage 2 and 3 and 4 years ago. I think about our preferred scale. We're looking at our commissions. We have 6,500 agency locations 6 months ago that had our preferred schedule. That number is down to closer to 2,500. So we're looking at expenses. I think we're working all the levers. I do feel like the book is big enough that we can be successful there. It is a terrific complement to what we do on the direct side with AARP, and you know we're leaning into the mature component of that agency book. So I'm not giving up. I see progress underneath. But very disappointed that the first 6 months of 2016 have played out the way they have.

Ian Gutterman
Balyasny Asset Management L.P.

I understand. I understand. But I'm going to sneak one last one in for you, Doug, is, you mentioned some increasing competition in group. Anything you can elaborate on there?

Douglas G. Elliot
President

On the disability lines, we've just felt our hit ratios, meaning success ratios, have not been where they had been the prior couple of years. So as we look at the first half of '16, I would've expected a few more wins in that category. We see a little bit more challenging times in what I would describe as the Middle Market area of group. So in that 500 to 2,000 life case, our success has not been the same as it has been in the National Accounts space. I know we're stronger. We've had a traditionally very strong platform in national. But we have leaned into that Middle Market hard with resource and talent the last couple of years. So I think that is the ground. It actually reminds me a bit of the P&C side, where I see a lot of the softer market conditions in that Middle Market of P&C. I see the same area in LTD and disability.

Operator

Your next question comes on the line of Bob Glasspiegel from Janney.

Robert Glasspiegel
Janney Montgomery Scott LLC, Research Division

Two follow-ups on Personal Lines and the U.K. sale. On Personal Lines, it sounded like, Doug, most of the actions you were taking were on the agency side of the business, either direct agency or agency AARP relationships. Am I right to infer there's a greater hit in the personal in your agency book than AARP, or did I misinterpret that?

Christopher John Swift
Chairman of the Board of Directors, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

Bob, there certainly are agency actions directly aligned with that side. But when I think about our pricing, our product segmentation, claim, operational, Open Road, those all have opportunity to impact favorably our direct business as well. So don't think of this as an agency-only strategy. We're working both sides and have room for improvement in both halves.

Robert Glasspiegel
Janney Montgomery Scott LLC, Research Division

But so agency is not being pressured more than AARP in auto? You don't give out the byline in the underwriting.

Douglas G. Elliot
President

Yes. We don't disclose that. I will tell you that the loss ratio -- well, the combined ratio overall performance difference in those segments is in the neighborhood of 10 points. So there is more concentrated effort to get agency auto back closer to our long-term target, and there's a further distance to make that happen. But we are working across our book of business just trying to make sure our overall auto book is also where it needs to be long term.

Robert Glasspiegel
Janney Montgomery Scott LLC, Research Division

Okay. If I could sneak one more in. On the U.K. sale, what percentage of your asbestos and environmental reserves does that book represent? And I think you said it didn't impact -- the sale didn't impact the Q2 A&E charges, so there was none for those lines in this segment?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes, Bob. That's correct. There was -- none of the reserve charge that we took this quarter was related to those exposures. We did provide details, both in our 10-Q and our slides, on exactly what reserves are included. But just to give you those numbers, for the asbestos reserves, there's about $210 million of exposure associated with the U.K. sale that would go away from that column. And then about $42 million in environmental reserve. And then we've got other reserves, obviously, in the all other category of about $243 million that will also transfer. So in total, it's a little under $500 million in net reserve.

Robert Glasspiegel
Janney Montgomery Scott LLC, Research Division

And then will it change survival ratios? I assume there -- the payout trends are similar to your other book, of other reserves?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. It might have them come down just a little bit, but really, no significant impact.

Operator

There are no further questions at this time. I will turn the call back over to the presenters.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you. And thank you all for joining us today and your interest in the Hartford. If you have any additional questions, please do not hesitate to follow up with us. We wish you all a good weekend, and good luck with the rest of earnings season. Goodbye.

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