S&P Capital IQ

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The Hartford Financial Services Group, Inc. NYSE:HIG

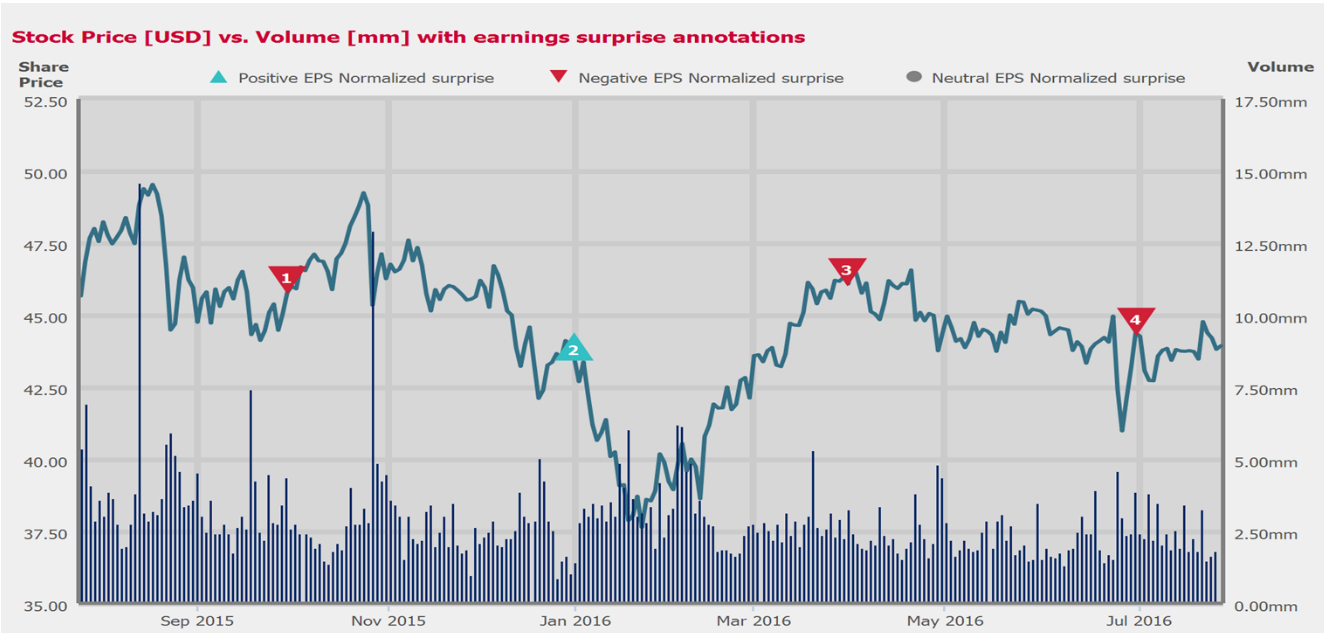
FQ3 2016 Earnings Call Transcripts

Friday, October 28, 2016 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2016-			-FQ4 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.95	1.06	▲11.58	1.04	3.31	4.07
Revenue (mm)	4733.83	4695.00	▼(0.82 %)	-	-	19243.38

Currency: USD
Consensus as of Oct-28-2016 12:27 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2015	0.99	0.86	▼(13.13 %)
FQ4 2015	0.98	1.07	▲9.18 %
FQ1 2016	1.01	0.95	▼(5.94 %)

FQ2 2016	0.80	0.31	(61.25 %)

Call Participants

EXECUTIVES

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Chairman, Chief Executive Officer and Member of Finance, Investment & Risk Management Committee

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Presentation

Operator

Good morning. My name is Michelle, and I will be your conference operator today. At this time, I would like to welcome everyone to the Hartford's Third Quarter 2016 Earnings Results. [Operator Instructions]

I would now like to turn the call over to Sabra Purtill, Head of Investor Relations. Please go ahead.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you. Good morning, and welcome to the Hartford's Webcast for Third Quarter 2016 Financial Results. The news release, investor financial supplement, slides and 10-Q for this quarter were all posted on our website yesterday. 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 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 differ materially. 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, which are available on our website.

Our presentation today also includes 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 at least 1 year.

I'll now turn the call over to Chris.

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

Thanks, Sabra. Good morning, everyone, and thank you for joining us today. I am pleased with our overall third quarter results. In Commercial Lines and Group Benefits, performance was strong and demonstrates focus on maintaining margins while being disciplined about growth in a sustained competitive environment. I'm also pleased with the actions we've been taking to improve personal auto performance.

In addition, the balance sheet and capital generation remains strong. And last evening, we announced the board authorized a new $1.3 billion equity repurchase plan as well as a 10% increase in our quarterly dividend.

Starting with Personal Lines. We are intently focused on improving auto profitability. We're implementing a range of initiatives, including aggressive rate actions that address sustained higher loss cost trends caused by a multitude of factors including increased miles driven, speed and distracted driving. We are also addressing profitability through adjustments to our new class plan, more focused marketing and the termination of unprofitable agency relationships.

I have deep confidence in the Personal Lines leadership team and in their strategy to improve performance.

Though results remain challenged in the third quarter, we will steadily improve profitability in personal auto and expect to see better returns in 2017 as the actions we take work their way through the book.

In Commercial Lines, the underlying combined ratio, which excludes catastrophes and prior year development, was very strong at 90.0. This represents a full point improvement over the prior year. I am pleased with our competitive positioning across Commercial Lines and with our ability to defend the margins we've worked so hard to achieve. The team is successfully balancing underwriting discipline with profitable growth in selected markets.

In Small Commercial, we're generating new business growth at very attractive returns. For the quarter, written premiums grew 5% and the underlying combined ratio was 86.8. The Small Commercial market has garnered a lot of attention recently with peers and new entrants launching first-time initiatives. The Hartford has been the leader in this space. We've been investing in Small Commercial for over 3 decades and our end-to-end capabilities are the industry's gold standard. We continue to enhance our innovative approaches to customer experience, digital and the use of data, analytics, all backed by our industry-leading customer service centers. We are committed to innovating to advance our market position.

Consistent with last quarter, competitive conditions in the larger end of the market, such as Middle Market and National Accounts, remain challenging. Our primary focus is to maintain margins with selective top line growth. This quarter, we had continued success in that goal with improved underlying combined ratio on a relatively flat premium base.

In Middle Market, retentions remain strong as we work to retain our best accounts and our 93.1 underlying combined ratio improved more than a 0.5 point over prior year. New business, however, declined 15%, reflecting pricing and underwriting discipline.

Outside of our P&C businesses, Group Benefits generated strong profitability with a 5.6% core earnings margin and improved disability loss ratio and good sales in a competitive marketplace.

At Talcott, the business continues to perform consistently and in line with our expectations, while Mutual Funds posted another solid quarter. And third quarter investment results benefited from stronger limited partnership income. Excluding partnership returns, the solid underlying performance of our investment portfolio reflects measured risk-taking and disciplined investment decisions.

We continue to make progress in executing our strategy to invest capital in our businesses to expand capabilities. We closed the acquisition of Maxum in July, and the team's expertise in the E&S market is already paying dividends and broadening our Commercial Lines risk capabilities.

We also expanded the Mutual Funds platform. We entered into smart beta ETF space through the acquisition of Lattice Strategies and further broadened our actively managed investment offerings through a relationship with Schroders.

I spent a lot of time on the road this year meeting with and listening to our distribution partners. As I reflect on those conversations, what really stands out is their support of our consistent approach to new and renewal business, along with their trust and confidence. And they like the fact that we're becoming a broader and deeper risk player. This is encouraging feedback from our partners whom share my confidence in The Hartford's ability to execute given the fundamental strength of our platform and the improvements we've made to the organization.

As we close out the year, we will remain focused on maintaining margins in Commercial Lines and Group Benefits and improving profitability in personal auto. Though we continue to face industry and market headwinds, we have the skills, experience and commitment to successfully carry out our strategy and to create shareholder value.

Now I'll turn the call over to Doug.

Douglas G. Elliot
President

Thank you, Chris, and good morning. Overall, this was a solid quarter for our Property & Casualty and Group Benefits businesses. We posted strong results in both Commercial Lines and Group Benefits where we continue to effectively navigate very competitive market conditions. In Personal Lines, there are positive signs that our pricing actions and underwriting initiatives are gaining traction, even as frequency trends remain elevated. In the third quarter, Personal Lines posted core earnings of $25 million, up $8 million from third quarter last year. The underlying combined ratio, which excludes catastrophes and prior-period development, was 96.1, increasing 0.5 point from last year. This is primarily the result of higher auto loss -- liability loss cost, partially offset by a decrease in expenses.

Catastrophe losses in the quarter were $37 million, down $31 million from third quarter 2015. In homeowners, the underlying combined ratio of 79.6 improved 2.8 points versus last year, driven by favorable expenses. The underlying loss ratio was in line with prior year but running above our expectations for the quarter. Year-to-date, performance in this line has been very solid as we continue to take rate increases and effectively manage our underwriting execution.

In auto, the underlying combined ratio of 103.1 was 1.5 points higher than we posted in third quarter last year. This reflects the 2016 emergence of increased loss cost trends, partially offset by lower expenses. The underlying auto loss ratio for third quarter 2016 is slightly elevated when compared to 2015 after adjusting for the unfavorable 2015 accident year development, which we recorded in the first half of this year. For the 2016 accident quarter, frequency trend was approximately 3%. Our first and second quarter 2016 loss picks have continued to hold. Severity continued to increase slightly on the 2015 accident year but remain within our estimates and we had no prior year development for auto this quarter. We expect the substantial rate, underwriting, agency management and new business actions we have implemented to begin earning their way into the book of business in the coming quarters.

We are beginning to see early signs of expected improvement in our business metrics, and given persistent trends, we're moving aggressively on multiple fronts. For example, we continue to accelerate our rate filings. We now expect to achieve nearly $240 million of annualized rate increases on the auto line based on our current in-force business. This is $30 million higher than our projection as of second quarter 2016 and double what we achieved in 2015.

We expect written pricing in the fourth quarter to approach 9%. The earned premium impact of this rate is ultimately 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 both 2017 and 2018.

New business marketing has been reduced in many jurisdictions until the increased rates are in effect in the market. In AARP Direct auto, new business was down 36%. AARP Agency auto was down 29% and Other Agency auto was down 45%. We've also reduced our direct marketing spend, lowered operational costs and reduced commissions, which contributed to a 3-point improvement in the expense ratio. As a result of these profit improvement actions, written premium growth for both AARP Direct and AARP Agency was flat for the third quarter 2016. Other Agency was down 20%, consistent with our strategy to shift our business mix toward AARP members and our more highly partnered agents. Retention in our AARP channels was relatively stable, a positive outcome as we increase rates.

The revised 2016 full year underlying auto combined ratio of 101 to 103 that we shared with you last quarter is under pressure from continuing frequency trends. We were expecting the rate of change in auto frequency to moderate in the second half of 2016, based on the elevated levels that emerged in the second half of 2015. Given higher-than-expected auto frequency trends this quarter, we now expect the full year underlying auto combined ratio to be at the higher end of our range. Achieving the 2016 full year underlying combined ratio of 93 to 94 for total Personal Lines will be dependent on auto frequency trends and homeowner losses in the fourth quarter.

Although auto frequency has been elevated longer than we expected, my confidence grows every day that we're moving in the right direction to restore profitability in this business.

Shifting over to Commercial Lines. We had a strong quarter with core earnings of $247 million up $31 million from third quarter 2015. The increase is largely attributable to higher net investment income and increased underwriting gain. The combined ratio of 93.9 improved 0.6 point versus prior year, due primarily to less unfavorable prior year development and a lower expense ratio, partially offset by higher catastrophe losses.

Workers' compensation continues to perform very well. This is our largest line of business. Our strong margins improved slightly in the current accident year and we continue to manage this line very closely, remaining vigilant on pricing and loss cost trends. Commercial auto, on the other hand, continues to be under pressure across the industry and we increased our 2016 accident year loss ratio estimates to reflect the ongoing loss cost increases. We also recorded $18 million pretax of prior year development to address severity trends, primarily in Small Commercial in accident year 2015.

Auto is a relatively small line for us, representing approximately 10% of commercial P&C premium. We are achieving our highest written price increases in this line and continue to take aggressive underwriting actions.

The Commercial Lines expense ratio was favorable in the quarter, improving by 1 point versus third quarter 2015. However, we expect our full year ratio to be in line with prior year. I'm especially pleased with our renewal written pricing in standard Commercial Lines at 2% for the quarter, essentially stable over the past 5 quarters.

To achieve a few points of price in this competitive environment is a positive reflection of the solid discipline exhibited by our frontline teams.

Our strong performance in Small Commercial continued this quarter. We had excellent results on both the top and bottom line. The underlying combined ratio of 86.8 was consistent with last year. Excluding the results of the Maxum acquisition, which closed during the quarter, the underlying combined ratio actually improved by 0.2 point versus third quarter 2015. This reflects an improvement in workers' compensation and a lower expense ratio, offset by deterioration in auto and package results.

Written premium in Small Commercial was up 5% in the quarter versus prior year. Maxum represents approximately 1 point of this growth.

Retentions continue to be strong, and new business, excluding Maxum, was up 5% to $135 million as we continue to execute in a very competitive market.

Moving to Middle Market. We posted an underlying combined ratio of 93.1, improving 0.7 point from third quarter 2015. This was primarily due to favorable workers' compensation margins and lower expenses, partially offset by higher auto loss cost and unfavorable non-catastrophe property experience.

Middle Market written premium in the quarter was down 0.7 point compared to prior year. New business of $99 million was down 15% from last year as we continue to maintain our pricing discipline in the face of competitive market conditions.

Specialty Commercial had another very strong quarter. The underlying combined ratio of 93.7 improved 5.4 points versus prior year, driven by strong margins across National Accounts, Bond and Financial Products.

Specialty Commercial written premium was down 4% compared to third quarter 2015. In both years, the written premium is affected by auto premiums and several retro accounts. Normalizing for these items, written premium is up modestly in Specialty Commercial, driven by solid new business in National Accounts.

We continue to navigate these markets effectively and I'm pleased with our pricing discipline and overall results.

In Group Benefits, we had a very solid quarter with core earnings of $51 million, up $4 million from prior year resulting in a core earnings margin of 5.6%. The increase in core earnings was driven primarily by higher premiums, lower disability losses and lower expenses, partially offset by higher group life losses. The group life loss ratio of 80% for third quarter 2016 was driven by higher-than-expected mortality claims from larger policy values. We've experienced similar trends in the first half of 2016 and are evaluating underlying factors and appropriate actions going forward.

Fully insured ongoing premium was up 5% for the quarter. Overall book persistency on our employer group block of business continues to hold around 90%. Fully insured ongoing sales were $61 million for the quarter, flat to third quarter 2015. We continue to feel competitive pressures, particularly in long-term disability.

As with our Property & Casualty businesses, we remain disciplined on pricing and underwriting, successfully differentiating our offering on superior service and claims capabilities.

In summary, this is a solid quarter for our businesses. Commercial Lines and Group Benefits delivered strong results, demonstrating our commitment to disciplined pricing, strong retention and maintaining margins as we continue to experience competitive market conditions.

In Personal Lines, we're pleased with the early traction our initiatives are gaining. Pricing, underwriting and agency management actions are working their way through the book of business to address elevated loss trends and restore underwriting profitability in personal auto.

And finally, I'd like to welcome our new Maxum teammates to The Hartford. Maxum's capabilities are perfectly aligned with our strategy to become a broader and deeper risk player in the marketplace. And I look forward to working very closely with this team on the journey ahead.

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 cover the remaining segments, the investment portfolio and capital management, before we turn the call over to questions.

Mutual Fund's core earnings were down $1 million from third quarter of 2015 due to a 3% reduction in investment management fees. Total AUM was up about 6% from a year ago due to a 9% increase in Mutual Fund AUM, which was partially offset by a 6% decrease in Talcott AUM. The decrease in investment management fees reflect the continued shift to lower fee Mutual Funds, consistent with industry trends.

Our team has been proactively responding to the changing mutual fund market. As Chris mentioned, our acquisition of Lattice adds smart beta exchange traded funds to our portfolio lineup. This is a fast-growing market with positive net flows, and Lattice is an innovative platform that we can grow and also use to launch actively managed ETFs in the future.

In addition, last week we added a new sub-advisor relationship with the adoption of 10 mutual funds managed by Schroder Investment Management with about $3 billion in AUM. These funds, which have been re-branded as The Hartford-Schroders funds, broaden our platform and expand our offerings, particularly in international and emerging markets.

Talcott continues to perform well, focused on running off the annuity books efficiently and effectively while returning capital to the holding company. Core earnings decreased this quarter by $3 million compared with third quarter 2015, but we're well ahead of our outlook due to very strong returns on limited partnerships, both from improved hedge fund performance and higher private equity returns. Excluding the impact of limited partnerships, the decrease in Talcott's core earnings was due to the decline in fee income as the book continue to run off, offset in large part by reduced expenses.

This quarter, full surrender activity on an annualized basis was 7.4% for variable annuities and 5.4% for fixed annuities.

Talcott's DAC unlock charge was modest this quarter as adjustments to a variable annuity lapse and market assumptions largely offset the impact of writing off the remaining DAC on our fixed annuity book. The fixed annuity DAC write-off was caused by the impact of the sustained low interest rate environment, resulting in lower expected gross profits on the book. As we said in July, during the third quarter, Talcott paid a $250 million extraordinary dividend to a holding company, completing our expected $750 million dividend plan for 2016. In 2017, we expect to request dividends in the range of $500 million to $600 million.

Investment results were strong this quarter, with a sharp improvement in limited partnership returns. Limited partnership investment income totaled $93 million before tax this quarter compared to $22 million before tax in the third quarter of 2015. This quarter's annualized investment return for LPs was about 15%, which is well above our 6% outlook and has pushed our year-to-date annualized limited partnership return back up to 7%.

Hedge fund performance was slightly positive compared to losses in third quarter 2015, and private equity income was exceptionally strong, including a significant valuation write-off for one of the partnerships this quarter. Excluding limited partnerships, the before tax annualized portfolio yield was 4.1% this quarter, slightly lower than 4.2% last year due to the combined impact of lower reinvestment rates and lower income from nonroutine items. Given the low level of current interest rates, we continue to expect portfolio yield compression in the fourth quarter and into 2017.

Turning to credit performance. Our investment portfolio remains highly rated and well-diversified. Credit experience was good during the quarter with total impairments in mortgage loan valuation reserve charges of $14 million before tax, down from $39 million in third quarter 2015.

In 2015, we had a higher level of credit losses, including intent-to-sell impairments on some floating rate and non-investment-grade securities, including some energy-related exposures.

To conclude on earnings, third quarter core earnings per diluted share were $1.06, a 23% increase from third quarter 2015. Excluding prior development and limited partnerships, core earnings per diluted share rose by 7% over last year or $0.06 per share.

Catastrophe results were largely consistent with third quarter 2015, with no major hurricane losses in either period. For Hurricane Matthew, which was a fourth quarter event, we currently estimate losses of $40 million to $60 million before tax, which would consume a large portion, if not all, of our fourth quarter CAT budget of $60 million before tax.

The 12-month core earnings ROE, excluding Talcott, was 9.1% and the P&C core earnings ROE was 11%. Both of these metrics include the unfavorable prior development on personal auto and A&E reported in the first 6 months of 2016.

Turning to shareholders equity, book value per diluted share, excluding AOCI, rose 6% from a year ago, resulting in total shareholder value creation, including dividends over the past 12 months, of 8.4%.

Finally, during the quarter, we repurchased $350 million of stock. During October, we repurchased 2 million shares for $85 million, leaving approximately $195 million remaining under the 2014 to 2016 equity plan of $4.375 billion.

Yesterday, we announced a new equity repurchase authorization and an increase in our quarterly dividend. The new equity repurchase authorization is $1.3 billion and is effective October 31, 2016, through December 31, 2017. We expect to use the new authorization ratably over 2017. The quarterly dividend was raised by $0.02 or 10% to $0.23 per share.

As you know, reducing debt and improving our debt service ratios have both been important objectives over the last few years. This month, we repaid $275 million of maturing debt, consistent with our previously announced plan. In 2017, we intend to repay $416 million of Senior Notes in March, which is our only 2017 debt maturity.

Our 2017 capital plan was developed with the expectation that 2017 dividends and holding company cash flows in total will be about at the same level as in 2016.

While Talcott dividends will be $500 million to $600 million, which is down from the $750 million we received this year, we expect this reduction will be offset by higher dividends from our other subsidiaries and other holding company resources.

To conclude, this quarter's results were strong, and as Doug discussed, our profitability improvement initiatives for personal auto are well underway. We continue to generate very strong margins in

Commercial Lines and Group Benefits and we are growing profitably in Small Commercial, our top-performing business.

Finally, with disciplined execution, year-to-date investment results remain very good and along with generally favorable equity market levels have helped Talcott deliver good bottom line results. With strong earnings and capital generation, we are very pleased to be able to announce our capital management plans for 2017.

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. Michelle, we have about 30 minutes for Q&A. So if you can give the instructions for the polling for the Q&A, and then we will start.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Ryan Tunis from Crédit Suisse.

Ryan Tunis
Crédit Suisse AG, Research Division

Just a couple on Personal Lines, on the auto. So I think you guys mentioned that severity and frequency were both still up 3% year-over-year. And I'm just wondering if the actions that you've taken so far contemplate things continuing to get a little bit worse or still running at these levels? Or should we think about the actions you've taken -- do those more assume that in 2017, 2018, you'll have kind of what's been like more a historical normal in terms of frequency, especially?

Douglas G. Elliot
President

Ryan, good morning. This is Doug. Let me take that question and try to pull apart a few of the pieces. First thing is that we were a little disappointed that our frequency in third quarter was a little higher than we expected it to be, particularly given what we thought were going to be favorable trends against the 2015 patterns in the back half of the year. As we lean into fourth quarter, obviously, we'll watch those 3 months carefully. Encouraged by what we're seeing in October but need to finish the year strong for 2016 to complete itself. As we think about 2017, we'll share more when we get to January. But I'll say this, it looks to us like we're in an environment where loss trends don't look like averages over the past 10 years. So we are anticipating an abnormal environment, hoping that it isn't as abnormal as the last 2 years have been. But we'll talk more about that with more detail in January.

Ryan Tunis
Crédit Suisse AG, Research Division

Okay. And then my follow-up, I guess, is probably a little bit more of a modeling one around auto. But just thinking about the momentum on the expense ratio there. And I mean the fact that that's improved a lot, direct marketing costs have come out, I guess, lower bonuses. Should that continue to come down over the next few quarters? Or does sort of where you're running now reflect all the actions you've announced or have planned?

Douglas G. Elliot
President

Two things I would say. First is, clearly, we're taking extraordinary change, levers, if you will, based on our revised Open Road plan. So yes, we did some things in the third quarter that were a bit outsized compared to our run rate. So yes, you need to step that back to get a more normal run rate going forward. But we're continuing to match our pricing adequacy, our view about profitability with our marketing strategies, and they're incredibly correlated. So we'll continue to do that quarter-by-quarter. This is an approach that we are keenly focused on margins and the margins have to be in line for us to be kind of ramping up marketing efforts. So I hope to see a different day soon, but we'll work hard at that. The other thing I just want to say as well, I think you've seen and, hopefully, heard in my script, we've worked hard on the rate change activity. And many of you that have looked inside the State filings have seen the advancement of that strategy. I gave you a forward look into the fourth quarter. That's evidence of, really, what's happening at the desk level. So as our filing momentum continues, we expect fourth quarter to show 9 points of pricing activity. That is very reflective of our aggressive approach to getting on top of these loss trends.

Ryan Tunis
Crédit Suisse AG, Research Division

Okay. And I guess, just to follow-up real quick to that. I think you also mentioned, it's not just renewal rate, it's also mix change. I guess, when you think about, longer term, getting back toward the 96 to 96.5 underlying you've run on historically, how much of that, do you think, really relies on getting renewal rate versus just kind of -- maybe undoing some of the things that happened a year ago in terms of just improving the, I guess, the mix of book?

Douglas G. Elliot
President

Yes. I don't want to give you an exact, definitive answer because I'm not sure there is one. But I'll say this, there are clearly positive signs that are going to manifest inside the aggressive rate actions offsetting some of the trends that we're seeing across the industry, by the way, not just in the AARP book, but clearly in our book as well. I'm also encouraged by the number of levers that we're working in our Other Agency and in our other channels. So as we think about kind of this roll forward into 2017 and '18, there are going to be benefits, important benefits on both sides of that equation. But I want you to know that based on my pricing comments this morning, we are leaning into what we need to do to address the cost and the loss trends that are in the marketplace today.

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

Ryan, it's Chris. The only color I would add for you, remember, we are optimistic about the AARP book, its relationship, our knowledge in that market. And so consistent with Doug, I'm not going to give you a precise formula, but there is a substantial amount of improvement that'll come from a retrenchment and a focus on our core, our core AARP, our abilities to market to them in a direct and an efficient fashion, while using the agent channel for those customers that want to go through an agent and really shut down, shed some of the Other Agency, non-member agency, as we call it, activities where we tried to grow a little too fast in the past. So I would not underestimate the mix comment that you said because it will improve the results over that 2-year period of time.

Operator

Your next question comes from Michael Nannizzi from Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I guess just, Doug, just one question, just following up on personal auto. When you talk about improvement in '17 from the actions you've taken so far, what are your assumptions around loss trends? You mentioned you were a little bit surprised with 4Q sort of holding flat and not improving. Are you optimistic in your outlook? Or are you taking into consideration in that view of improving trends and profitability what you saw here so far in the fourth quarter?

Douglas G. Elliot
President

Thanks, Mike. The loss trend discussion is an interesting one today, right? So we're spending a lot of time in our data. We also are spending a lot of time looking at industry data, fast-track data that I know all of you look at. So as we look forward, we have expectations based on the actions we're taking that we're going to see improving signs in our book of business. And based on some of the early progress across both retention of our existing book and also the new business we're putting on, we feel good that we are turning the dial in a favorable direction on things we can control relative for our own loss trends. You step back from that and you look at fast track data, and you see aggregate severity and frequency in this industry over the past 7, 8 quarters in a very different spot. So our lens into '17, '18 has changed a bit over the last couple of quarters, as has our approach to rate change. So they're directly correlated. It's the reason we're ramping up. It's the reason that our rate activity in '16 is 2x what it was in '15. But Mike, I would say that we are willing to be mobile and agile and adjust to what we see going forward. We do think it'll be a bit more tempered in '17, but at the moment, we need to see better signs across the industry that auto experience is going to demonstrate that.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. And then you mentioned marketing spend as a lever in Personal Lines. Can you talk about how much room do you have there as a lever if you want to -- that scenario where you decide you want to pull back further. How much sort of juice is there in that operating lever?

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

Michael, it's Chris. I would say that we've been fairly aggressive in pulling that letter -- lever over the last 2 quarters. How much more can we do, obviously, is a function of where we see the ability to market on a more targeted basis, state basis, where we think there is still opportunities to acquire business at acceptable rates. So I'm not going to give you a precise formula, but I mean, it's been cut back quite substantially already. We feel good about that level, where it is right now from a run rate side, particularly as we head into '17. But if there is any additional discomfort in what we're seeing, it is a lever that we could continue to modify and pull. So if we're running pro forma about a 50% of what our historical rate's been, we still theoretically have $0.50 on those additional dollars to pull.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And just one last one if I could. Just -- there's been some activity in the space on the acquisition side with -- and with rates sort of lifting up little bit here recently. Can you just talk about Talcott and the potential there? Or any potential interests from third parties, and if that's something that you are -- you would consider more specifically now than maybe previously?

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

Thank you, Michael. I think you know the stock answer: We're not going to comment upon rumors or speculation. So -- but I could share with you maybe just a framework that probably many of you have heard over the years in what our sort of strategy and goals with Talcott were. I mean really, we put that block into runoff 5 years ago, really, with the idea of reducing risk and policyholder liabilities over time. We wanted to return excess capital to the holding company and we always wanted to meet our customer commitments. So I think over the last 5 years, it's played out exactly as we would've wanted. The book is -- the liability side of the book has been reduced to over 50% and Talcott's provided the holding company with a good deal of capital that has allowed us to manage -- be managed in the most efficient way. So as we look forward, we're perfectly comfortable in running this off over a longer period of time. But myself, Beth, we've always said, we'd always consider a permanent solution if it was really truly permanent, and that usually, in our vernacular, means a legal entity sale. So I think in the future, we'll always be prudent in exploring opportunities but I wouldn't foreshadow a lean, one way or another, at this point in time. I mean, it's running off, as we planned. And if there are solutions out there that make economic sense for us, that would be acceptable to regulators, that take care of our customers and employees, we would explore that.

Operator

Your next question comes from Randy Binner from FBR.

Randy Binner
FBR Capital Markets & Co., Research Division

I'll ask a couple more on Talcott. One, with the runoff on contract accounts, the 10% and 5% numbers, those are still good; they're slowing down a little bit. Do you have any further initiatives planned to accelerate the movement of contracts out of the block?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Sure, Randy. This is Beth. I'll take that. So at the current time, no large initiatives like the ones that you've seen in the past. I think as I've commented on before, the team is always looking at things that we can do. And I think we've done some of those larger initiatives which, obviously, favorably impacted the surrender activity over the last couple of years. And now I see it as continued sort of tweaks on that process, but we do not have a contract initiative underway at the present time.

Randy Binner
FBR Capital Markets & Co., Research Division

Okay. And then on the 500 to 600 request plan for 2017, can you break that out between what's operating free cash flow versus just capital release as the required capital goes down over time? And then what the timing of that would be up in '17? Would it be -- I think this year, it came up more in kind of the first half.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. So a couple of things. I mean, it's hard to parse out an exact number. If you go back to the comments that I made in July when we look at absolute surplus generation during the course of the year, given where interest rates are, I would expect, before consideration of the dividends that we took out during the course of 2016, that our statutory surplus would be a little bit lower than where we started because we do anticipate needing to post cash flow reserves in the fourth quarter. So even though through the 9 months we've seen an increase in surplus before dividends, we'd expect most, if not all of that, to go away as we go towards the end of the year. So when I think about the capital that we're taking out next year, it's really looking at what excess do we have under stress scenarios, how comfortable do we feel relative to the levels that, that would mean that we're running Talcott at and, based on that, feel very comfortable with the range of $500 million to $600 million. As far as the timing over the course of '17, we haven't landed specifically on that, but I would expect that we would, again, not take it all out at once. Probably take some out in the first part of the year and some in the second, but that timing is still to be determined.

Randy Binner
FBR Capital Markets & Co., Research Division

Just the last one is: Do we have a -- did you provide an update on the RBC ratio down at Talcott as of now?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

No. We did not put an update on RBC ratio. I would say that the RBC ratio, without giving a specific number, continue to be very strong in this market environment. Again, when we think about excess capital and ability to take dividends out, we're always looking at it in a stress. So to some extent, what the current RBC level is, is not so much of an input for us as we think about the amount of capital that we can put to the holding company.

Operator

Your next question comes from Brian Meredith from UBS.

Brian Meredith
UBS Investment Bank, Research Division

A couple of quick numbers question and one broader question for you. First, Doug, what was the impact on current year loss ratios in Commercial Lines from the increase in loss picks on the commercial auto business? I imagine there was current year development.

Douglas G. Elliot
President

There was, Brian. It was about 0.5 point across all the commercial impact from our auto changes.

Brian Meredith
UBS Investment Bank, Research Division

Great. And the other quick numbers one [ph], what's the impact on reserve development for the Florida workers' comp reserve increase?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So I'll take that one, Brian. So yes, as we look at our reserve position at the end of the quarter and workers' comp, we did take into consideration the impact of those rulings and putting that in the mix with -- along with some of the favorable trends that we've seen, really resulted in no real change needed to our overall carried reserves.

Brian Meredith
UBS Investment Bank, Research Division

Okay. Great. And then last question, Doug. I'm just curious. We've seen a tick up in medical cost inflation this year, at least recently. Are you seeing any signs at all of that in the workers' comp line yet?

Douglas G. Elliot
President

Brian, we're not. We're watching that very carefully and we're very pleased with our frequency and severity trends. Very early in the accident year, but our 2016 workers' comp book, very good shape. Frequencies continue to be flat to down slightly. And our medical and our indemnity severities are in pretty good shape. So we are not seeing the blips there yet.

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

Brian, it's Chris. Just one point. Both Doug and I get a monthly report from our investment management arm, HIMCO, just on detailed inflation activity, so it is something, as he said, we watch closely. I think also, the important thing to remind everyone is no matter what the current trends are, I mean, what we put up on the books has a long-term inflation trend associated with it, and that's in the 6% to 7% range. So to the extent that, that trend is not needed, then obviously, that creates excesses. But to the extent it's needed, know it's already there and built into our reserving philosophy.

Brian Meredith
UBS Investment Bank, Research Division

Great. And just lastly, quickly. Beth, could DOL future standards had a big impact on surrender rates out of Talcott as we look here forward?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. So we're continuing to stay close to our partners on that to understand that. I think that it could have some impact as financial advisors look to implement the rules and think about what advice they give to their customers. At the present time, we're not expecting a significant change, but it's something that we'll look at and monitor very closely. But it wouldn't surprise me if we saw a little bit of a slowdown potentially.

Operator

Your next question comes from Meyer Shields from KBW.

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

If I can start on the Mutual Funds business, I guess, the press release talked about higher expenses related to Lattice. Are those expenses associated with the acquisition or the operation of the business?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

It's a little bit of both, Meyer. So obviously, there were some costs relative to the acquisition, and then just as we bring that platform onto ours, we will see some uptick in expenses.

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

Okay. And then within P&C, I guess, can you talk about how Maxum is performing in terms of premium volumes and underwriting margins compared to your expectations?

Douglas G. Elliot
President

Meyer, this is Doug. It's very early days. They've just been with us really 60 days. No progress or aberration to speak of, so it's been a well-performing underwriting group in its extended history. We're pleased about having them on board. But in the third quarter, there wasn't anything really to speak of that would be out of pattern for Maxum.

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

Okay. And then last question, if I can. Can you give us an update on the agency account within, I guess, the non-AARP book?

Douglas G. Elliot
President

The agency count has not moved a lot since last time we spoke. I think just over 10,000 was the number of locations, I think, we shared with you last. So maybe a couple of tuning adjustments we made since then. I know that we made a few more moves in Florida since the second quarter call. But substantially, it's the same book of business and same agents. We're just working our way through our changes.

Operator

[Operator Instructions] Your next question comes from Alex Scott from Evercore.

Alex Scott
Evercore ISI, Research Division

I just had one quick one on Talcott. I know you mentioned the DAC rate down this quarter, and for 4Q, some of the statutory work. Just thinking about GAAP reserves, I know some of them are kind of held as an embedded derivative, some of them are not. Is there any contemplation of an exit value in those reserves? I guess, how should we think about that impacting 4Q?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So as I sit here and think about our GAAP reserve, I think you're asking about for fourth quarter, not a lot of changes that we'd anticipate relative to sort of the annual assumption updates that we look at in the fourth quarter. There hasn't been a lot of change in those expectations. So sitting here today, I'm not expecting that we would see a significant impact from the fourth quarter review of our assumptions on a GAAP basis.

Operator

And your next question comes from Jay Gelb from Barclays.

Jay H. Gelb
Barclays PLC, Research Division

Beth, the $1.3 billion of buybacks in 2017, I think that's slightly above what the Street was kind of expecting going into the year. And it also feels like you kind of pull forward the discussion of that at this point in the year. So is there anything else you can tell us about in terms of the decision that led to that amount or the timing?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

So Jay, really, as we looked at our holding company requirements and the cash flows that we have and the dividends that we'd be taking out of the subsidiaries and look to that in total, it felt like a very reasonable number to us and generally kind of in line with what we did this year. As far as the timing of the announcement, we had always talked about announcing our 2017 plans as we came towards the end of the year. And announcing that now and having that authorization, obviously, does give us the opportunity to be opportunistic in the fourth quarter given that our previous authorization was running down. So that was really the thought process there relative to getting that authorization done now.

Jay H. Gelb
Barclays PLC, Research Division

Okay. Where does that put you -- or put the company from a debt-to-capital standpoint relative to your long-term targets, also taking into account the debt running off in 2017?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. So when we look at both what the debt that we paid off this month and our expectation for the maturity that we will repay in March, we are definitely marching down towards our longer-term targets. And so we've always talked about sort of being in the low-20s, and obviously, both of those things are starting to put us there. So when I think back as to all of the actions we've been taking on the debt front over the last several years and the way they do -- the way we've been going about it, feel very, very good about the progress that we're making and getting our debt stack to be more in line with what our long-term expectations are.

Jay H. Gelb
Barclays PLC, Research Division

That's helpful. And then one last one on Talcott. There's clearly a lot of moving parts, including the benefit of improved limited partnership returns in the third quarter. Is it too early to ask about where you see kind of a normalized trend in Talcott's earnings in 2017?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. I would say let's wait until we get to our fourth quarter call when we talk a bit about expectations for 2017. I'll remind you, we did say that we will not be providing forward EPS guidance going forward, but we'll give some discussion on that. But the way I would have you think about it is, obviously, the limited partnership returns do provide some ups and downs as you look at the Talcott earnings over the course of the year. And the majority of the sort of non-investment income return comes from the fees that are generated on the variable annuity book. And we're pretty -- they're transparent in how that is running off. So I think if you use some of that, you get an expectation relative to run rate.

Operator

I have no further questions at this time. I turn the call back over to the presenters for closing remarks.

Sabra R. Purtill
Senior Vice President of Investor Relations

Thank you, Michelle. And thank you all for joining us today and your interest in The Hartford. If you have any additional questions, please don't hesitate to follow up with Investor Relations team. And we'd like to wish you all a good weekend and a Happy Halloween.

Goodbye.

Operator
Thank you, everyone. This concludes today's conference call. You may now disconnect.