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Horace Mann Educators Corp. (HMN)

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Horace Mann's Third Quarter Investor Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Heather Wietzel, Vice President, Investor Relations. Please go ahead.

Heather J. Wietzel
Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you and good morning, everyone. Welcome to Horace Mann's discussion of our third quarter 2019 results. Yesterday, we issued our earnings release and investor supplement. Copies are available on the Investor page of our website, along with our investor presentation, which was posted this morning.

Our speakers today are Marita Zuraitis, President and Chief Executive Officer; and Bret Conklin, Executive Vice President and Chief Financial Officer. They're in two different locations.

Joining Marita in Bermuda for the Q&A is Bill Caldwell, EVP-Product. Bret is here in Springfield, along with Matt Sharpe, EVP-Strategy and Business Development; Wade Rugenstein, EVP-Operations; and Ryan Greenier, VP-Corporate Finance.

Before I turn it over to Marita, I want to note that our presentation today includes forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The company cautions investors that any forward-looking statements include risks and uncertainties and are not guarantees of future performance. These forward-looking statements are based on management's current expectations, and we assume no obligation to update them. Actual results may differ materially due to a variety of factors, which are described in our news release and SEC filings.

In our prepared remarks, we use some non-GAAP measures. Reconciliations of these measures to the most comparable GAAP measures are available in our news release.

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

Marita Zuraitis

President, Chief Executive Officer & Director, Horace Mann Educators Corp.

Thanks, Heather. Good morning, everyone, and welcome to our call. Last night, we reported third quarter core earnings of $0.64 per diluted share, more than double last year's result. Our annualized core ROE was 8.3%. These results show that our deliberate actions to enhance our value proposition to the education market, including important strategic transactions, are taking hold. We are on a path to accelerating shareholder value creation and substantially growing our education market share.

I'll talk more in a minute about how we're leveraging our leadership position in the education market to become the financial services company of choice for all educators. But first, let me touch on a few highlights of this transformative year. Most notably, NTA became a part of Horace Mann at the start of the third quarter as the Supplemental segment.

In its first three months, NTA contributed $6.9 million in earnings, with a solid pre-tax profit margin in line with the level of profitability we anticipated. As we've discussed, this stable contribution of the Supplemental segment will provide important sales and earnings diversification. We're very pleased with the first stages of our integration efforts, which have been bolstered by the fact that both companies are working from the same foundation, a mission-centric culture dedicated to serving educators.

As we've noted before, we are undertaking a thoughtful staged approach to our cross-sell strategy to ensure we're building sustainable growth. More than half of the Horace Mann agents have been appointed to sell supplemental products and are working to integrate the new products into the sales process. We expect an additional $5 million to $7 million of incremental annual earnings by 2021 from cross-selling the supplemental products to Horace Mann households.

We're also kicking off the first steps to reach some of the NTA customers with P&C products during the fourth quarter. The all-in P&C combined ratio was 96.2% for the quarter and 98.5% year-to-date, a testament to the work we've done to improve profitability. The quarter benefited from a 4.7 point improvement over the prior year in the underlying auto loss ratio. In fact, since we announced our auto profitability initiative in 2017, we have improved our auto underlying loss ratio by more than 7 points, surpassing our original goal of 5 points.

The segment was profitable despite an uptick in non-catastrophe fire loss severity in the quarter. Our analysis of the losses found no concentration by geography, by agent, or by cause, and frequency was unchanged from last year. Finally, the annualized net interest spread for our Retirement segment was 224 basis points in the third quarter.

The annuity reinsurance transaction dramatically improved to the return profile of this segment. We are able to achieve a spread in line with our profitability targets, despite the challenging interest rate environment. Our Retirement book is positioned for growth in both fee and spread-based products, allowing our customers to select the product that best suits their needs. Annuities continue to be a preferred savings option for many educators, and our annuity sales increased again in the third quarter, compared with a very strong third quarter of 2018.

Before I move on to our outlook, I wanted to briefly comment on recent news coverage of the 403(b) marketplace. Horace Mann is not subject to recently reported inquiries from the SEC or the New York Department of Financial Services. But as a company dedicated to helping educators achieve lifelong financial success, we appreciate efforts to provide greater transparency into the varied ways in which retirement solutions are offered in the K-12 education market.

Our retirement solutions include fixed annuities, variable annuities, and non-proprietary mutual fund products. We offer competitive transparent 403(b) product pricing, with no loads and no surrender charges. We take into account each educator's financial goals and savings preferences to help find the solution that's right for them. That's what Horace Mann is all about.

Now turning back to our outlook, as we discussed in September at the KBW Insurance Conference, we have a clear defined path to a 10% return on equity from three distinct drivers. First, we expect to gain a full point of ROE from the NTA acquisition in the first 12 months of bringing our companies together. Second, over the past several years, we have streamlined our organizational processes to accelerate profitable growth and strengthen our solution orientation. We are now beginning to realize savings from these initiatives. In addition, we are making significant progress on additional expense synergies and efficiency projects that will reduce our annual operating expense run rate by at least $15 million, which will add another point to ROE.

Fourth quarter core EPS will reflect approximately $0.07 per share for severance charges resulting from staffing reductions already made as part of this effort. This is one of the primary reasons we have tightened our guidance for full-year 2019 EPS to between $2.05 and $2.15. Bret will give more color on the details of our guidance changes later in the call.

Third, by 2021, we expect to realize an additional point of ROE through elements of the NTA integration, higher net investment income from aligning that portfolio with our current investment strategies, and cross-sell of supplemental products to Horace Mann policyholders. Those three drivers, all currently underway, will get us to the double-digit ROE threshold, and that's before any contribution from additional growth. From this solid foundation, return on equity will benefit as we gain market share.

Five years ago, we started making substantial improvements to our products, distribution, and infrastructure to be able to continue to help more educators achieve lifelong financial success. Today, with our recent transactions, we have the pieces in place to fulfill that vision. From a product perspective, we've built out a complete product game board with solutions for educators at every life stage. We've upgraded our product suite to add features that educators want, and solutions that address the unique financial issues they face.

In terms of our distribution strategy, with the addition of NTA's 200-plus agents and successful worksite marketing operation, we have the opportunity to share data, encourage cross-sell, and adopt best practices from each other. This led to our national building-by-building analysis of coverage and sales opportunities. Combined, our company has a presence in roughly half the school buildings in the country. This includes anywhere from one policy to thousands of policies. So our growth strategy will vary accordingly.

On the infrastructure front, we've upgraded our systems across every segment to be more customer and agent-friendly, while gaining systemic advantages that can reduce our costs and improve our efficiencies. We've just launched the second phase of our Guidewire implementation, with the introduction of the new P&C administration system in our first state, Illinois. The benefits of the upgrade are substantial in terms of data segmentation and analysis, digital capabilities, and the ease of use. We've staged our rollout to pick up larger states with the best growth opportunities earlier in the process. By the end of 2020, we plan to have states representing about 60% of our customers on the Guidewire platform.

As we move into this next phase of our growth strategy, we evaluated our organizational strategy against these key elements of our solution orientation. As we announced two weeks ago, we have aligned our resources behind the three PDI strategic pillars, with Bill Caldwell leading product and Matt Sharpe leading distribution. Wade Rugenstein will lead infrastructure and operations, as well as maintaining responsibility for the integration of the Supplemental segment. This streamlined structure will allow us to prioritize and accelerate growth opportunities.

To close, we are heading into 2020 with a full product game board, an expanded agency force, and an experienced, talented leadership team. The transformational changes we've made gives us a clear path to accelerating shareholder value creation and substantially increasing our market share in the education space. Thanks.

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

Bret A. Conklin

Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.

Thanks, Marita, and good morning, everyone. As Marita noted, the $0.64 of third quarter core earnings demonstrate that we are better equipped than ever before to meet the financial needs of educators. Our transformative efforts and multiyear initiatives, focused on improving our products, distribution, and infrastructure, have resulted in a larger, more diverse company with a clear path to a double-digit ROE.

This is the first quarter that National Teachers Associates, or NTA, is included in our results as the Supplemental segment, contributing $6.9 million, or $0.16 per share, to core earnings. This aligns with our expectations for a $12 million to $14 million contribution in the second half of this year. Although we are not providing historical earnings information for NTA, these results do align with their performance before becoming part of Horace Mann.

In our ongoing business segments, results were solid. Underlying P&C profitability remains on track. We also continue to benefit from the significantly reduced interest spread risk in our Retirement segment, following the reinsurance transaction earlier in the year. In Life, profitability remains strong.

I'm going to begin with a review of segment results and outlook before I summarize the details of our updated EPS guidance for 2019. Let me start with the new Supplemental segment. Supplemental added $32.9 million in premiums and contract charges, or 14% of our third quarter total. Net investment income on the Supplemental portfolio was $3.7 million. Due to its strong profit margin, the segment contributed 25% of core earnings, illustrating the diversification value it brings. Premium persistency was 88.9%, with almost 300,000 policies in force. As we've said, premiums for this business are relatively stable quarter-to-quarter.

The benefits ratio was a healthy 44.7% for the quarter, with the operating expense ratio at 28.2%. These ratios generally align with our go-forward expectations, but we'll give color on specific metrics when we provide detailed 2020 guidance on our year-end investor call.

Operating expenses excluded $3.2 million in non-cash amortization of intangible assets. Our preliminary estimate of intangible assets being amortized is $160 million, which will be broken down in the 10-Q between the value of business acquired, the value of distribution acquired, and the value of agency relationships. Due to the nature of the Supplemental business, the useful life for these assets has been determined to be as much as 35 years for the value of business acquired, and about 17 years for distribution relationships. As a result, the annual run rate for intangible amortization should be $12.5 million to $13 million pre-tax, which should be relatively constant for the foreseeable future. The pre-tax profit margin was 23.7% for the quarter, and we anticipate it will remain north of 20% on an ongoing basis.

Turning to the Property and Casualty segment, for the quarter, core earnings were $14.2 million versus a loss of $3.2 million last year. Both the underlying combined ratio of 89.7% and the reported combined ratio of 96.2% improved substantially over last year. The reported combined ratio benefited from Q3 cat losses that were about half of those a year ago. 17 events, primarily wind and hail in the Midwest and Plains states, totaled about $14.7 million in losses pre-tax. With year-to-date pre-tax cat losses at $47.6 million, we believe full-year cat losses should be between $50 million to $55 million, a tightening of the range we've used in our guidance this year. At the high end, cat losses would be slightly more than 7.5 points on the full-year combined ratio.

Turning to auto performance for the quarter, the reported combined ratio improved 7.1 points year-over-year to 92.4 points. Rate increases, averaging in the middle single digits across the book, continue to keep us ahead of loss cost. Loss trends remain consistent. Severity is elevated compared to historical levels, although the pace of the increases continues to moderate somewhat. Frequency declined again in Q3. As we discussed last quarter, the year-over-year delta in the underlying loss and combined ratios has moderated slightly, as we are now comparing to a very strong second half 2018 underlying results.

Auto is expected to remain profitable for the full year, with 3 to 3.5 points of improvement in the underlying loss ratio for the year, and about 7 points of cumulative improvement since 2017. As Marita noted, that's well-ahead of our original objective and a key driver of ROE improvement.

Turning to property, the reported combined ratio improved almost 30 points because of lower catastrophe losses. However, the underlying loss ratio rose more than 7 points because of higher non-catastrophe fire losses that Marita mentioned. These temporarily offset the benefits of homeowner rate increases tied to the higher cat and non-cat weather that we've seen in many geographies over the past few years. Due to the fire losses, we now expect the full-year underlying property loss ratio to be flat, compared with 46.2% in 2018.

Underwriting results benefited from $3.5 million in favorable reserve releases in the auto book, and we remain solidly in the upper half of the independent actuaries' range for total P&C reserves. The P&C expense ratio was 26.4 points for the quarter, and we expect the full-year ratio will remain in line with our guidance. Our target for the combined ratio for the P&C business for the full year remains at the high-90s, with the nine-month ratio at 98.5%. The underlying auto combined ratio should be below 100%, and the underlying property combined ratio in the low-70s.

Net written premiums for the year should be up slightly, reflecting rate increases. Overall, retention is down from 2018. But in key geographies that are above our profitability targets, we are seeing positive trends in new business and expect this will accelerate over time.

For the Life segment, third quarter sales of recurring premium products were up 13%, although lower single premium product sales resulted in a decline in total sales for the quarter. As a result of lower net investment income, core earnings were down slightly for the quarter.

With lower single premium sales this year, we now anticipate full-year total Life sales to be down slightly, although we still expect the segment to deliver $15 million to $17 million in ex-DAC earnings. Our agents continue to help more of our customers see how life insurance can contribute to the financial well-being of their families, and we continue to expect long-term sales growth.

Before I turn to the Retirement segment, let me quickly revisit the reinsurance transaction we completed in the second quarter. It addressed the interest rate risk of a legacy block of annuities, with a minimum crediting rate of 4.5%. The transaction released $200 million of capital, $185 million of which was redeployed to purchase NTA, reducing Retirement segment invested assets effective July 1.

The required accounting treatment for the transaction was the deposit method, which means some of the elements of the transaction continued to flow through our financials, even though they are the responsibility of RGA. In addition, our balance sheet now shows a deposit asset on reinsurance, and total net investment income includes an entry for accreted investment income. The investor supplement shows some of the Retirement metrics, excluding the reinsured block, to more clearly illustrate the results of ongoing operations.

For the retained business segment, at September 30, we had $4.2 billion in assets under management, and $7.9 billion in assets under administration. Annuity sales deposits were up this quarter, even comparing against a very strong third quarter in 2018. Annuities continue to be an important part of our product set, as they appeal to the financial objectives of our educator customers, while complementing our growing suite of fee-based products.

The annualized net interest spread for the quarter was 224 basis points, compared with 233 basis points in the second quarter. I'll talk more about the interest rate environment in a moment, but we expect that the net interest spread will remain in the low-200s in the fourth quarter. Our spread guidance of 190 to 200 basis points for the full year includes first quarter's pre-reinsurance spread of 142 basis points.

Retirement had no DAC benefit in the third quarter. Due to higher than anticipated returns on alternative investments, Retirement core earnings of $5.9 million for the quarter were slightly ahead of the approximately $5 million run rate we had expected for the third and fourth quarter this year. Nonetheless, our guidance for full-year 2019 after-tax Retirement earnings, excluding DAC unlocking, remains at $25 million to $27 million.

Briefly on investments, the pre-tax yield on the portfolio was down slightly year-over-year at 483 basis points in the third quarter. Our new money rate in the third quarter was slightly below 4%. The overall credit rating of the portfolio is consistent with the prior periods, and remains very high with an average rating of A+.

Total income on the managed investment portfolio was $69.2 million in the third quarter, down $1.1 million sequentially, as returns on alternative investments remained strong but were slightly below Q2. The fair value of the alternatives portfolio was $355 million at September 30, with year-to-date returns above 9%.

Yields in the public fixed income market continue to be challenging, and we see more compelling risk adjusted returns in private credit, commercial mortgage loans, and infrastructure. As a result, we continue to increase allocation to these asset classes via alternative funds.

With the Fed reducing rates by another 25 basis points last week, we believe our new money rate for both the fourth quarter and 2020 should be around 375 basis points, slightly lower than the new money rate we saw in Q3.

We still expect net investment income from the managed investment portfolios, including NTA, to be around $300 million for the full year 2019. The quarterly go-forward run rate of accreted investment income on the deposit asset on reinsurance should be within $1 million, plus or minus, of the levels reported in Q2 and Q3. As a result, total 2019 net investment income should be in line with our previous guidance of down slightly to $370 million for the full year.

Before I turn to the outlook, as we had indicated last quarter, Corporate segment expenses increased in Q3 to the new quarterly run rate of $6.5 million, due to additional interest expense on the line of credit. As we noted in the release, we have $135 million outstanding on the line, and our total debt-to-cap ratio is 24.8%, consistent with our current ratings. We continue to target a 425% RBC for all of the insurance subsidiaries.

Turning back to our guidance, as we noted yesterday in the release, we tightened our full-year core EPS range to $2.05 to $2.15. We're taking into account the uptick in third quarter fire loss severity and its effect on the full-year property loss ratio, as well as anticipated one-time severance costs. We will give detailed 2020 guidance on our year-end call in early February, but the three drivers articulated by Marita give us confidence we will reach a 10% ROE in the next year or two.

To recap, first, we expect a full point of ROE from the accretive acquisition of NTA. Second, we expect another point from reducing our annual operating expense run rate by at least $15 million in 2020 and beyond, reflecting the synergies and efficiency efforts we discussed. Third, the NTA integration effort should add another point, as we fulfill our cross-sell objectives and align their investment portfolio with our current strategies.

The solid foundation we've built in the past few years will support market share expansion, with ROE benefiting from growth across the businesses. Our intent for the excess capital, generated by our stronger organization, remains focused on the most accretive uses. This includes growing our business at returns that meet or exceed our ROE targets, returning a significant portion of annual earnings back to shareholders via compelling dividend, and opportunistically buying back shares when market conditions warrant.

To close, we see three key proof points in our third quarter results that set the stage for continued improvement in 2020 and beyond. First, our P&C profitability initiatives have been successful. Second, the addition of the Supplemental segment has delivered the intended benefits of revenue and earnings diversification for our company. And finally, the ROE profile of this combined business is strong and more than capable of reaching double digits in the next two years.

Thank you. And with that, I'll turn it back to Heather for Q&A.

Heather J. Wietzel

Vice President-Investor Relations, Horace Mann Educators Corp.

Allison, I think we're ready to poll for questions.

QUESTION AND ANSWER SECTION

Operator: All right. Thank you. And we will now begin the question-and-answer session. [Operator Instructions] Our first question today will come from Matt Carletti of JMP. Please go ahead.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Hey, thanks. Good morning.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.

A

Morning.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Good morning, Matt.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Marita, I was hoping you might be able to just remind us or kind of walk us through your updated thoughts, now with NTA closed and on board, of more the logistics of how we should expect to see the cross-sell start to take place in terms of the ease of licensing or additional licensing or lack thereof of legacy Horace Mann agents to sell NTA products and vice versa.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah. If you don't mind, Matt, I'm going to let Wade jump in on that. He's been front and center on our integration efforts, and I know he has some specifics that he'd like to share, and then I can come back in...

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Perfect.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

...and add anything [ph] for the top (00:28:26), if necessary.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Great.

Wade A. Rugenstein
Executive Vice President-Supplemental Products & Chief Information Officer, Horace Mann Educators Corp.

A

So this is Wade. As far as the integration, the expression we continue to use is a thoughtful sales integration, and the first priority is to get the Horace Mann agents appointed with NTA and start that process. And then the second phase of that will be getting the NTA agents up to speed on the Horace Mann project. So I think that's gone really well. We've made a lot of progress since close until now and still work to be done, but a lot of energy within the sales force. I mean, I don't know, Matt, if you want to comment on that a little bit more.

Matthew P. Sharpe
Executive Vice President-Strategy & Business Development, Horace Mann Educators Corp.

A

Thanks, Wade. Yeah. Matt, it's Matt Sharpe. How are you this morning? One of the things to consider was we already had an established sales force within NTA, so they have a couple hundred agents that are already selling. So the priority of the integration was to make sure that we didn't disrupt that sales force in any way and maintain the sales momentum that we had going on with the NTA.

The second phase of it was licensing, appointing all of our agents, educating them on the products, and starting to integrate those products into the sales process, and that's going to take some time. As Marita mentioned in her opening comments, about half of our agents were already appointed, and the vast majority of them already possess the license to sell the product. So it's just a matter of working our way through the field force, doing that training and integrating that product into their sales process.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Okay, great. Very helpful.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah. And the only thing I'd add, Matt, if I can just add to that, when we think about the role that we put Wade in early on, some of the benefit there was by having him initially over all technology for the organization and now over all operations. I think we got a running start on connecting the wires that need to take place in most integration efforts, having done many of these in my past, there's a fair amount of time in connecting companies, because we're both in a common space with a common mission, doing worksite marketing in the schools for as long as we both have. The connection of the value propositions and the culture were easy, but there's still a fair amount of infrastructure and systems and operational synergies and connections that need to take place in any integration. By having Wade involved in that early, quite frankly, even right before and during close, we had time to do a lot of that work.

So I think we get a running start, so that to your question, we can immediately focus on how we drive that cross-sell. And Matt said it well, the idea was, first, do no harm, right? We want to continue to grow and do well in the supplemental products, but quickly turning it to how do we take advantage of the cross-sell opportunity. But it's exciting to me that we did get a running start on the integration.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Okay, great. And then just more of a numbers question still on NTA, I mean, we obviously got the quarterly financials. Can you give us a little bit of color on kind of what – with this order of magnitude, kind of what sort of sales growth has been kind of the baseline there, since we don't have the year ago to compare against?

Wade A. Rugenstein
Executive Vice President-Supplemental Products & Chief Information Officer, Horace Mann Educators Corp.
A

Yeah. I think from a historical perspective, we've had a little growth from 2018 to 2019 in the third quarter, continue to have a very healthy sales pipeline and interest in the product. So, third quarter was a very normal quarter for us, and continue to have good momentum going into the fourth quarter.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

And maybe just to...

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Okay.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

This is Bret. To tack onto what Wade shared, obviously the first time for the Supplemental coming out party, if you will, and very pleased at what we've been talking about to analysts and investors is actually showing up in the numbers, and you can literally see the diversification in the business mix that that brings to the Horace Mann consolidated financial picture. So, the increase in the top line and the ROEs that that segment provides is exactly what we'd hoped it to be, with more upside to come.

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Great. Okay. And then one last just clarification question, just so – and make sure I'm thinking about this the right way, when you guys give your ROE guidance, the basis or the denominator in that that we should use, and so reported not tangible book, but ex-unrealized gains on the fixed income portfolio. Is that correct?

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

Yes. That's correct, Matt.

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Great. Wonderful. Well, congrats on having NTA on board, and best of luck going forward.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

Thanks, Matt.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Thanks.

Operator: Our next question today will come from John Barnidge of Sandler O'Neill. Please go ahead.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

Thanks. I appreciate your comments. The New York and SEC inquiries, and you have no load and no surrender charge, transparent pricing. Can you kind of talk a little bit about how we should be thinking about this as actually an opportunity to accelerate some of the consolidation that's been going on in the education market? And obviously Horace Mann does multiple products across the spectrum.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah, John, this is Marita. I'm glad you asked the question the way you asked it, because that's exactly how we think about it. Obviously, we're well aware of the articles that appeared in The Wall Street Journal. They seem to describe inquiries into compensation and sales practice. You mentioned it, we've had no inquiries from the SEC or New York; Horace Mann is in most states offering 403(b) business but we're not in New York. And we actually, as I said very clearly in the script, we actually appreciate the efforts that provide what we consider greater transparency into multiple ways in which retirement products are offered in our education market.

Horace Mann has offered tax deferred annuities since 1961. That's actually when Congress first allowed those products to be sold. We've recently introduced, as you know, a 403(b)(7) open architecture, it's a mutual fund platform, we called it Retirement Advantage. Two-thirds of our annuity account values are actually in fixed accounts, which I think speaks to the nature of our conservative retirement planners in the education space. We have over 75 years' worth of history, and changes to products and process in response to regulatory changes are kind of natural for us, and we evolve, we saw it with the DOL, we saw it with the SEC changes, and we'll continue to do that if necessary.

But I think what's really key is the Horace Mann sales approach. We work with educators holistically on solutions and not just providing an individual product. Our agents are paid on an asset-based fee for enrolling the educators. We don't offer proprietary mutual funds. Our only proprietary product is a stable valued fixed account investment option that we offer in the 403(b) retirement platform.

You mentioned no loads, no surrender charges, and our fees for the product are well under 2%. So we believe that positions us well. This is what we do. This is what we've always done. We believe the way we sell our products and the transparency that we bring is important there, and we believe in choice for educators. It may be a little trite to say, when companies compete, the consumer wins. But in this case, we think that we stack our product and our approach up well against the competitors, and we're glad that there's choice and potentially more transparency out there. A lot to unpack, but it's an important question, so I'm glad you asked it.

Operator: Okay. And we will move on to the next question. And we have Gary Ransom of Dowling & Partners. Please go ahead.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yes. Good morning. I wanted to ask about the underlying auto loss ratio, which, if I look at past trends and maybe even consider seasonality, is much better than you might have expected. And I just wondered if there was something going on there.

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.
A

Yeah, Gary, it's Bill. I'd say, we've been working on this for quite some time. When I unpacked the frequency and severity, frequency is down slightly. We would have expected that to be more flat. So we are seeing favorable frequency. And severity, although elevated over prior years, isn't as high as some of the other companies or competitors talking about social inflation. Again, we work in a niche. We're not selling commercial auto policies. We don't have a ton of super high limits. And we've taken a lot of actions in the states where this is originating from, namely Florida and Georgia. Our Florida base has shrunk nearly two-thirds in terms of policies over the last couple of years. So, yes, we are above – we are beyond where we thought we would be, but it's because of the strategies that we put in place over the last couple of years.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

So it sounds like the underlying loss trends were a good-sized contributor as well. Correct?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.
A

Yes. Yes.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

Yes. Okay.

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.
A

Yes, the combination of the favorable frequency and better than expected severities.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

Thank you. Another question is on catastrophe guidance, you gave us some guidance that didn't seem to include a real big number for the fourth quarter. And I just wanted to make sure you had in your mind all the storms that happened in October and what – anything that might have happened in the wildfires. More recently, that was all in consideration when you gave that guidance. Is that also true?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.
A

Yeah, Gary. Clearly, we know what happened in October. That does not change our guidance. When you think about the wildfires that have recently occurred, I will put these in the bucket of typical wildfire losses, tend to be more rural where educators don't live. Our underwriting drill has been strong historically. The Camp Fire was obviously a lot different, and we're seeing that play out in the courts. But as far as the recent fires that we're talking about for the industry, hundreds of losses, low hundreds, versus thousands in the Camp Fire. So it's just a more typical year for wildfire and we typically don't have losses in these fires. And there was a storm in Dallas, but I would – that was immaterial to our earnings in October. So that is in our consideration for the guidance.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

All right. I guess that's all I have. Thank you.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.

A

Thanks.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Thank you.

Operator: Our next question is a follow-up from John Barnidge of Sandler O'Neill. Please go ahead.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

Sorry, I was on speaker. Going back to slide 6 of the deck, you talked about double-digit core ROE 2021 and beyond. That suggests an earnings power well above current consensus absent a special dividend. Am I thinking about that correctly?

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.

A

You want to repeat your exact comments again, John? This is Bret.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

So, slide 6, potential double-digit core ROE 2021 to 2025.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.

A

Correct.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

Consensus exists for 2021. The double-digit core ROE would be suggestive of an earnings power of the company that's well above what consensus is expecting. Am I thinking about that correctly?

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.

A

Yeah. No, I think you are. And a couple things, obviously, we've got some – as we came out at the – with our last dividend notice with the expense synergy goals that were – have baked into our future guidance, that's one piece of it. Obviously, just bringing NTA aboard into the family in and of itself doing nothing with that is going to add an additional 1% of ROE. But I think there are several things that come into play out in the 2021 to 2025.

Obviously, we're not content with just hooking the company up, if you will. There's cross-sell opportunities that, as Marita mentioned in her prepared remarks, of $5 million to $7 million for 2021, I would say that's probably on the conservative side, and that's just, as Matt was talking about and Wade, having our agents, if you will, sell the NTA products first, but then there's ultimately NTA selling the Horace Mann products. So, there's, I think, that aspect of going out in the future.

And then also just growing our current book of business now that, as Bill mentioned, we've been working on the probability of the auto book for several years, and we've got that to a point that it is generating the 10% ROE, which had not been in the past. So kind of combining, you could certainly see what the ROE of the Supplemental segment, coupled with the P&C segment and then future growth of the book that we have today, is going to get us to that double-digit ROE in the future.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah, this is Marita. The only thing I'd add – Bret, that was a good unpacking of the ROE picture. In the investor presentation, that directional ROE slide only included those components that we have already in flight. That directional slide included no growth. And as Bret said, now that we look at our products being accretive to that ROE, growth is on top of that trajectory that we included – that we didn't include in that chart.

So we feel that when we think about the phases of our strategy, that first phase being the fix and build phase where we built product, where we improved solutions to our agents, where we modernized our infrastructure and drove some efficiencies that we're now able to see some of those expenses coming out, allowed us to really look at 2019 and into 2020 as that transformative stage, where we take advantage of the acquisition of NTA and BCG, the reinsurance transaction to de-risk the portfolio and fund for the NTA transaction. And then obviously the work that we're doing to improve our infrastructure, I think it positions us extremely well for that next phase, which we refer to as the growth phase. And when we look at unpacking this ROE, it includes all that hard work we've done and doesn't yet anticipate the growth that we know is clearly there at that next phase of our journey.

Operator: [Operator Instructions] Our next question will come from Freddie Sleiffer of KBW. Please go ahead.

Frederique Sleiffer
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Good morning. My first question is just on auto, and apologies if I missed this earlier, but what average rate increases are you still putting through the book? And are you seeing these accelerate or decelerate quarter-over-quarter?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

Our rate plan for this year is mid-single-digits in auto, and we will meet that plan. And I would say, categorizing next year, we're starting to see deceleration in rates. Rates will be less than 5% next year.

Frederique Sleiffer
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, great. And then just moving on to Supplemental, the morbidity and operating expense ratios came in much lower than we were expecting. So are these a good run rates model going forward, or should we expect some seasonality in results?

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

No, I think what was included in the results are the run rates. I think even in my prepared remarks, the pre-tax profit margin's 20-plus percent, so no significant changes there with respect to the run rate of Supplemental.

Frederique Sleiffer
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Okay. And then just following up on that, given the strong loss and expense ratios, is there a regulatory limit on how low these can be?

Wade A. Rugenstein
Executive Vice President-Supplemental Products & Chief Information Officer, Horace Mann Educators Corp.
A

This is Wade. No, it's something we monitor. There's not a limit in terms of our products, something that we keep an eye on, and pleased with the results, and there's a lot of good work that goes into getting those results all the way through the sales process and into how we administer the policies.

Frederique Sleiffer
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Okay, great. That's it. Thanks for the answers.

Operator: Next we have a follow-up from...

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

Thanks.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Thanks, Freddie.

Operator: And we have a follow-up from John Barnidge of Sandler O'Neill. Please go ahead.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP
Q

Yeah. Just going back to your answer on the SEC and New York, I'm just curious, do you think this could accelerate consolidation of slots in the schools?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Yeah. John, we obviously have been doing this for a long period of time, and it does tend to come in waves. We've seen some emergence to single providers, and then back to more of an open enrollment, more providers. We have not seen a decrease in our slots. It's been relatively consistent. We don't have a problem opening slots in the schools. Again, we have a very clear way of bringing our 403(b) business into schools. It hasn't changed. It remains the same. Again, I think this is positive for educators and potentially positive for us, in that more folks will think more the way we think, which is transparency and is about bringing clear product capabilities and choice to the educators to supplement their retirement.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

What I'm trying to get at is, do you think it could actually be something with which you could benefit?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah. I mean, I think potentially, where we benefit is the educators benefit. I think that when there is more transparency, I think when there is more choice, there are less situations where we might be blocked from a particular school that has a single provider. But for us, we keep on doing what we're doing. We have not seen a decrease in enrollments. We've seen an increase. We're happy about our retirement trajectory. The more we build capability, the more we build solutions, the more we provide transparency, the more we provide choice, I think the more we'll be able to continue to grow our enrollments, and therefore, our assets under management.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

...very much for your answers.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

You're welcome.

Operator: Ladies and gentlemen, this will conclude our question-and-answer session. At this time, I'd like to turn the conference back over to Heather Wietzel for closing remarks.

Heather J. Wietzel
Vice President-Investor Relations, Horace Mann Educators Corp.

Allison, thank you, and thank you, everyone, for joining us today. I'll be available by phone if there are any follow-up questions, and we look forward to seeing folks over the next couple of months. Our next trip will be in the New York next week for the JMP conference. We'll also be traveling with some of the other folks. So let me know if you're interested in the visit as well. Thank you.

Operator: The conference has now concluded, and we thank you for attending today's presentation. You may now disconnect your lines.