Company Name: Horace Mann Educators
Company Ticker: HMN US
Date: 2014-10-23
Event Description: Q3 2014 Earnings Call

Market Cap: 1,179.30
Current PX: 28.81
YTD Change($): -2.73
YTD Change(%): -8.656

Bloomberg Estimates - EPS
Current Quarter: 0.658
Current Year: 2.278
Bloomberg Estimates - Sales
Current Quarter: 264.000
Current Year: 1049.000

# Q3 2014 Earnings Call

## Company Participants

- Ryan E. Greenier
- Marita Zuraitis
- Dwayne D. Hallman
- Matthew P. Sharpe
- Stephen P. Cardinal

## Other Participants

- Vincent M. DeAugustino
- Bijan Moazami
- Sean Dargan
- Bob R. Glasspiegel
- Colin W. Devine

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning. My name is Arnica, and I will be your conference operator today. At this time, I would like to welcome everyone to the Horace Mann Third Quarter 2014 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I will now turn the conference over to Ryan Greenier.

### Ryan E. Greenier

Thank you, Arnica, and good morning, everyone. Welcome to Horace Mann's discussion of our third quarter 2014 results. Yesterday, we issued our earnings release and investor financial supplement. Copies are available on the Investor page of our website.

Our speakers today are Marita Zuraitis, President and Chief Executive Officer; and Dwayne Hallman, Executive Vice President and Chief Financial Officer. Steve Cardinal, Executive Vice President of Property and Casualty, as well as Matt Sharpe, Executive Vice President of Annuity and Life, are also available for the question-and-answer session that follows our prepared comments.

Before turning it over to Marita, I'd like to note that our presentation today includes forward-looking statements as defined in the Private Securities Legislation 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 press release as well as SEC filings.

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

And now, I'll turn the call over to Marita Zuraitis.

## Marita Zuraitis

Thanks, Ryan. Good morning, everyone, and welcome to our call. After yesterday's market close, Horace Mann reported third quarter operating income of $0.55 per share, a strong result, including relatively benign catastrophe losses, continued margin expansion in auto, as well as favorable annuity spreads and a more normalized level of life mortality.

P&C auto profitability continued to improve on a year-to-date basis, and underlying combined ratio is running over 2 points better than last year. Property results were adversely impacted by an elevated level of non-cat weather losses, reflecting a recent trend in higher loss severities.

We continue to push property rate to address this increased weather trend, while further improving our underwriting processes. Total P&C written premium continued to grow, up 3% on a year-to-date basis, largely on rate actions. And prior-year reserves continue to develop favorably.

Ex-DAC annuity earnings increased modestly in the quarter despite the challenging interest rate environment. The increase was driven by strong investment performance and proactive crediting rate management. Given the healthy growth in assets under management, strong sales momentum and stable persistency ratios, our annuity business is well positioned for solid performance even in the current low interest rate environment.

Earnings for the life segment were consistent with modeled mortality, compared to favorable experience we saw in the prior-year quarter. All together, the results contributed to an 8% annual increase in book value per share, which ended the quarter at $24.91, excluding net unrealized gains on investments.

From a business perspective, we continue to implement product, distribution and infrastructure initiatives centered around our strategy to find more, win more, and keep more educators. As we've said before, our customer base is what makes us unique. We have a compelling value proposition for K-12 public educators and the broader education market.

Our vision is to help protect the short-term risk of educators and help them secure their long-term financial future. We tailor our products to an educator's unique needs, and we have knowledgeable distribution that understands our segment. And we're building modern infrastructure to ensure ease of doing business for a customer segment that is not necessarily focused on their financial needs.

We are accelerating our efforts to introduce more educators to our brand, and at the same time we're developing initiatives to round out our existing customer base with our full product suite. We know from past experience every additional product we place in an educator household supports our already-strong retention and persistency levels.

Let me share some specifics about what we've done this quarter to find more, win more, and keep more educators. Looking at P&C we saw early signs of success in our offensive strategy, similar to the fixed indexed annuity roll out, our agency force is energized about the improvements in our auto product and has reacted enthusiastically.

Auto quote volumes have increased, particularly in areas where we've introduced more refined segmentation. Close rates remain relatively consistent. Auto sales increased 7%, and we wrote 13,000 true new auto policies in the quarter, resulting in sequential increase in PIF count over the second quarter. We're encouraged by these initial signs of success, and we believe this momentum will continue as we roll out additional product refinements. Annuity sales continued to be strong, up 17%, largely on our new fixed indexed annuity product.

We continue to see significant increase in the number of Horace Mann agents writing fixed-indexed annuity business. At the end of the third quarter almost two-thirds of our agents had written at least one new FIA product, a significant increase from the small number of agents that sold the third-party vended products we previously offered.

This strong performance is a testament of our ability to design a product tailored to an educator's needs and also provide agents with the appropriate training and support that enables them to be successful. In addition we are focused on ensuring we have a complete product suite to meet the coverage needs of educators.

Our initiatives with the Horace Mann General Agency and use of third-party vendors are allowing our agents to say yes more often at the point-of-sale. Between the enhanced training and support as well as our build out of third-party vendor options, our agency force productivity and enthusiasm is clearly improving. Within the life segment sales remain strong and our reoccurring premium offerings were up 14% in the quarter.

Turning to distribution I'd like to share a few examples of our enhanced marketing efforts to attract new educator customers. During the quarter we continued to refine our digital advertising approach with the goal of improving brand awareness within the educator community. We launched an online branding series, titled An Extreme Calling, that takes a lighthearted view of the challenges educators face.

Based on actual situations provided by teachers on our educator advisory panel, the videos are fully integrated with our Facebook and Pinterest pages and have generated thousands of views, likes, and shares. It's a unique approach to reach educators in a way that connects to their daily lives, and we believe it will aid in name recognition.

In addition we are conducting a coordinated direct mail campaign and more aggressive DonorsChoose funding in targeted markets where we'd like to increase brand awareness, improve school access, and grow our business.

From an infrastructure perspective we continue to invest in our business. During the quarter we launched additional technology enhancements in our customer contact center, including online chat capability. Within hours of going live our customers found and were using this new functionality. Importantly this flexibility works with their classroom schedules.

Similar to the early signs of a more robust auto offense, this successful launch is an early signal that we're on the right path. In addition to this exciting new feature we have introduced new training and incentives to our customer contact center representatives to encourage them to increase their cross-sell activity to existing customers.

The annuity and life system implementation remains on track. We are also carefully looking to modernize our P&C systems and are in the due diligence stage.

I continue to be encouraged by the successful implementation of our multi-year strategy to profitably grow our business and become a larger, more dominant player in the educator space. The leadership team, our agents, and employees, are aligned around our mission to find more, win more, and keep more educators.

Our efforts are centered around new household acquisition and rounding out our existing customer base with our full product suite, in addition to continuing our strong track record of customer retention. Given the strong year-to-date sales and retention metrics as well as solid financial performance, I know we're on the right path to be the company of choice for our nation's educators.

And with that I'll turn the call over to Dwayne for some financial highlights.

## Dwayne D. Hallman

Thanks, Marita, and good morning. Third quarter operating income of $0.55 per diluted share, a good, solid quarter, although modestly lower than the prior year. P&C earnings improved largely on a lower level of cat losses and auto margin improvement, but was partially offset by higher non-cat weather losses in property.

Ex-DAC annuity earnings improved modestly as we continue to grow assets under management as well as produce favorable annuity spreads. Life earnings declined by almost $2 million on more normal mortality levels compared to the favorable experience in the prior year.

Looking in more detail of P&C, after-tax income of $11.8 million was 6% higher than the prior-year quarter. This quarter's combined ratio was 96.3%. Catastrophe losses in the quarter, $5.7 million or 4 points, were relatively benign, but we did see an elevated level of non-cat weather activity.

If you recall, the second quarter of this year included a significant amount of both cat and non-cat weather losses. During the third quarter, the severity of the non-cat weather loss emergent was inconsistent with previous patterns. As a result, we increased our current accident year loss estimate for the second quarter, which in turn impacted the third quarter underlying property loss and LAE ratio by roughly 6 points. So on an adjusted basis, the ultimate second quarter reported loss and LAE ratio is now 53.3%, which is equal to the current third quarter loss and LAE ultimate on a pure accident quarter basis.

On year-to-date basis, the underlying property result of 78.6% was approximately 3 points higher than the prior year. This increase is largely related to the aforementioned higher level of incurred non-cat weather as well as fire losses. While we have strong underwriting and exposure management processes, we continue to look for opportunities of improvement and take appropriate rate actions in response to the loss activity.

Auto results in the quarter were encouraging. Not only were sales strong, but the underlying combined ratio improved by more than 2 points to 99.9%, almost entirely on improved loss experience. On a year-to-date basis, the underlying combined ratio improved 2.6 points to 98.7%.

Underlying margins have expanded as rate increases continue to outpace loss costs. We continue to see favorable BI frequency trends and BI severities appear to be moderating. Overall, our rate plan exceeds loss cost trends. For prior accident years, the favorable reserve development was primarily in BI. The total P&C expense ratio for the quarter was 27.6%, slightly above prior year, but inline with our full-year estimate.

While we are pleased with yet another quarter of solid underlying P&C auto results, we remain focused on achieving our target of a mid-90s% reported P&C combined ratio, which is comprised of a high-90s% result in auto and a low-90s% in property over the course of a full-year. Through the first three quarters of 2014, we are at 97.5 points, almost 2 points better than last year.

Turning to annuity, net income excluding DAC unlocking was $11.1 million, a 3% increase over the previous year. Assets under management grew by more than 8% from a year ago, reflecting strong sales, equity market appreciation, and strong deposit persistency.

The annualized net interest spread on a year-to-date basis was 204, ahead of the prior year. This reflects strong performance in our fixed income investment portfolio, which experienced an elevated level of prepayment activity during the quarter, as well as solid alternative investment returns. In addition, we continue to be very proactive in crediting rate management.

In the life segment, operating earnings declined to just under $4 million. Mortality in the quarter was in line with expectations, compared to the favorable experience in the prior year. Life sales continue to be strong, up 16% on a year-to-date basis.

Net investment income was $82.6 million, up 5% from prior year, due to higher asset balances in the annuity segment. Finding attractive new opportunities to put money to work remains challenging given the interest rate environment. Our new money reinvestment rate for the quarter was just under 4%. Given the current interest rate outlook, we anticipate further declines in portfolio yields, as we move in to 2015.

In total, the company's solid earnings generated an 8% increase in book value per share, excluding net unrealized gains on investments, which ended the quarter at $24.91. On a reported basis, book value increased to $31.51, which includes $480 million of net unrealized gains. This quarter's are results for building on our solid track record of strong book value growth, excluding net unrealized gains in investments. In addition, we repurchased over 50,000 shares during the quarter at an average price of $28.61.Given the current program's inception, we have repurchased more than 1.4 million shares at an average price of $18.85.

As we have said before, our repurchase activity is opportunistic, and it tends to take advantage of market volatility. Putting it all together, third quarter results were strong. P&C margins continue to improve, annuity margins remain favorable, and the life segment is performing well.

Sales are increasing, and we remain confident in the earnings power of all three of our business segments. With respect to full year earnings, we increased guidance to $2.20 to $2.30 per share. This reflects strong year-to-date annuity results and third quarter cat losses that were lower than expected. It also considers elevated non-cat weather loss trends we've seen this year.

The revised guidance range assumes the fourth quarter underlying auto loss and LAE ratio will improve slightly over the prior year, but keeping in mind our historical seasonal loss patterns for the final quarter of the year can be volatile.

For property, we assume the increased non-cat weather impact will continue and contribute to an underlying loss and LAE ratio a couple of points above prior year. Annuity earnings have outperformed our original guidance and we expect this segment to continue to produce solid results.

That said, we anticipate slightly lower earnings, ex-DAC unlocking, in the fourth quarter as a result of reduced investment prepayment activity and slightly higher operating expenses compared to the third quarter. Our expectations for the life segment earnings are similar to the results we just reported for the third quarter.

In closing, we are excited about the strong top line results in annuity and life and encouraged by the early signs of emerging P&C offence. We look forward to sharing more successes with you as we continue to implement our strategy to find more, win more, and keep more educators.

Now I'll turn the call over to Ryan to start Q&A.

## Ryan E. Greenier

Thanks Dwayne. Arnica, please open the line up to begin the Q&A portion of the call.

# Q&A

## Operator

[Operator Instructions] Your first question comes from Vincent DeAugustino with KBW.

**<Q - Vincent M. DeAugustino>**: Good morning, everyone.

**<A - Marita Zuraitis>**: Good morning.

**<A - Dwayne D. Hallman>**: Hi, Vincent.

**<Q - Vincent M. DeAugustino>**: Just to start with, Marita, one of the comments that you had made – it was actually two comments. First, on the segmentation improvement point and then the second on the enhanced marketing efforts, particularly around direct mail and DonorsChoose. So I guess the way I was, I guess, thinking about it before the quarter is that there is somewhat of a link between the two, where you might be deploying some of those enhanced marketing efforts first, specifically where your competitive positioning has improved on that segmentation enhancement. So I just wanted to touch base with you and Steve on that and just see how you are working through that.

**<A - Marita Zuraitis>**: I love when you answer your own question in your question. That's exactly right. I mean, from the beginning this really has been a combination of offense and defense in places where we're already rate adequate and we've had some decent results, pushing sales in these places, driving better segmentation, driving cross-sell initiatives.

And then as you said, taking the whole strategy. I hate to be a broken record, but it is about making sure we have the product, making sure we have the appropriate segmentation. But then it's also about distribution, giving them the training and the tools. And it's also about the infrastructure improvements. And obviously, it makes a lot of sense to start with the offense and push those things in places where you are rate adequate and you are comfortable with the results that you're seeing.

So you're right the cross-sell initiatives, what we are doing in the call center, where we are putting our DonorsChoose dollars, would obviously be first in those places where we are the most confident. And then on the defense side, continuing to push rate and underwriting actions to continue to drive that profit improvement that you're seeing come through the numbers.

**<Q - Vincent M. DeAugustino>**: Okay. Then, just on the – I think so far where the hail impact from second quarter has been discussed was more on the property side. So if we go back last quarter, I think one of the comments that you guys had made was around, for example, usually being able to use some paintless dent repair tactics on hail damage, and that not being an option last quarter with how severe that hail damage was. So I just wanted to clarify if there was any impact to the core auto loss ratio from some of that hail development as well, and maybe if it just wasn't big enough to call out in the press release or comment.

**<A - Marita Zuraitis>**: Yeah, no we are not seeing that. I mean obviously, we would continue to use the things available to us from a hail perspective. But as you see and as I know you're hearing from the industry, this is pretty widespread. It is an overall increase in severe call it non-cat, at least from a PCI perspective, events. And it's pretty wide spread.

**<Q - Vincent M. DeAugustino>**: Okay. So the development in 3Q on 2Q was all property, but there wasn't anything we should be considering on auto as well?

**<A - Marita Zuraitis>**: That's correct.

**<Q - Vincent M. DeAugustino>**: Okay, great. Then I guess one last quick one for me. On the higher home value, kind of effort to – I think it is Chubb that you are using on that. But as you guys, kind of look at your annuity and life book, I would imagine you would be able to look at that population of clients and see where maybe some teachers are maybe contributing a little bit heavier to the annuity compared to some of their peers, or would maybe be buying up higher coverages on the life side. And so, are you finding opportunities to look at those customers, and do some of the direct mail or send agents out specifically to target some of the higher value home sales? I am just kind of curious if you're able to do that type of mining at this point.

**<A - Marita Zuraitis>**: Yeah. I am glad you asked the question, and I will let Matt comment if he has anything additional to add. But for us, you hit the nail on the head, its all about the household. So our third party vended solutions that you saw in the second quarter with classic car and small commercial, now in the third quarter with enhanced property offering as well as property outside of our appetite, using third party vendors for that.

It is all about giving our agents an opportunity to say yes at the point of sale. And the higher valued home piece, we've already seen. We had one example in the quarter by using that higher valued home capability, we were able to land a multicar auto policy and certainly go in and cross-sell for the life and annuity premium. And you're right that those homeowners would have more available assets and probably the need for greater life protection. But I don't know if you have anything to add to that?

**<A - Matthew P. Sharpe>**: No, I'd simply say that we continue – Vincent, it's Matt, sorry. We continue to refine our cross-sell approach and that includes additional data mining around the household and the demographics, as well as other characteristics of the individual households to allow us to better target those customers with targeted solutions that we can provide to them. And helping our agents mine their books so that they can better identify who they are and how to approach him.

In addition to that we continue to align the way the products interact with each other from a compensation, recognition, and transactional basis between Property & Casualty and the ALG group and we're launching additional refinements all the time that help our agents integrate that conversation and have a multiproduct conversation within the household.

**<Q - Vincent M. DeAugustino>**: Okay, great. And sorry, just one last quick one and I'll let somebody else join in. So from the advertising investment should we think about that having any impact on the P&C expense ratio, or feeding into maybe the comment that Dwayne had made as far as annuity expenses being a little bit higher?

**<A - Marita Zuraitis>**: Well, first from the P&C standpoint, what's really interesting, as you can imagine with online advertising, it tends not be expensive, so the outreach allows us to get to a customer base in a very targeted way without spending a lot of money on national advertising. So the answer to that question is no.

**<A - Dwayne D. Hallman>**: Vince, in regards to annuity just as we continue to make investments in our [ph] monitor-ization (24:20) that we've talked about for quite sometime, some of that timing begins to pick-up in the fourth quarter. So it'll just be slightly higher.

**<Q - Vincent M. DeAugustino>**: Okay, great. Thanks, everyone.

**<A - Marita Zuraitis>**: You're welcome. Thank you.

## Operator

The next question comes from Bijan Moazami with Guggenheim.

**<Q - Bijan Moazami>**: Good morning everyone. I'm trying to figure out the spread that you guys are going to be generating out of your auto insurance. In particular Dwayne mentioned that BI severity is coming down. If you could provide a little bit of the numbers in terms of how much really in percentage the frequency and severity is varying, and how much price improvement you are achieving? Trying to get a sense of where these margins are going?

**<A - Dwayne D. Hallman>**: Bijan, this is Dwayne. As far as the detail of the individual numbers of frequency and severity, historically we've not publicly disclosed our individual severity and frequency numbers. Just as we described on the severity side, we are seeing some moderation in our book. But as far as how that relates to pricing, the price increases we have taken over the last year have stayed ahead of just in general loss-cost. But nothing for us unusual is happening between the frequency and severity components that at this point would launch Steve into a different view of price taking. Steve, if you want to follow-up with that at all?

**<A - Stephen P. Cardinal>**: Yeah, I mean we took mid-single-digits this year which was ahead of our loss-cost. Last year, same thing as we look at. And we still have opportunities in areas where we have reasons to push a little bit of rate. And we have other areas where we're looking improve our offense, and we've seen some of that move through this year.

**<Q - Bijan Moazami>**: And from a competitive perspective and I understand you guys sell through exclusive agency distribution in a narrow market. Is your mid-single-digit rates making you more competitive or less competitive? I assume probably less competitive, because you have a little bit more sales?

**<A - Stephen P. Cardinal>**: I think when we look at our marketplace, you hit on it exactly. We have a – we focus on a narrow niche with the career agent distribution. So I'm not facing a comparative rater. But not only that we've been refined with our pricing and segmentation to take the rates where we need it on segments of the book that would place it. We've seen our conversion ratio stay relatively flat and our quote volume really pick up. So a lot of our increase in sales, while we've been able to manage through the rates, is we're very comfortable with where that is right now.

**<A - Marita Zuraitis>**: And the increased segmentation is giving us the opportunity to have a broader amount of cohorts in the business. We are taking a scalpel approach if you will to this, allows us to be specifically competitive where we want to be competitive. So there's no doubt that the increased sophistication and segmentation helps us to be competitive where we choose to be competitive.

**<Q - Bijan Moazami>**: On the home owners business that's been having more and more difficulties. And I guess just like everyone else, try and figure out what is this not-cat weather or the impact of it. Do you guys attempt to quantify that a little bit? Is there any kind of increase in that trend going forward? Should be we assuming some of that event in fourth quarter or the first quarter of the year?

**<A - Marita Zuraitis>**: Yeah, I mean the good news if you will about property is you see the losses, you build it into your pricing, and eventually you've got a higher rate level that contemplates this higher level of activity. But of course we keep track of where it is, how severe it is, the cause of the losses in the geographies. Is it hail? Is it water? Is it wind? And then you address your rate and your underwriting, quite frankly based on where you are seeing those increased trends.

**<A - Stephen P. Cardinal>**: And when we look at our book from last year, we took high single digit, this year mid-single digit. Those rates continue to come in. As we look at the activity from this year, we will build that into our pricing moving forward.

**<A - Dwayne D. Hallman>**: Bijan, this is Dwayne and just as a reminder, in my opening comments, indicated that we are expecting some of this non-cat weather to continue in the fourth quarter. And that would result in a loss/LAE ratio a couple of points above the prior year.

**<Q - Bijan Moazami>**: Okay. Perfect. And the last question relates to the annuity business. Of course, the net interest margin is expanding. Could you comment on what is the net interest spread that you're running on the new products that you are selling?

**<A - Stephen P. Cardinal>**: We price for around 2.25% to 2.40%. That's the spread that we look for on new business, Bijan.

**<A - Dwayne D. Hallman>**: And, Bijan, that's one reason why we've been able to maintain our spreads. It is not only the positioning of our investment portfolio, managing the spreads on a proactive basis, but also the layering on of new business in this environment for the last few years at our targeted or above targeted spreads has really helped us maintain that spread target.

**<Q - Bijan Moazami>**: Perfect. Thank you.

## Operator

Your next question comes from Sean Dargan with Macquarie.

**<Q - Sean Dargan>**: Thank you. Just following up on annuities, it is the largest contributor to earnings. And as we look across street consensus for interest rates next year, I think 10-year yield forecasts are coming down. You've been able to maintain spreads in part, I think, due to some discipline around crediting rates. I am just wondering if you can tell us how much further you can cut crediting rates, or if you can give us a sense of what percentage of your in-force is at the statutory minimum?

**<A - Dwayne D. Hallman>**: Sean, this is Dwayne, I'll take a first part of it and then let Matt come in and chime in on the crediting rate. You are right, as far as maintaining our spread activity it's been proactively managing the crediting rates, but also positioning our portfolio, in our view, that the rates were going to stay low for some period of time. I think this is a good example of – we would love to be able to manage a company on a quarter-by-quarter basis, but in reality that's not how it works.

So we positioned ourselves back in 2009 and 2010 for basically this long period of low interest rates that occur, and that's helped quite a bit. And as we layer on the new business, as I mentioned a minute ago, at or above targeted spreads has really helped us. But as far as the crediting rates in a minimum level I'll turn it over to Matt.

**<A - Matthew P. Sharpe>**: Good morning, Sean. 86% of our book is already at the floors, so we have a little bit of room left to go in terms of adjusting crediting rates down. But just to reinforce to Dwayne's point that I think he has made very eloquently, our ability to layer on new business because of the captive distribution force I think gives us advantage in terms of our ability to sell through a low interest rate environment, as we have demonstrated in every quarter over the last two or three years.

**<A - Marita Zuraitis>**: Yeah. The only thing I would add to that is I think this quarter is another good example where our mix as a company is beneficial to us, being unique and having a nice balance between P&C and ALG. It also gives us a nice mix from an earnings potential as well.

**<Q - Sean Dargan>**: All right, thanks. You had some unfavorable DAC unlock in the annuity results. Is that something you revisit quarterly in the first two quarterly results?

**<A - Dwayne D. Hallman>**: Yes, the unlocking is purely related to market performance. So during the current quarter as the market basically gave everything back, it triggers a DAC unlocking. So compared to last year when the market performance was quite strong, there was actually favorable DAC unlocking. So it's full blown calculations we go through monthly. Obviously, you see it on a quarterly basis.

**<Q - Sean Dargan>**: Thanks. And can you give us any kind of sensitivity as to certain movement in S&P 500, what would that mean to the unlock?

**<A - Matthew P. Sharpe>**: Sure. In the DAC model, we expect about 3% return a quarter. So 1% deviation from that expectation would result in a $200,000 and $300,000 pre-tax DAC impact. S&P is not an exact proxy because it's the Horace Mann group of funds. But that will give you a rule of thumb, anyway.

**<Q - Sean Dargan>**: Okay, thank you. And just one last question about mortality and life. You said that third quarter was within the expected range. But if I just look at the benefit ratios over the several years, they've seem to have gotten more unfavorable is – were you just running better than expected mortality for a period, and now you expect mortality to be in the expected range? Or I am just trying to see what's changed.

**<A - Matthew P. Sharpe>**: I think you have it correct, Sean. The mortality for a couple of years there was running favorable, and it seems to have trended back towards more where we would expect it to be. When the actuaries actually plot the benefit out, these – the current range that we are seeing is right on or right near the regression line. So it's in line with our expectation.

**<Q - Sean Dargan>**: Thank you very much.

## Operator

Your next question comes from Bob Glasspiegel with Janney Capital.

**<Q - Bob R. Glasspiegel>**: Good morning, Springfield. I heard Sean's superb question on low rates and couldn't quite process your answer, so let me come at it a second time. I mean, with rates down 75 bps, and you sort of moderated your investment income speech to reflect the clear impact that it's going to have, but I really couldn't follow what you were saying. This was impacting your either pricing or accounting decisions, with the Fed saying inflation is going to stay low, it looks like low rates here to stay. So are you factoring in a 2.25% 10-year plus spreads into your pricing decision today real-time and accounting decisions today?

**<A - Dwayne D. Hallman>**: Bob, this is Dwayne, thanks for joining the call. Yeah, we run a process here, what I refer to as our proxy. And we use it both on the investment side and our crediting rate side. So the way I describe it is no one can get off the ranch as far as doing something out of whack that would impact the crediting rate or the investment portfolio.

And we are actually looking weekly as to what's available to us in the market place as far as our portfolio structure, determining what that reinvestment rate is, and then using that proxy to set our crediting rates on new business on the annuities side, as well as adjusting prior crediting rates if we can. So as I mentioned before, it's a very proactive process, taking into account exactly what is occurring in the market place.

As far as the portfolio is concerned, as I mentioned, we positioned it for a low interest rate environment. We have not, at this point started decreasing duration of any magnitude, thinking rates are going to pop up in the next 6 months to 9 months. But I think over a longer period of time, you'll start to see the duration decline somewhat and the introduction of some floating-rate securities, additional floating-rate securities in our portfolio, to protect us somewhat. But as far as the new business, as Matt mentioned earlier, with our captive agent force, we're right in the sweet spot as far as competitors are concerned, and we're looking at current market data to set our crediting rates.

**<Q - Bob R. Glasspiegel>**: So at a 2.25% 10-year you can still earn your targeted ROE on new business you're pricing today.

**<A - Dwayne D. Hallman>**: We still can today. Obviously, if rates continue to decline even further than the crediting rates would, obviously probably get down to a 1% level, and in the current environment products aren't allowed to go below 1%.

**<Q - Bob R. Glasspiegel>**: So you would just step – let's say the 10-year went to 1.50% and stayed there, you'd probably just exit fixed annuities and new business, or you offer someone else's products, or -?

**<A - Matthew P. Sharpe>**: Bob, it's Matt. How you're doing this morning?

**<Q - Bob R. Glasspiegel>**: Great.

**<A - Matthew P. Sharpe>**: I don't know if anyone would be selling annuities in a 1.5% 10-year rate environment. But if they were, they would certainly be restructured to reflect that rate environment, which is exactly what we would do. We would have to restructure our product to account for that ultra-low rate environment for an extended period of time. We still have other levers, including the way the products are designed, the way commissions are paid, the way the bonuses operate – all the other pieces and parts that we could call on in the events that happen.

**<Q - Bob R. Glasspiegel>**: Okay. Two other quickies. Was there – the premiums decelerated 1%, Marita's speech sort of sounded like productivity is improving; PIF is leveling off. Was there something funny in the numbers that caused the deceleration? Tough compare, whatever. Or -?

**<A - Stephen P. Cardinal>**: Hey, Bob. This is Steve Cardinal; I appreciate the question. I think you look at kind of two-part, two stories within the book. Our auto insurance premium, we see the sales moving up, we see that PIF moving up in a positive direction, we like what's happening with that side.

When you are talking the total P&C, we look at the property premium and we have an impact within those numbers that includes some coastal management issues in Florida and other – and another place, Massachusetts; and those contribute significantly to some headwinds for the from property premium. When we look across the 46 states, we like the premium growth ex- those states. We're confident and comfortable with the premium growth we're seeing outside of that coastal management areas.

**<A - Dwayne D. Hallman>**: Hey, Bob, if I could just add a little bit more color to the Florida. As we've mentioned before, we are under our new program to basically eliminate all of our property business in Florida outside of some renters' policies and maybe some select homeowners' policies. And by the end of first quarter, middle of the second quarter of next year we will be completely out.

It's actually running ahead of our schedule, as our agents have done a great job transitioning that business to companies that they can write with. And as you know, some of those companies, their doors open and close from time to time when they accept business. The agents have been very good in getting that business moved earlier than we expected.

**<Q - Bob R. Glasspiegel>**: I thought after sinkholes you were out, but I guess there was a tag position left.

**<A - Dwayne D. Hallman>**: Yes, Bob, you're correct. In what we would refer to as Sinkhole Alley, we are completely out. But this is the remaining homeowners business throughout the rest of the state of Florida.

**<Q - Bob R. Glasspiegel>**: Got you.

**<A - Stephen P. Cardinal>**: And, Bob, we...

**<Q - Bob R. Glasspiegel>**: Go ahead.

**<A - Stephen P. Cardinal>**: ...we see the premium as our auto has picked up and outside of Florida, as those actions come to a close in middle of next year, property is an important part of value proposition for educators, and we see that business, we'll be looking to improve that and increase that premium moving forward.

**<Q - Bob R. Glasspiegel>**: And one last question, your homeowners bump-up in sort of non-cat weather that you said is going to plague Q4 a little bit. I mean are you pricing for – have you put any pricing increases in for non-cat weather bumps? Or is this just sort of unlucky trend continuing into Q4 that you're not needing to price for?

**<A - Stephen P. Cardinal>**: Yes. I'll kind of go through it, Bob, thanks for that again. We do take rates – we took rates – been very aggressive on the defense last year. We had high single-digits, this year mid single-digits. As we look at these weather trends we anticipate that they will continue. They will be baked into our pricing decisions moving forward.

**<A - Marita Zuraitis>**: And if we need more, we'll take more.

**<Q - Bob R. Glasspiegel>**: Thank you everyone.

**<A - Dwayne D. Hallman>**: Thanks, Bob.

## Operator

[Operator Instructions]. Your next question comes from Colin Devine with Jefferies.

**<Q - Colin W. Devine>**: Good morning. I had a couple quick clarification questions on the annuity business and then one more strategic. On fixed annuities of the block, the $3.8 billion, what level – what portion of that would be in indexed? Is the first one.

Second, you mentioned 86% of the block I believe is at its minimum crediting rate level right now. On average perhaps what is that? And then also how much of the block is outside its surrender charge period? So if rates ever do rise, it might be vulnerable to lapses.

And then turning more to the strategic questions, are you thinking about an indexed UL product to complement the annuity one you have, since that seems to be the hot dot in life these days? And then also perhaps, Marita, if you could discuss a little bit where you're going with your sort of retirement strategy for educators in terms of what products you're thinking about? Thanks.

**<A - Matthew P. Sharpe>**: Good morning, it's Matt. How are you doing this morning?

**<Q - Colin W. Devine>**: Great.

**<A - Matthew P. Sharpe>**: Let me start with the indexed annuity sales components. We just introduced the fixed indexed annuity in the middle to the end of the first quarter, so it's a relatively small percentage of our total fixed block. It represented just over 38% of our total sales in the third quarter and about 36% of our year-to-date sales overall. So it's a relatively small percentage of the book, which represents about – around $90 million.

**<Q - Colin W. Devine>**: Okay.

**<A - Matthew P. Sharpe>**: We did mention earlier that 86% of the block is currently at the floor. And Dwayne has the...

**<Q - Colin W. Devine>**: Yes, is there an average level on that roughly?

**<A - Dwayne D. Hallman>**: Yeah there's a couple places to help you out on that. Obviously we hadn't filed this Q yet, but the June 30 Q is available. If you pull that in the – about three quarters of the way through the Q there is a table that breaks out the minimum guaranteed levels. So the way we look at it is we have a good-sized block of business that's over a 4% crediting rates. So that is roughly 58%. And if you think about between the 3% and 4% band, it's roughly

16%.

But as we've talked about layering on new business and the advantages it has had for us is roughly 26% of our business is less than 3%, and a majority of that's below 2% minimum guaranteed crediting rates.

And then also I believe it has been posted or will be posted this morning, our investor presentation. There's a chart included in there that breaks out balances between – above 4% and below 4%. And you can see how that has trended from a period of 2008 to current. And then I believe there's an overlay on that chart as far as our portfolio and the spread component.

**<A - Matthew P. Sharpe>**: On the surrender charge question, Colin, it's roughly 50% of the book is still within the surrender charge period, and about 50% of it is outside of the surrender charge period, with the bulk of it being in the 4.5% or so.

Let me make a couple comments to give you a little extra color around – out of the surrender charge period. Since the bulk of our book is – or 56% of our book is above 4% embedded guarantee, those tend to be the contracts that are outside of the surrender charge period.

So for a customer to actually want to move that contract, rates are going to have to move a fair bit in order for them to actually be enticed away from it. We also have a large percentage of our customers that have relatively small account balances. So the likelihood that we have competitors targeting us for exchange activity is also reduced. And then the career distribution system also favors us in terms of persistency. And you can see that in our persistency measures over the years.

**<Q - Colin W. Devine>**: Yeah, I was actually going to ask that. So just to maybe frame that, to compare what you are paying on a new fixed annuity as a crediting rate today – it gives us the reference versus the floor. That you are really not that vulnerable.

**<A - Matthew P. Sharpe>**: Yes, current crediting rates are around 1.4%.

**<Q - Colin W. Devine>**: It maybe a while before we see rates rise enough to – yeah -

**<A - Marita Zuraitis>**: Yeah. I also think it's important to note in this whole discussion the conservative nature of our client base and what their focus is.

**<Q - Colin W. Devine>**: Then if we could move to the indexed UL, is that something that is on the drawing board, I guess? And then more, what are you really doing sort of for educators within developing really your postretirement strategy? As you said, keep the assets – grow them and keep them.

**<A - Matthew P. Sharpe>**: So that both are great questions. Let me comment on the IUL question first. We are currently pricing a universal IUL product that we hope to have released sometime in the year 2015. We are squeezing it in along with the new systems implementation, so there is a little – there is a little movement in terms of where it will ultimately end, whether it is this year or early next – I mean, sorry, early late 2015 or early 2016, but that is the plan, to launch an indexed universal life product.

On the post-retirement section, today we have a number of embedded features in the contract around annuitization, the ability to take systematic withdrawals. That seems to be the method of choice for our customers, although, that is where we will be turning our attention in terms of product and service development going forward, once I get through the index universal life build.

**<A - Marita Zuraitis>**: Yeah, and we've talked about all of this before when we've talked about the life cycle of an educator and the fact that we are uniquely qualified, with the data and intelligence we have about this segment, to really think about and digest that life cycle from the time someone is studying to be an educator all the way through retirement. And we've spent a lot of time on both ends of that life cycle.

First with the newer educators, how we create product distribution and infrastructure around a newer educator, and then certainly later on in the life cycle, holding on to those assets all the way through the life cycle. So you have and will continue to hear a fair amount about both ends of that spectrum on the life cycle of an educator.

<**Q - Colin W. Devine**>: How would you, just as a final question – if we took perhaps slide 5 from the presentation that splits out the K-12 market, how does that compare to your client base in terms of what percentage is retired, active?

<**A - Marita Zuraitis**>: I mean right now -

<**Q - Colin W. Devine**>: The higher education obviously isn't relevant, but -

<**A - Marita Zuraitis**>: Yeah, I mean right now, the majority of our book is sitting in that K-12 public sector, because that clearly is our focus. It's in the 80%s. How many of our customers? 80%-ish sitting in that K-12 public sector bucket. And then we also spread out our clients across that life cycle. And what you see – and some of it is demographics, and we've talked about this before – folks with assets to protect and investment to be made sit in that middle bucket. And for us it is about spending a little more time finding them earlier and keeping them longer, like we have said before.

<**Q - Colin W. Devine**>: Well, that is where was getting. Of that 80% you just mentioned, how many of them would be active and how many would be retired?

<**A - Marita Zuraitis**>: I mean again, I don't specifically have the number right in front of me.

<**Q - Colin W. Devine**>: Okay.

<**A - Marita Zuraitis**>: I do know that we see about 11% penetration across the spectrum of educators. Obviously some states much higher than that, some states much lower than that. And what's really interesting about the demographics and why we like this slide is we also don't kick educators out of the club. So we have a home, we have an auto, we have a set of assets over the life cycle. If there is a second career or someone retires earlier, we keep those assets as well. And the good news is, we then can also attract that educator that replaces someone who leaves for a second career or retires earlier as well.

<**Q - Colin W. Devine**>: Okay. Thank you.

## Operator

Your next question comes from Vincent DeAugustino with KBW.

<**Q - Vincent M. DeAugustino**>: Good morning again. I was a little surprised to not have gotten an agent question or agent count question yet, so I guess I will step up for that. But nice to see the sequential and year-over-year increase on the exclusive agency side. So what I'm kind of curious about is, if we think about that agent count being kind of broken down between somewhat tenured agencies and newer ones, and then how much production you would expect from a tenured agency, what are you guys thinking about from kind of a waterfall, if you will impact as some of those newer agencies mature in terms of ramping up their premium production? And not just premium on P&C but across the whole organization.

<**A - Marita Zuraitis**>: Again I love that implied answer in the question, Vincent. I am not going to answer the question unless it comes from Bob. I am just teasing you there, Bob. Like we've said before, the agent count number is not the sole measure here and certainly not fixated on that. We were down in the first half, we will continue to be up in the second half, and again that count should level out and be relatively flat year-over-year.

What we have been fixated on is the training of the agents, the productivity of these agents. It is back to the PDI, building products that the agents can sale, good products, good segmentation. They have proven that when we do that they can increase their sales momentum from a distribution standpoint, giving them the tools and the support they need to do that. And then from an infrastructure standpoint improving the customer experience. When we do all those things, these agents tend to be successful.

The second thing that's interesting is we're attracting new agents with that new productivity and clarity in mind of what good looks like and what will be successful out there. And then attracting on new agents to that – that set of criteria that we know is going to lead to better productivity. So we feel good about the agents that we have out there.

Many of our existing agents, to your question, have really grabbed on to this increased offense and enthusiasm and excitement, and all the tools they need to say, yes, at the point-of-sale and have a total product offering. And we've also been able to attract new agents to the value proposition as well, coming from some pretty unique places. So we are excited about where our agents are and how they are prepared to take this new offense and sell it.

**<Q - Vincent M. DeAugustino>**: Okay, great. Thanks for taking the follow-up and best of luck. Thank you.

**<A - Marita Zuraitis>**: Thank you.

## Operator

At this time, there are no further questions. I would now turn the call back over to the presenters for closing remarks.

## Ryan E. Greenier

Thanks, Arnica. Thank you, everyone, for the interest in joining us this morning on Horace Mann's third quarter earnings call. If there is any further questions, don't hesitate to reach out to me. Thanks.

## Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.