Assurant Third 3Q 2004
Conference Call Transcript
November 4, 2004
10:00 a.m. EST

OPERATOR: Good morning and welcome to the Assurant third quarter 2004 financial results conference call. At this time all participants have been placed on a listen-only mode and the floor will be opened for questions following the presentation.

I would now like to turn the call over to Mr. Larry Cains, Senior Vice President of Investor Relations.

Please go ahead, Mr. Cains.

LARRY CAINS, SENIOR VICE PRESIDENT OF INVESTOR RELATIONS, ASSURANT: Thank you, operator.

Welcome to Assurant's 2004 third quarter earnings conference call. Joining me are Kerry Clayton, our President and Chief Executive Officer; and Rob Pollock, our Chief Financial Officer. Today's prepared remarks will last approximately twenty minutes, after which time we will open up the call to questions. Before we get underway, I'd like to make the following remarks. This morning we issued a press release announcing our third quarter 2004 financial results. The press release as well as corresponding supplementary financial information may be found at our web site at www.assurant.com. Now a word about forward-looking statements. Some of the statements we may make during this call main contain forward-looking information. Our actual results may differ materially from such statements. We advise you to read the discussion of risks and uncertainties associated with our business and results of operations contained in our SEC filings which can be accessed from our Web site. Additionally, this presentation will contain non-GAAP financial measures which we believe are meaningful in evaluating the company's performance. For more detailed disclosures on these non-GAAP measures, the most comparable GAAP measures and a reconciliation of the two, please refer to the supplementary financial information posted on our Web site. Finally, all percentages in our press release and those that we will discuss on this call are calculated based on the actual numbers before rounding.

Now, I'd like to turn the call over to Kerry.

KERRY CLAYTON, PRESIDENT AND CEO, ASSURANT: Thank you, Larry. Good morning everyone, and thank you for joining us today.

During the third quarter, the people of the southeastern coastal states, and particularly Floridians, experienced the worst hurricane season in memory. I'm proud to say that Assurant was there to provide them peace of mind and to help more than 20,000 homeowners rebuild their lives.

Clearly, our third quarter results were impacted by the unprecedented level of hurricane activity, but excluding their impact, Assurant had a very good third quarter demonstrating the strength of our diversified specialty insurance strategy. Net operating income for the quarter of $73.2 million was down 23% compared to the same quarter of last year, due to the just mentioned storm activity. Catastrophe losses after reinsurance recoveries and after taxes were $49 million in the quarter compared to $6.5 million in the third quarter of last year. Despite the hurricanes, on a year-to-date basis, we continued to grow with net operating income of $258 million, up 2% for the nine months.

Top-line growth, as measured by net earned premiums, increased 3% to $1.6 billion for the quarter, and up 8% for the nine months to $4.9 billion. The premium growth was led by Assurant Health, our market-leading individual and small group medical insurer.

As we've stated in the past, we are focused on achieving superior returns that represent the top quartile of the insurance industry. For the nine months our annualized pro forma return on average equity was 11%, down slightly from the six month ratio.

I'll now briefly review the performance of our key operating segments.

Assurant Solutions, our specialty property and consumer protection insurer took the full weight of the quarter's catastrophe losses. But, as a result of our reinsurance arrangements, Assurant Solutions was still able to earn a net operating income of $3 million for the quarter. Excluding the catastrophes, loss ratios were excellent in our specialty property businesses.

We continue to see good premium growth in our creditor-placed homeowners insurance and in our international businesses.

Exhibiting the strength of our diversified strategy, Assurant Health experienced an especially good quarter, partially offsetting the catastrophe losses which affected Assurant Solutions. Earnings growth at Assurant Health was primarily driven by premium growth in our individual medical business and continued improvement in the overall combined ratio. Assurant Health's combined ratio for the quarter was a spectacular 90.1%, improved from an already excellent 93.2% for the same quarter of last year.

Health Savings Accounts, or HSAs, in which we have a first mover advantage, continued to be a strong contributor to individual medical sales in the third quarter, representing 40% of new sales, up from one-third of sales in the second quarter. Despite increased competition and new entrants into the HSA market, we continue to benefit from our leadership position and we're seeing increasing interest and increasing applications.

In Assurant Employee Benefits, we saw a decrease in profit in the third quarter of 2004 when compared to the third quarter of 2003, due to an $11.5 million after-tax net reserve reduction which occurred in the third quarter of 2003. Excluding this reserve change, net operating income for the third quarter increased 42%. For the nine months, the increase would be 14%. The improved underlying results are due to better loss experience in the disability and group life lines.

Assurant Employee Benefits had modest premium growth for the quarter and year-to-date, the result of strong growth in disability offset by slight declines in dental and group life. Several other companies have now increased their disability rates, making us more competitive since we took our rating actions earlier than most of our competitors. Additionally, voluntary sales are encouraging and continue to grow, especially in dental.

In Assurant Preneed, net operating income in the third quarter is essentially unchanged from the same period of 2003. Our actions to reduce crediting rates, where we have the ability to do so, are starting to benefit income, but the continued low level of new money rates has had an offsetting impact. As we've said before, any rise in interest rates will substantially benefit the profitability of this business.

Net earned premiums increased slightly for the quarter and for the nine months. We continue to command the leading position in the pre-need insurance market.

Now let me discuss some factors that may impact our performance for the balance of the year.

Interest rates have remained at record low levels. Additionally, the economic outlook continues to be mixed with consumer confidence levels down and consumer spending and employment figures showing only a slight positive trend. Over the long term, we believe interest rates will trend higher and the economy will show further improvement and these developments will benefit our business.

At Assurant Solutions we often have a multi-year cycle to secure new clients. We continue to gain new clients both domestically and internationally and focus on building a good prospect pipeline for future growth. In the manufactured housing business, some of our large distribution partners are anticipating an increase in sales due to the loss of older homes from the hurricanes.

Assurant Health's growth in 2004 continues to be driven by sales of individual medical coverage, increasingly with HSAs. Small group sales continue to be soft due to two factors: higher medical premiums resulting from continued high medical inflation; and increased competition including aggressive pricing by some competitors. As we've mentioned for the past several quarters, we're experiencing heightened competition in both the individual medical and small group markets and we experienced a slight decline in our number of members during the quarter.

In Assurant Employee Benefits, we're focusing on expense control and underwriting discipline in this highly competitive environment. This business is poised to benefit from new job creation, as well as hiring increases by our small business customers. We continue to maintain our emphasis on voluntary products, as well as strong expense control.

In this low interest rate environment, Assurant Preneed is focusing on diligent expense management. We continue to look at new marketing approaches also.

Now, let me provide a summary of some key corporate developments.

As we announced two weeks ago, our Board of Directors has elected a new independent director, Michelle Coleman Mayes, bringing our Board to ten directors, six of whom are independent. Michele is Senior Vice President and General Counsel of Pitney Bowes and serves on our Board's Nominating and Corporate Governance Committee and Compensation Committee. We are continuing to interview for the two remaining open board positions.

In addition, the Board declared a quarterly cash dividend of $0.07 per common share, payable in December.

Continuing our strategy to optimize deployment of our capital, we used available cash to repurchase 1,355,000 shares during the third quarter, and in October, we repurchased an additional 954,000 shares, all at an average price, including commissions, of $26. This represents about one-sixth of the shares our Board has authorized us to repurchase.

With respect to capital management, the tax legislation signed two weeks ago may provide us an opportunity to more economically remove excess capital from some of our foreign entities and from certain life insurance subsidiaries. We're currently examining the new tax rules to understand any potential benefits they may provide.

Before turning it over to Rob, I think it's important to comment on New York Attorney General Eliot Spitzer's investigations. The bid rigging targeted by Mr. Spitzer is clearly wrong and the practices described do not reflect the values or activities of Assurant. As a leading insurer, we take the recent allegations in our industry seriously. We believe it is critically important to evaluate all of our business practices on an ongoing basis to ensure that we continue to operate in an ethical and legally compliant manner and in the best interest of our customers, shareholders and employees. We also expect producers that we work with to operate ethically and we will not do business with a producer that we believe is acting otherwise.

Our general counsel is conducting a thorough internal review of our producer compensation arrangements. We will continue to monitor external developments as well and we will address any needed changes in our practices or any changes required by regulations or any changes in the law.

Now I'll turn it over to Rob to review our results in more detail.

ROBERT POLLOCK, CHIEF FINANCIAL OFFICER, ASSURANT: Thanks, Kerry.

As Kerry mentioned, despite the impact of the hurricane activity during the quarter we are pleased with our results. In the third quarter net operating income, which we define as net income excluding investment gains or losses and other unusual items, decreased 23.2% to $73.2 million from $95.3 million in 2003. Pro forma net operating income per share was $0.52 in the third quarter, down from $0.67 last year. The hurricane losses of $49 million after reinsurance and tax reduced third quarter 2004 earnings per share by $0.35, compared to catastrophe losses of about $0.05 per share in the third quarter of 2003.

Looking at net earned premiums for the quarter, they grew to $1.6 billion from $1.5 billion in 2003. Net investment income increased 6.2% to $160 million from $150.7 million. The annualized yield from our portfolio was down to 5.56% from 5.70% in the third quarter of 2003, but invested assets were up.

Now let's turn to the business segments starting with Assurant Solutions. Net operating income in the third quarter of 2004 was $3 million. Claims from the four hurricanes are expected to total $100.8 million pretax. Reinsurance recoveries will be $25.3 million reducing our next exposure to $75.5 million pretax or about $49 million after tax. A significant portion of the recoveries will be from the Florida Hurricane Catastrophe Fund.

Excluding the hurricanes, results were quite good, driven by good experience in our special property businesses.

Net earned premiums in the third quarter of 2004 decreased almost 2% to about $603 million from $613 million in the third quarter of 2003. On a nine month basis, net earned premiums increased almost 6% to $1.8 billion from $1.7 billion in 2003.

In the extended service business, we are seeing steady growth. However, due to the assumption of new clients in 2003 and the timing of earned premium from these clients, third quarter 2004 net earned premium is down compared to the third quarter of 2003. We have seen an increase in year-to-date earned premiums. Also, fee income from the extended service contract business is growing nicely. Finally, although our international operations currently represent only 11% of our total, we are seeing growth in our credit insurance and extended service contract businesses overseas.

At Assurant Health, we continue to see very strong results. Net operating income in the third quarter of 2004 grew over 56% to $47.9 million compared to $30.6 million in 2003. The improvement is driven by increasing individual medical business and favorable claims experience.

Net earned premiums increased 11.1% in the quarter and 13.4% for the nine months. Individual medical insurance continues to be the growth driver of this business as net earned premium increased and strong Health Savings Account sales continued. Small group sales and membership continue to drop due to increased competition from large case players and actions on our part to focus on profits. We are pleased to see that the individual medical business continues to grow as a percentage of Assurant Health's revenue, now representing 55% through nine months.

Overall membership increased 3.1% to 1.16 million from 1.12 million at the end of the third quarter of 2003. Individual membership at the end of the third quarter was 807,000 members, up from 755,000 in the third quarter of 2003. Small group membership has continued to drop with membership at 348,000, down from 365,000 in the third quarter of 2003. As we mentioned during our previous calls, competition has intensified in both the individual and small group markets. While we saw drops in small group members in prior quarters, we also experienced a small decrease in our individual membership from the second quarter.

Turning to Assurant Employee Benefits, our group dental, disability and life insurer, net operating income in the third quarter of 2004 decreased 32.2% to $15 million compared to $22.1 million in the third quarter of 2003. Last year's results included a benefit from a reserve reduction of $11.5 million. Excluding this item, net operating income was up significantly during the quarter and nine months. The improved results are primarily driven by better disability and life loss ratios offset by slightly worse dental experience.

As we have mentioned on prior calls, quarter-to-quarter comparisons may show variability given the low frequency and high severity nature of group life and long term disability claims.

Net earned premiums in the third quarter of 2004 grew slightly to $305.8 million compared to $297.3 million in 2003. We are pleased to report we are seeing a strong trend from employer-paid to employee-paid insurance. We have experienced new business sales growth of over 25% from voluntary or employee-paid programs on a year-to-date basis. Because of increasing medical costs, as employers cut back on non-medical benefit plans, we are well-positioned to offer voluntary plans to employees. Also, we have taken actions to reduce expenses to maintain expense levels commensurate with revenues.

In Assurant Preneed, net operating income was up just under 1% at $8.9 million. Interest rates have continued to stay low and the investment spread we earn remains at historically low levels.

In the third quarter of 2004, Assurant Preneed had net earned premium growth of 1.7% to $132 million versus the same period in 2003. The slowing in premium growth from the past few quarters results from the loss of business from several independent funeral homes that were not meeting our return targets.

Next, I'll briefly comment on our Corporate and Other segment. Corporate and Other reported a net operating loss of $1.2 million for the third quarter compared to income of $9.9 million in 2003. Corporate and Other includes public company costs, expenses related to Sarbanes-Oxley 404 compliance and investment income, which was lower than last year. Amortization of deferred gains from business sold through reinsurance declined consistent with the run off of policies associated with these businesses. Interest expense in the third quarter of 2004 declined by $9.2 million after tax compared to the third quarter of 2003, as a result of less debt and lower interest rates.

At the end of the third quarter, total assets were $23.6 billion and total invested assets in cash and equivalents were $12.1 billion. In the third quarter of 2004, we recorded no writedowns for other-than-temporary impairments, compared to $100,000 in after-tax writedowns in the third quarter of 2003.

Our total shareholder equity at September 30, 2004 was $3.6 billion, $3.2 billion excluding accumulated other comprehensive income. Annualized pro forma return on average equity, based on nine months net operating income and excluding accumulated other comprehensive income from equity, was 11.0%. Our pro forma book value per share at the end of the third quarter was $23.07, again excluding accumulated other comprehensive income.

Now I'd like to turn it back to Kerry to open the floor for questions.

KERRY CLAYTON: Thanks, Rob. Operator, we're ready for questions.

OPERATOR: Thank you, sir. The floor is now open for questions. If you do have a question please press star, followed by one, on your touch-tone telephone at this time. If at any point your question is answered you may remove yourself from the queue by pressing the pound key. Questions will be taken in the order that they are received and we do ask that while posing your question you please pick up your handset to ensure proper sound quality.

Once again, to ask a question at this time, please press star-one on your touch-tone telephone.

And our first question today is coming from Mr. Charlie Gates of Credit Suisse First Boston.

Sir, please go ahead with your question.

CHARLIE GATES, CREDIT SUISSE FIRST BOSTON: Good morning.

KERRY CLAYTON: Hi, Charlie.

CHARLIE GATES: Two questions initially. One, if one of you could elaborate on how the Assurant Solutions reinsurance program works—that's my first question. My second question, I'm looking at this page number seven in your stat supplement and I'm looking at the trend here in consumer protection solutions, I know Rob made a brief comment to that, but if you could elaborate on that trend, that is, how it's worked lower? What are the implications of that and how do you see that evolving?

ROBERT POLLOCK: Sure. Let's start first with the reinsurance program, Charlie. As you know, we spend a lot of time on our risk management activities and we think we're quite good at that. Our reinsurance program is really comprised of two different programs. In Florida, we have coverage from the Florida Hurricane Catastrophe Fund. That's a program that's operated by the State of Florida and it operates on a legal entity basis. Alright?

CHARLIE GATES: Yes.

ROBERT POLLOCK: And so that's one piece of the puzzle. The second piece is we have normal layered protection related to excess of loss treaties and we have both a specific and an aggregate program in effect this year. We put the aggregate program into place as a result of last year when we saw, as you know, a large number of small storms. Now the layered program basically provided coverage per storm in excess of $20 million. This year we exhausted the $20 to $25 million layer and decided to not reinstate that. However, we have full coverage above $25 million with full reinstatement. Okay? We had an aggregate program - I mentioned that as well - and we put that program in place to really cover losses in excess of the first $10 million in excess of $30 million and that helped dampen our losses this year as well.

CHARLIE GATES: The confusing part I got was between the $20 and the $25 million.

ROBERT POLLOCK: Right. Yes, and that really is an interaction of the Florida Cat Fund and, you know, these different storms. So if we looked at the storms individually- and I don't have the break out here, Charlie- each of them exceeded $20 million.

CHARLIE GATES: OK.

ROBERT POLLOCK: Some of them basically put us in the position of penetrating that layer. OK?

CHARLIE GATES: OK.

ROBERT POLLOCK: And we decided to use the reinsurance as a result.

CHARLIE GATES: OK.

ROBERT POLLOCK: If we move over and talk about consumer protections on page eight, I think the big thing that's driving results here is still our U.S. credit business, which we've mentioned previously is in run off.

CHARLIE GATES: So that's basically the shift from credit insurance to debt protection that basically is shown here?

ROBERT POLLOCK: Yes, that's right. And I think we're very close to the U.S. business being stabilized because of a number of client additions we've been able to bring on internationally. And we've talked previously about it takes some time - Kerry mentioned it - to bring a new client on and have it at full production.

CHARLIE GATES: Maybe I've got this confused, but one of you made reference, I think, in one call to the fact that consumer in the United States - I'm going to ruin the expression - topped out, meaning that I guess all other things being equal, is there anything as far as the influence of that on this whole trend?

ROBERT POLLOCK: I don't think so. I think there's another important thing to remember here, Charlie, which is that consumer protection includes the extended service contract business.

CHARLIE GATES: OK.

ROBERT POLLOCK: And sometimes in that business we earn premiums, other times we earn fee income, depending on how the arrangement is structured. So, it may not show up in that earned premium line but it shows up in our fee income line and, if you look at that, I think you'll see we're having nice growth.

CHARLIE GATES: Thank you.

KERRY CLAYTON: Thanks, Charlie.

OPERATOR: Thank you. Your next question is coming from David Lewis of SunTrust Robinson.

Please go ahead with your question.

DAVID LEWIS, SUNTRUST ROBINSON: Morning, and thank you.

KERRY CLAYTON: Hi, David.

DAVID LEWIS: Kerry, can you elaborate a little bit more on the Spitzer investigation? I can't recall whether you've announced whether you've actually received any subpoenas. And particularly in your Employee Benefits and Health areas - I assume you don't, in the Health, pay any kind of contingencies and in the Employee Benefits you may. Can you give us those levels and what your outlook is in paying those in the future?

KERRY CLAYTON: Yes, sure. First, we've not received a subpoena or any other request for information. I would reiterate first that we adhere to the highest of ethical standards, and certainly the kinds of activities that we read about with bid rigging and companies giving false quotes is totally contrary to our values. And I'm not actually aware of even being asked to do that. But again, we're investigating fully. You know, we have a variety of incentive compensation arrangements in our lines of business. We believe certainly that they have been, in the past, an important part of how we operate. The variety of them depends on the line of business and so forth. Again, we expect that our producers will operate in an ethical manner and will be properly motivated by incentive compensation arrangements that are made. And, we only do those in what we believe is a proper and ethical fashion.

DAVID LEWIS: Well, do you think if contingent commissions are no longer allowed that that would hurt your position at all with the brokers?

KERRY CLAYTON: I don't think so. You know, they're not a big part of our business. You mentioned the Employee Benefits business incentive compensation is a little over 5% of total compensation paid in that line of business. So, it's not a particularly big item. I think, again, the exact definitions of what's incentive compensation – you have lots of different arrangements in our businesses. And, I believe certainly at this time that we can react easily to whatever changes are made. But again, it's hard to anticipate totally what those might be.

I'd also comment again on the Employee Benefits business, our average size group is under a hundred lives but we do write some groups over a hundred lives, and in that part of the market the Form 5500, a Department of Labor form, is required. And we do fully disclose all broker/producer commissions including basic commissions, incentive compensation, and so forth in that form. And I would say that's not a practice that every company uses: that was our decision quite a while ago. We believe that the regulations require that, so we do include incentive compensation as well as basic when we report on those forms.

DAVID LEWIS: And so for Rob, just a broad question. Obviously, if we back out hurricane and catastrophe losses for both years your earnings were up a little better than 20%. How should we look at the $0.87 ex cat number as we look forward to the fourth quarter and moving into next year?

ROBERT POLLOCK: David, you know we don't provide forward-looking information. I guess that on the one side, I think looking at the Solutions business, which made a profit despite all this, I think it gives you a good indication on the strength of the platform there. On the Health side, those combined ratios, as Kerry mentioned, are extraordinary.

DAVID LEWIS: So therefore, we probably shouldn't assume that they'll continue at that level?

KERRY CLAYTON: I think you folks have asked that on several occasions and …

ROBERT POLLOCK: We're pleased that they've continued and improved.

DAVID LEWIS: OK, understand, thank you.

OPERATOR: Thank you. The next question today is coming from Adam Klauber of Cochran Caronia. Please go ahead with your question.

ADAM KLAUBER, COCHRAN CARONIA: Good morning. How much of the hurricane loss was in the homeowners, the force-placed business versus the manufactured housing business?

ROBERT POLLOCK: Sure, if we look at our creditor-placed homeowners about a third of the losses came there. In the manufactured housing it was about 20%. And then we have a mixture which relates to some personal lines and actually some older mobile home business which represented the balance.

ADAM KLAUBER: OK. Given this level of loss this quarter, will this change your growth strategy in Florida within these businesses?

ROBERT POLLOCK: We don't believe so. We are constantly monitoring our overall exposures. The Cat Fund performed admirably for us. We will, obviously, review our overall programs as part of our comprehensive and annual risk management strategy of reinsurance in this business. But I don't think the answer—because this is the first time since 1887 that four storms have hit one state in a calendar year.

KERRY CLAYTON: Actually, I mean, I would just add that I think we feel quite good about the fact that with this extreme level of catastrophe activity that we came through the quarter well, financially stable, none of our surplus was really impacted by this. And, certainly you fine tune your reinsurance program every year for your risks and we have very sophisticated models for measuring that risk. But, I think we feel quite good about how things went this quarter.

ROBERT POLLOCK: And, you don't want to lose the human element side of things here. I mean this was really our shining hour from many of our employees at Assurant Solutions. We had volunteers in our claims department who worked sixteen- or eighteen-hour days for extended periods of time to really help our policyholders. And, we think that is indicative of the value we add to our customers and the commitment of our employees in a time of need.

ADAM KLAUBER: Thank you. One more question, did the Health loss ratio include any reserve releases this quarter?

ROBERT POLLOCK: One of the things we've talked about, Adam, is our actual to expected experience. And, indeed, things continue to develop more favorably than we had anticipated and as a result there was some redundancy released.

ADAM KLAUBER: Thank you.

OPERATOR: Thank you. The next question today is coming from Bill Wilt of Morgan Stanley. Please go ahead with your question.

BILL WILT, MORGAN STANLEY: Hey, good morning. I was just going to ask the previous question so I'll ask, can you share the dollar amount of reduction in the Health loss ratio?

ROBERT POLLOCK: No, we really don't do that. What I'd point out though is that, as you know, we have a very conservative orientation and we wrote a lot of these new HSA high-deductible plans and it's turned out that the experience on them has been quite good and, therefore, some redundancies have developed.

BILL WILT: OK. And that takes into account the dynamic where deductibles, to the extent that they're eroded over the course of the year, you might see more claim activity toward the latter half of the year? I mean, second …

ROBERT POLLOCK: It's a great question, Bill. And we believe we understand the impact of that deductible erosion quite well. And yes, we think we've got that conservatively adjusted for as well.

BILL WILT: OK, thanks. A second one, if I could, on Solutions. Maybe just some comments on the expense ratio and trends in the expense ratio in Solutions, actions you're taking and some specific questions: as the portfolio of products evolves, is there a changing mix in the commission or the variable expenses associated with products that you're selling more or less of, and any comments on trends in the fixed component of expenses there?

ROBERT POLLOCK: Sure. I think there's two things for consideration here. One is, indeed, we have a changing mix which, I don't have all the details in front of me Bill, we'll get something together on that. I think the more important thing is in some of our extended service contract businesses we can report income through the premium line and there are other situations where things get reported on a net basis through the fee income line. And that, change in dynamic, although it has no impact on our bottom line, it can have significant impact on that expense ratio. So when it moves down to the fee income, we lose all the gross up that's often embedded when it shows up as premium.

BILL WILT: That's helpful. And extended service is roughly what percentage of the total?

ROBERT POLLOCK: I don't believe we disclosed that.

BILL WILT: OK, fair enough. One final one, if I could, and looking to the page in the supplement – I guess back to the comparison. You talked about the arguably unfavorable comparison consumer protection this quarter versus the quarter a year ago. The quarter a year-ago, the $430 million in consumer protection premium in the third quarter '03 looked like it spiked up that quarter. I know you talked about the run off and credit insurance as explaining part of the difference, but was there anything unusual that caused the acceleration of earned premium in the third quarter of '03 in consumer protection?

ROBERT POLLOCK: Part of it was what I mentioned on these extended service contracts where we took over books of business. So I think it's quite consistent with the fact that, when you take over a new client, sometimes you can, in essence, get a large volume of premium coming in during the quarter just during that recognition. And again, I think if I look on this on a going-forward basis, we've got quite nice growth going on here, Bill. It is a confusing picture within the numbers.

BILL WILT: That's helpful, thank you.

OPERATOR: Thank you. Next question today is coming from Jukka Lipponen of KBW.

Please go ahead with your question.

JUKKA LIPPONEN, KBW: Good morning.

KERRY CLAYTON: Hi, Jukka.

JUKKA LIPPONEN: Can you give us a sense of how the HSA sales are trending?

KERRY CLAYTON: The trend's been very positive in the HSA sales. We had a third - I'm sorry - a quarter of our sales in the first quarter were with HSAs and you'll recall that January 1st was the beginning of the HSA program. It rose to a third of sales in the second quarter and now 40% in the third quarter. So, again we continue to see a lot of activity. There's a lot of press still about HSAs, continuing awareness, and we would expect to see quite a bit of additional activity. I mean, we clearly have a strong first mover and leading position in that HSA market, and we have all of the facilities, the systems and processes to handle it because of our expertise in the former MSA market.

JUKKA LIPPONEN: Then secondly, can you give us an update on the GE relationship and then the Canadian subsidiary Best Buy, is that yet contributing to Solutions revenues?

ROBERT POLLOCK: Let's take Future Shop which is in Canada. The answer is no on that. It'll start coming on, I believe, in the fourth quarter of this year just a little bit. It really kicks in next year.

Our GE relationship is going very well. We're quite pleased with the results there. We're actually finding that, as a result of that relationship, we are getting additional leads into the new client pipeline. And I know, as a consequence of their relationship with one of our clients, we've actually developed a brand new program that without their partnership we would have never got to.

JUKKA LIPPONEN: And then just one last thing, did I hear it correctly that the voluntary benefit sales are up 25% year-to-date?

ROBERT POLLOCK: Correct.

JUKKA LIPPONEN: Thanks very much.

ROBERT POLLOCK: Sure.

OPERATOR: Thank you. The next question is coming from Ed Spehar of Merrill Lynch.

Please go ahead with your question.

ED SPEHAR, MERRILL LYNCH: Thank you. Good morning, everyone.

KERRY CLAYTON: Hi, Ed.

ED SPEHAR: I have a few questions, I guess going back to the Health side, you mentioned the reserve release but I'm just wondering if you look at the historical pattern which, I think, is release reserves from prior periods and then continue to use the conservative methodology that reserves releases in the current period.   Adjusting for those two factors was there anything unusual if we sort of look at the historical pattern related to reserve releases? Then, I've got a few follow-ups.

ROBERT POLLOCK: I guess what I'd say with that, Ed, is in estimating the current reserves we're always in dialogue and we're always conservative but you can only be so conservative with your numbers.

KERRY CLAYTON: Yes, I mean, it might be, as you say, every quarter you're, you're sort of truing up experience from the last several quarters and that results to adjustments to whatever estimates you had for those quarters at the prior time. And, that's a process that happens every quarter and I don't think there was any particularly unusual activity in the third quarter of this year.

ED SPEHAR: OK. And then looking at the – I was wondering if, on the Health side again, if you could explain a little bit more about the sequential change in individual membership?

ROBERT POLLOCK: Right. The individual component is actually comprised of our specialty business, which is the short-term medical product and our comprehensive major medical product. And we experienced a decline in that specialty product component during the quarter although we continued to have an increase in the individual comprehensive major medical piece. Those two are added together in our totals.

ED SPEHAR: OK. And then another sort of variance from what we were thinking I guess at least was that the Corporate and Other loss was a little bit less. Is this a run rate kind of number, was there anything else in there that we should be adjusting?

ROBERT POLLOCK: Boy, we're going to have to get back to you on that, Ed. That number bounces around a little bit just based on what's happened. One of the things we mentioned was 404 compliance costs. They may have been a little bit higher in the second quarter than they were in the third. You know, there's a lot of little things that can be going through there.

ED SPEHAR: OK. And then in terms of interest rates, I know you guys in the past have sort of looked at the impact from hundred up/hundred down kind of thing on your earnings outlook. And I'm just wondering if you can give us any sense for – I know you're not going to give us a forecast for earnings – but if you could give us a sense of the sense for sensitivity of the hundred up/hundred down or you can just …

ROBERT POLLOCK: Yes. I don't have it right with me. I know it was in our original S-1, I believe, Ed. The only reason I'm hesitant, and let us look at this a little bit, is you start getting into a dynamic as well with reserve assumptions, okay, particularly on LTD. So, otherwise you could think about it as if you look at our invested assets you could almost do some of the calculation your self.

KERRY CLAYTON: I mean, we have $11 billion …

ROBERT POLLOCK: Right.

KERRY CLAYTON: …of invested assets. I mean, if the overall portfolio rate went up …

ROBERT POLLOCK: A hundred.

KERRY CLAYTON: …a hundred basis points, we'd clearly have that much more investment income. The only direct piece is the portion of the Preneed business that has a discretionary rate on it. You could make your own assumption about whether the consumer price index might move up with interest rates but there we're talking about maybe half or so of the reserves on the Preneed business.

And then, as Rob mentions, there are some other reserves that are discounted like the long term disability that might be modified. But, you certainly come up with the bulk of the number, two-thirds of it or something like that as being not really connected with any kind of interest rate sensitivity in any way reserve. So that's why we say that, an increase in interest rates largely flows to our bottom line.

ED SPEHAR: Yes, I guess. Kerry, I wasn't focusing so much on the whole portfolio, although it would be nice to get the whole thing up a hundred basis points. Just in terms of the invested cash flow, so if you look at your operating cash flow, your maturities, calls, pre-paids, whatever we've got, I mean, what's that running out in terms of cash flow, if we look at that this year. Is that like…$500 million?

ROBERT POLLOCK: I think we're at about a six duration, Ed. And, as we've talked about previously, we have a separate benchmark for each of the businesses as part of our overall risk management. We think that's the appropriate way to deal with things. But you could – I know you're a duration expert so you can kind of figure out what that change would do.

ED SPEHAR: OK. That duration expert is news to me but thanks. And I guess the final question I have is, could you give us your statutory operating earnings numbers? And, you made reference to tax changes and the potential capital free-up that there could be, could you give us some sense of what your current plan is in terms of dividending up statutory operating earnings?

ROBERT POLLOCK: Well, that's a couple of different things. I don't have the statutory earnings with me, Ed. But let's talk about the two components of the tax act that are of interest to us. The first is domestically, it's the phase three tax in life insurance companies where, if you move the money out of the policyholder's surplus account, you in essence are going to free up your obligation to pay tax on that. What we need to evaluate, because we've got this in a number of our life insurance subsidiaries, is have we been holding excess capital, if you will, to prevent a phase three trigger in any of those companies. We have analysis underway on that right now.

Then the second is, it really relates to the repatriation of foreign earnings. We believe, again, we've got to go through and do the calculation as part of our disciplined capital management approach to the business. But we think there are opportunities there but we haven't read the legislation yet in terms of are you going to have to have specific uses for the money, what might those be, and do those at all constrain your ability to take the money out. So, we're looking at all of it and when we know, we'll report on this next quarter. But I just think it's too premature to know exactly what it is yet.

KERRY CLAYTON: Yes, we've read the legislation but a lot of it remains open until the regs come out on it …

ROBERT POLLOCK: Right, until they codify.

ED SPEHAR: OK, thank you very much.

KERRY CLAYTON: Thanks, Ed.

OPERATOR: Thank you. Next question is coming from Josh Shanker of Smith Barney.

Please go ahead with your question.

JOSH SHANKER, SMITH BARNEY: Hi, Rob, Kerry, Larry. How are you guys doing?

KERRY CLAYTON: Hi, Josh.

ROBERT POLLOCK: Great.

JOSH SHANKER: Just a few questions regarding the Benefits division looking forward. Last year in the fourth quarter, it seemed like there was a great deal of seasonality and you guys - particularly in disability - were poised to earn extra revenues. Is that going to repeat itself coming this year, or do you think that there's reason to assume seasonality in the coming quarter?

ROBERT POLLOCK: Well, two things, I believe in the fourth quarter of last year, if I remember correctly, I think that we may have had a one-time reserve buyout. That was either in the third or fourth quarter of last year, I don't recall which, Josh.

KERRY CLAYTON: Fourth.

ROBERT POLLOCK: It was in the fourth quarter.

JOSH SHANKER: And it would hit the income statement in the earned premium line?

ROBERT POLLOCK: Correct.

JOSH SHANKER: OK.

ROBERT POLLOCK: OK. But, we mentioned voluntary was up, our disability sales are up quite a bit. Now you've got to put that in context of very depressed levels over the last year. But our disability sales are up nicely and, as Kerry mentioned, as part of our conservative nature and risk management we raised rates probably earlier than most of our competitors, and as competition is now doing the same, that's making our products more attractive.

JOSH SHANKER: OK, very good. And in terms of the discussion that everyone's been having about favorable development in Health, when did this favorable development start hitting the book, which quarter? Is this like a first through third quarter of this year event?

KERRY CLAYTON: No. I think we've had favorable development …

ROBERT POLLOCK: Years.

KERRY CLAYTON: …for quite some time.

JOSH SHANKER: So it's been consistent pretty much along the same lines for each quarter?

ROBERT POLLOCK: Yes. I think if you look in the footnotes, I think that we might disclose some of that a bit more.

JOSH SHANKER: OK, very good. That's it.

KERRY CLAYTON: Thanks, Josh.

OPERATOR: Thank you. At this time we will be taking one further question and that is coming from Kelly Nash of KeyBanc Capital.

Please go ahead with your question.

KELLY NASH, KEYBANC CAPITAL: Thanks. I wondered if you guys could talk a little bit more about the Solutions pipeline and what you kind of see out for the next year or so, what accounts maybe you're working with or have already just recently gotten on the books?

ROBERT POLLOCK: Sure. Let's start internationally, I had mentioned, and again these aren't huge accounts, but I think they're indicative of our excitement in a number of these markets. We've landed thirteen new accounts internationally, four in Argentina, a couple in Brazil, five in Canada, a couple others, I guess one in Puerto Rico, something in the U.K. We've got lots of new accounts coming on there and we feel good about that. Again, I want you to remember that the lead time and when we actually have a full run rate going on is going to be a couple years out, alright, just given the nature of how this business works. We've also had a number of additions in the U.S., in specialty property businesses. We've had a number of new mortgage clients, mobile home – manufactured housing I should say. So we're feeling quite good about the number of new clients we've added this year and we think that the pipeline continues to good moving forward.

KELLY NASH: And then, regarding any impact that you see coming into play particularly on the Health side from the elections that have just been completed?

KERRY CLAYTON: We think basically President Bush has been a big supporter of Health Spending Accounts and several of our initiatives in the health sector and we feel that that sponsorship will continue. And so we feel pretty good about prospects at this point, basically a continuation of a fairly favorable environment that we've operated in for the last few years now.

KELLY NASH: And regarding the HSAs, you indicated that competition is increasing in that area. Have you seen an increase in competition in the third quarter even over the second quarter?

ROBERT POLLOCK: Yes, I'm sure there have been some new entrants come into the market. I don't know who they are in specific. One thing I'd mention – and you may have seen it – is we have kept an extensive data base on HSAs all as part of how we manage risk, etc. But I think you'll see that that's been cited in lots of different places. We are actually supplying the administration information related to who is buying these things. Is it just rich people, the answer is no. You know, half the HSA buyers earn less than $50,000 a year. Older people are buying these things. We see a number of purchasers who are over forty, but we're seeing younger people buy them as well. We're seeing people who were previously uninsured buy this product. So we think it's helping deal with fundamentally that problem of the uninsured and, in particular, younger people who've just not seen the value to having that high-cost medical program. They can go to something with a much more moderate cost and a savings vehicle associated with it. So we're quite pleased with activity on the HSA side.

KELLY NASH: And just one final question, obviously, the $49 million in cat losses was pretty high in the third quarter. Going forward – on a normalized basis – what kind of cat losses would you expect in the third quarter as you look historically back at previous third quarters?

ROBERT POLLOCK: You know, let me just give you our cat losses by quarter for 2003 and 2004: in the first quarter of 2003 zero; in the second quarter $8.4 million; in the third quarter $10 million; in the fourth quarter $12 million. Moving to 2004: zero in the third quarter; $1.6 in the second quarter; $75.5 in the third quarter. So, that gives you a history of what our numbers have been.

KELLY NASH: OK. And then I just wanted to make sure to get a sense of – so then looking at the $10 million, is that a much more normalized level even going, if you look back at 2002 and 2001 data that you have available?

KERRY CLAYTON: There really is no normalized in the catastrophe world.

ROBERT POLLOCK: But we are very good at the risk management side of things. We have very detailed models that allow us to estimate what we think the costs are. And I think what we've mentioned on prior calls is we typically buy reinsurance coverage to cover between a 1 and 250 and a 1 in 500-year storm exposure. And that's – we use that as a guiding principle in our risk management in the business. OK?

KELLY NASH: Great, thank you.

ROBERT POLLOCK: Sure.

OPERATOR: Thank you. I'd like to turn the floor back over to Mr. Kerry Clayton for closing remarks.

KERRY CLAYTON: In summary, our third quarter and nine-month 2004 results continue to demonstrate the strength of our diversified business strategy and the success of our specialty insurance focus.

Thank you again for joining us, and we look forward to updating you on our progress on our next call. Thanks.

OPERATOR: Thank you for your participation. That does conclude this morning's teleconference. You may disconnect your lines at this time. Have a great day. Thank you.

END