Torchmark Corporation

3rd QUARTER 2014 CONFERENCE CALL

October 23, 2014

CORPORATE PARTICIPANTS

Mike Majors *Torchmark Corporation - VP of IR*
Gary Coleman *Torchmark Corporation - Co-CEO*
Larry Hutchison *Torchmark Corporation - Co-CEO*
Frank Svoboda *Torchmark Corporation - EVP, CFO*
Brian Mitchell *Torchmark Corporation - General Counsel*

CONFERENCE CALL PARTICIPANTS

CONFERENCE CALL PARTICIPANTS

Jimmy Bhullar ***JPMorgan - Analyst***
Eric Bass *Citigroup - Analyst*
Randy Binner *FBR & Co. - Analyst*
Yaron Kinar *Deutsche Bank - Analyst*
Steven Schwartz *Raymond James & Associates, Inc. - Analyst*
Seth Weiss *BofA Merrill Lynch - Analyst*
Colin Devine *Jefferies & Company - Analyst*
John Nadel *Sterne, Agee & Leach, Inc. - Analyst*
Ryan Kreuger *KBW - Analyst*
Eric Berg *RBC Capital Markets - Analyst*
Mike Zaremski - *Balyasny- Analyst*

Mike Majors

Thank you. Good morning everyone. Joining me today are Gary Coleman and Larry Hutchison, our Co-Chief Executive Officers, Frank Svoboda, our Chief Financial Officer, and Brian Mitchell, our General Counsel.

Some of our comments or answers to your questions may contain forward-looking statements that are provided for general guidance purposes only. Accordingly, please refer to our 2013 10-K and any subsequent forms 10-Q on file with the SEC.

I will now turn the call over to Gary Coleman.

Gary Coleman - Co-CEO Torchmark Corp.

Thank you Mike, and good morning everyone.

Net operating income for the third quarter was $131 million or $.99 per share – a per share increase of 4% from a year ago. Net income for the quarter was $132 million or $1.00 per share – a 5% increase on a per share basis.

On our second quarter conference call, the midpoint of the guidance provided for the full year 2014 anticipated net operating income of $1.01 per share in the third quarter. The actual net operating income was two cents lower due to higher than expected Part D drug costs.

With fixed maturities at amortized cost, our return on equity as of September 30 was 15.1% and our book value per share was $27.57 - a 10% increase from a year ago. On a GAAP reported basis, with fixed maturities at market value, book value per share increased 27% to $34.55.

Life Insurance

In our life insurance operations, premium revenue grew 4% to $492 million and life underwriting margins were $139 million, approximately the same as a year ago.

Net life sales increased 14% to $91 million.

On the health side, premium revenue, excluding Part D, grew 1% to $210 million and health underwriting margin grew 5% to $49 million.

Health sales increased from $23 million to $48 million.

Administrative expenses were $45 million for the quarter, 1% more than a year ago. For the full year 2014, we anticipate that administrative expenses will be up around 1% and be approximately 5.7% of premiums.

I have one more item to discuss before turning the call over to Larry. Recently, there were reports that Torchmark had suffered a data breach. There was an isolated, internal breach in which we believe that someone at one of American Income's agency offices in the Northwest used compromised log-in credentials to obtain personal information from approximately 400 insurance applications. We have notified the individuals affected and continue to follow the investigation.

I will now turn the call over to Larry Hutchison for his comments on the marketing operations.

Larry Hutchison- Co-CEO Torchmark Corp.

Thank you Gary.

First, let's discuss American Income

At American Income, life premiums were up 7% to $194 million and life underwriting margin was up 3% to $60 million. Net life sales were $43 million, up 18% due primarily to increased agent counts. The producing agent count at the end of the third quarter was 6,155, up 13% from a year ago. The average count for the third quarter was 6,106, up 6% from the second quarter.

We expect 11 to 12% life sales growth for the full year 2014 and 6% to 10% growth for 2015.

Now, Direct Response

In our direct response operation at Globe Life, life premiums were up 6% to $174 million and life underwriting margin declined 2% to $41 million. Net life sales were up 7% to $35 million.

We expect 8% to 9% life sales growth for the full year 2014 and 5% to 9% for 2015.

Liberty National

At Liberty National, life premiums declined 2% to $68 million while life underwriting margin declined 7% to $18 million. Net life sales grew 18% to $9 million, while net health sales increased 22% to $4 million.

The producing agent count at Liberty National ended the quarter at 1,604 – up 22% from a year ago. The average agent count for the third quarter was 1,554, up 4% from the second quarter.

Life net sales growth is expected to be within a range of 9% to 11% for the full year 2014 and 5% to 9% for 2015. Health net sales growth is expected to be within a range of 17% to 19% for the full year 2014 and 5% to 9% for 2015.

Now Family Heritage

Health premiums increased 7% to $52 million while health underwriting margin increased 20% to $11 million. Health net sales were up 18% to $12 million.

The producing agent count at the end of the quarter was 761, up 6% over a year ago. The average agent count for the third quarter was 763, up 1% from the second quarter.

We expect sales growth for the full year 2014 to be in a range from 7% to 9% and 4% to 10% for 2015.

Now, United American General Agency

Health premiums increased 2% to $71 million. Net health sales grew from $6 million to $10 million.

We expect general agency net sales growth for the full year 2014 to be in a range of approximately 30% to 40%. While group health sales are hard to predict, we would expect relatively flat sales in 2015 due to two large group cases we acquired in 2014.

Now, Direct Response Health

Medicare supplement sales were $19 million, compared to $1 million in the year-ago quarter. This is due to a new large group case. While most of our group Medicare supplement business is distributed through our United American General Agency channel, this case is classified as Direct Response because we mail coverage offers directly to the retirees as coverage is available on a voluntary basis. We expect sales in a range of $22 to $23 million in 2014 and $5 to $7 million in 2015.

Medicare Part D

Premium revenue from Medicare Part D grew 17% to $90 million, while the underwriting margin declined from $9 million to $5 million. The decline in underwriting margin is due to the higher than anticipated Part D drug costs we mentioned earlier. We expect Part D premiums of $345 to $350 million in 2014 and $190 to $235 million in 2015. Despite the significant decline in premiums expected for 2015, dollar margins are expected to be relatively flat due to reduced exposure to auto-enrollee claims. Frank will discuss this further in his comments.

I will now turn the call back to Gary.

Gary Coleman

I want to spend a few minutes discussing our investment operations.

First, excess investment income:

Excess investment income (which we define as net investment income less required interest on policy liabilities and debt) was $55 million, an increase of $1.7 million or 3% over the third quarter of 2013. On a per share basis, reflecting the impact of our share repurchase program, excess investment income increased 8%.

For the full year, we expect excess investment income to increase by about 3%; and on a per share basis, the increase should be about 8% compared to 2013.

These growth percentages are negatively impacted by Part D. We estimate that the delay in receiving reimbursement from Centers for Medicare & Medicaid Services (CMS) for the higher than expected Part D claims will result in $4 million of lost investment income for the full year. Excluding this reduction, the increase in 2014 excess investment income would be about 5% or 10% on a per share basis.

Now, regarding the investment portfolio:

Invested assets were $13.3 billion, including $12.7 billion of fixed maturities at amortized cost.

Of the fixed maturities, $12.2 billion are investment grade with an average rating of A- and below investment grade bonds are $570 million, compared to $586 million a year ago.

The percentage of below investment grade bonds to fixed maturities is 4.5%, compared to 4.8% a year-ago. With a portfolio leverage of 3½ X, the % of Below Investment Grade bonds to equity, excluding net unrealized gains on fixed maturities, is 16%.

Overall, the total portfolio is rated A-, same as a year ago.

In addition, we have net unrealized gains in the fixed maturity portfolio of $1.4 billion – approximately the same as at the end of the second quarter.

Regarding investment yield:

In the third quarter, we invested $174 million in investment grade fixed maturities, primarily in the industrial and financial sectors.

We invested at an average yield of 4.24%, an average rating of A-, and an average life of 18 years. The average yield and average life are lower than in previous quarters due to over half of third quarter investments being made in private placements. Excluding privates, new investments in the third quarter had an average yield of 4.86% and an average life of 29 years.

Through today, the fourth quarter new money rate has been about 4.75%, which is the rate we have assumed for the fourth quarter at the midpoint of the 2014 guidance.

For the entire portfolio, the third quarter yield was 5.89%, down 2 basis points from the 5.91% yield in the third quarter of 2013. At September 30, 2014, the portfolio yield was approximately 5.90%.

We are concerned about the decline in new money rates this year. On past analyst calls, we have discussed in detail the impact of a "lower for longer" interest rate environment. As a reminder, an extended low interest rate environment impacts our income statement, but not the balance sheet.

Since we primarily sell non-interest sensitive protection products accounted for under FAS 60, we don't see a reasonable scenario that would require us to write off DAC or put up additional GAAP reserves due to interest rate fluctuations. In addition, we do not foresee a negative impact on our statutory balance sheet.

While we would benefit from higher interest rates, Torchmark would continue to earn substantial excess investment income in an extended low interest rate environment.

Now, I will turn the call over to Frank to discuss share repurchases and capital.

Frank Svoboda-CFO- Torchmark Corp.

Thanks, Gary.

I'd like to first take a few minutes to discuss the reduction in 2014 earnings guidance. The midpoint of our guidance fell eight cents from $4.10 to $4.02. Five cents of this reduction is due to additional adverse Part D experience. The remaining three cents includes the effect of both higher Part D claims and lower new money rates on excess investment income and slightly lower underwriting income from our non-Part D operations.

With respect to Part D, we have added a new schedule on our website entitled "Medicare Part D margins", which provides information regarding Part D premiums and margins. As can be seen on the schedule, the Part D margin as a percentage of premium is expected to decline from 11.8% in 2013 to 7-8% in 2014. This reduction results from higher claims driven primarily by two issues:

1) Claims related to the new Hepatitis C drugs that are trending at the high end of the range we discussed on our second quarter call; and

2) A CMS administrative rule change implemented in the third quarter retroactive to the beginning of the year that effectively shifts responsibility for a portion of Part D claims expenditures on group business from CMS to insurance carriers.

For 2015, we expect significantly less volatility in Part D. One, we have adjusted our 2015 pricing to reflect the impact of the Hepatitis C drugs and the administrative rule change. And two, we expect to have about 87% fewer auto-assigned insureds in 2015 than we have in 2014. Since auto-assigns have accounted for nearly 85% of our Hepatitis C claims this year, our exposure to Hepatitis C claims should be much lower next year.

While the loss of auto-assigns will result in lower premium income in 2015, we expect underwriting margins to remain relatively flat in 2015 compared to 2014 because the percent of premium profit margin should return to pre-2014 levels.

As we've discussed before, the higher than expected Part D costs don't just impact our underwriting margins, they also impact our net investment income. The higher costs increase the amounts paid upfront "on behalf of the government", and we won't get reimbursed by CMS for their share of the costs until November of 2015. The impact of the higher Part D claims in 2014 on our excess investment income has been included in our guidance for both 2014 and 2015.

Next, I want to spend a few minutes discussing our share repurchases and capital position.

In the third quarter, we spent $97.6 million to buy 1.8 million Torchmark shares at an average price of $53.72. For the full year through today, we have spent $317.3 million of parent company cash to acquire 6 million shares, at an average price of $52.30.

The Parent started the year with liquid assets of $60 million. In addition to these liquid assets, the parent will generate additional free cash flow in 2014. Free cash flow results primarily from the dividends received by the parent from the subsidiaries less the interest paid on debt and the dividends paid to Torchmark shareholders. We expect free cash flow in 2014 to be around $375 million. Thus, including the $60 million available from assets on hand as of the beginning of the year, we currently expect to have around $435 million of cash and liquid assets available to the parent during the year. As previously noted, to date in 2014, we have used $317 million to purchase Torchmark shares, leaving around $118 million of cash available for the remainder of the year.

As noted before, we will use our cash as efficiently as possible. Absent better alternatives and if market conditions are favorable, we expect that share repurchases will continue to be a primary use of those funds. We also expect to retain approximately $50-$60 million of liquid assets at the parent company. For 2015, we preliminarily estimate that our free cash flow available to the parent will be in the range of $360–$370 million dollars.

Now Regarding RBC at our Insurance Subsidiaries:

As stated on previous calls, we have maintained our insurance company capital levels at or above an NAIC RBC ratio of 325% on a consolidated basis, which has historically been sufficient to maintain our ratings. This RBC ratio is lower than some peer companies, but has been sufficient for our companies in light of our consistent statutory earnings, and the relatively lower risk of our assets and policy liabilities. We currently expect to exceed our targeted RBC levels for 2014.

Those are my comments. I will now turn the call back to Larry.

Larry Hutchison

Thank you Frank.

For 2014, we expect our net operating income to be within a range of $4.00 per share to $4.04 per share.

For 2015, we expect our net operating income per share to be in a range of $4.15 to $4.55, resulting in a midpoint of $4.35 - an 8% increase over the midpoint of our current 2014 guidance.

Those are our comments. We will now open the call up for questions.

Question and Answer

Jimmy Bhullar - JPMorgan - Analyst

Hi, good morning. I had a couple of questions. You discussed the Part D claims issue, but I'm wondering if you could talk about the higher life claims as well. It seems like life insurance claims are higher than they've been in a while.

And then secondly, on buybacks, given what S&P published a couple of months ago, has there been any change in your long-term strategy on share buybacks? And how do you think about capital at the subs and the holding company level.

Gary Coleman - Torchmark Corporation - Co-CEO

Okay, Jimmy, first we'll talk about the life claims. Life claims were up primarily in Direct Response, although they're up slightly at Liberty National and American Income.

At Direct Response, the claims are trending slightly higher than we expected at this point during the year. I think we're expected to be -- the policy obligation percentage to be -- half a point to a point higher than what we had in all of 2013. We don't think there's a significant trend there, but that's something we will monitor.

On Liberty National, part of the increase there was we had a low claim quarter in the third quarter of 2013. But we expect the full-year policy obligations to be at or around, or maybe slightly higher than what we had for 2013. But again, we see this as more of a fluctuation than a trend.

At American Income, our policy obligation percentage there has been within a 1% range for several years. We think that the third quarter being a little bit higher is, again, a fluctuation and not a trend. But for the full year we're expecting it to come in at around 32%, which is where we were last year and what we anticipate going forward.

Jimmy Bhullar - JPMorgan - Analyst

Okay, and then on buybacks?

Frank Svoboda - Torchmark Corporation - CFO

Yes, Jimmy, on the buybacks and the S&P issue, we do not see, you know at this point in time, any change in the long-term strategy on the buybacks. We're still evaluating our various options to address the shortfall that S&P has.

And want to point out that that's just a change in view with respect to capitalization that we've had in place at the holding companies, our insurance companies, for quite some time. So there's really has been no significant changes there, but we do think that there's a better alternative out there for us to use, other than changing any philosophy on the buybacks.

Jimmy Bhullar - JPMorgan - Analyst

And then just lastly, you mentioned and noted it being a headwind for earnings not for the balance sheet. But if we are in this type of environment, can you discuss what you're --are you doing anything on the pricing side to offset part of the impact? Or are you accepting lower returns as long as rates are low?

Gary Coleman - Torchmark Corporation - Co-CEO

Well, Jimmy, we're not anticipating increasing pricing at this point. But I think if you remember, I think it was a year or two ago, we increased rates at both American Income and Direct Response.

And at that time we increased the rates more than we felt we needed to. So I think if we stay in this lower rate environment where we are, I think we're - having increased them more than we needed to back then, I think we're okay at this point.

Frank Svoboda - Torchmark Corporation - CFO

One thing I would add to that, Gary, is that at that point, when we put in that pricing increase, we really anticipated at the time that the rates would stay low at least into 2015. At least at this point in time it's not a real surprise.

Jimmy Bhullar - JPMorgan - Analyst

Okay, thank you.

Eric Bass - Citigroup - Analyst

Hi, thank you. Just wanted to start on the Part D business. Was interested in your thoughts on the long-term view on the Part D market.

This has been the most volatile piece of your business in recent years and it seems like it's getting harder to predict from year-to-year. So does this change at all how you're thinking about pricing and whether you want to attract auto-enrollees going forward?

Gary Coleman - Torchmark Corporation - Co-CEO

Yes, it definitely does. We don't like the volatility and most of the higher claim costs and the volatility we've had has been in the auto-assigns. We're going to have a significant, as Frank mentioned, a significant reduction in auto-enrollees next year. I think we're going to be very careful in our pricing in the future as to whether we have any at all.

Eric Bass - Citigroup - Analyst

Got it; so when you think about the premium growth kind of beyond 2015 should not assume a significant increase because you attract more auto-enrollees in the future. Is that a reasonable way to think about it?

Gary Coleman - Torchmark Corporation - Co-CEO

Yes. You won't see the big increases that we had because that has come as we've added the auto-enrollees. We'll still stay with our individual and our group business. And we expect just moderate growth there.

Eric Bass - Citigroup - Analyst

Okay. And maybe we can switch quickly to free cash flow. I think your guidance for next year is implying free cash flow that's a little bit down from what it was this year. I imagine some of that may be the drag from the higher Part D claims and lower investment income. But if you could just talk about any other moving pieces there.

Frank Svoboda - Torchmark Corporation - CFO

Eric, that's exactly right. Our preliminary estimates, and I will stress that it's pretty preliminary at this point because we have not even completed our third-quarter statutory filings and statutory income projections. So - but our initial look for statutory earnings in 2014 would indicate that they are -- actually it'll come in just a little bit lower than we had in 2013.

So therefore the dividends up from the insurance companies in 2015 is expected to be just a little bit less. And that's what's really driving the slight decrease in the free cash flow.

And it really is primarily the drag from the Part D operations that we're seeing in 2014 on both investment income as well as underwriting. And then you'll notice in general, we've funding several initiatives with respect to our sales growth. Keep in mind that all of those fundings of those initiatives are fully expensed on a statutory basis, so those do tend to have a little drag on the earnings as well.

Eric Bass - Citigroup - Analyst

Got it, thank you. And last, very quickly, can you talk about what did you assume for life underwriting margins in your 2015 guidance?

Gary Coleman - Torchmark Corporation - Co-CEO

At the midpoint of our guidance, the underwriting margins are around -- they're between 28% and 29%, which is we're going to end 2014 at probably 28.5%. So, we're not expecting it to change going into 2015.

Eric Bass - Citigroup - Analyst

Great, thank you very much.

Randy Binner - FBR Capital Markets. - Analyst

Great, thanks. I have a couple. One is just a follow-up on what Eric was asking there. And this goes back to Frank, your commentary on the opening part of the call.

When you say that underwriting margins and Part D are going to recover to more normal levels, I think that would be a low-teens underwriting margin. I just want to clarify that.

Are you assuming that auto-enrollee claims also improve next year? Or that there simply just won't be as many when you talk about the overall underwriting margin for Part D improving next year?

Frank Svoboda - Torchmark Corporation - CFO

Yes, it really is a little bit of a combination of both. The underwriting margin that we're seeing overall, we do expect to be in that 10% to 13% range. So we do see that clearly, which is about where we've been pricing and where we've estimated on a normal course in the past few years.

And then it's really just less exposure to the autos. Several regions of the autos have very low underwriting margins. As we've lost those regions, then we're starting to see that the overall margins on the auto -- what is left on the auto-assign business should come up as well.

Randy Binner - FBR Capital Markets. - Analyst

Okay. And you don't think that it'll be a region creep, I guess, that the other regions would have the same problem as the other? Is there a reason to think that would be a different experience?

Frank Svoboda - Torchmark Corporation - CFO

We just have,-- we've basically gone from 22 regions in 2014 to where we're going to have 4 regions in 2015.

Randy Binner - FBR Capital Markets. - Analyst

Okay.

Frank Svoboda - Torchmark Corporation - CFO

So we just have a lot fewer numbers. Basically our enrollment, it's an 87% decline is what we're anticipating as a decrease in the overall enrollment in the auto-assigns.

Randy Binner - FBR Capital Markets. – Analyst

Alright, that's helpful. It's more dramatic on the drop in the autos, got it. And then I'm going to ask about the breach, just because it feels like the stock is maybe off a little bit more than what happened fundamentally. It sounds like you're explanation here is that it sounds quite limited, with 400 applications being affected and those folks being notified.

I'm guess the two questions I have is, is there a financial exposure here that's notable? Is this the same issue as being outlined in this Krebs article online? Is it the same thing as that?

Larry Hutchison - Torchmark Corporation - Co-CEO

Randy, this is Larry. We don't think there's any financial exposure here. I think a breach is really the wrong term to use here. There's not a third-party obtaining the information.

We think someone within the organization actually took this information. It's very small and we've contacted the 400 people involved. So we don't expect any further activity around this item.

Randy Binner - FBR Capital Markets. – Analyst

Okay. Is it the same issue that's being covered in the online media on that?

Larry Hutchison - Torchmark Corporation - Co-CEO

Yes it is.

Randy Binner - FBR Capital Markets. - Analyst

Alright, very good. Thank you.

Yaron Kinar - Deutsche Bank - Analyst

Good morning, everybody. Going back to the Part D segment or operations. Would you be able to quantify the earnings headwind into 2015 from the cash flow issue there?

Frank Svoboda - Torchmark Corporation - CFO

Yes. We basically have about $115 million that we are going to be receiving, if you will, from CMS in late 2015. So we estimate that lost investment earnings should be close to $6 million, are the headwinds for 2015.

Yaron Kinar - Deutsche Bank - Analyst

Okay. So I guess if I take that out of the midpoint of the 2015 guidance range and I compare that to the original guidance range for 2013, I get the EPS growth of roughly 6%, 7% year over year. And I guess it just seems a little below what maybe investors have grown accustomed to see from Torchmark. I was curious what else was going on there to hold you back?

Frank Svoboda - Torchmark Corporation - CFO

What you also need to take into account when looking at that is the drag on 2014 from the Part D operations. Our underwriting income at the midpoint of our guidance, you know at the beginning of the year, we were anticipating around $36 million.

We're looking at coming in around somewhere in the range of $26 million, $25 million to $27 million in 2014. And we expect that to be relatively flat going into 2015.

So that's creating, from your starting point, that's creating an additional drag. Plus you know -so as we looked at it, if you do include the $6 million at the midpoint of the 2015 guidance and compare it to the midpoint of our final guidance here for 2014, you'd end up somewhere a little north of 9%.

Yaron Kinar - Deutsche Bank - Analyst

Okay, and then maybe switching gears a little bit to agent count. Seems like both Liberty National and American Income, they're a little bit ahead of the schedule.

Do you anticipate the growth to slow down over the coming quarters or to continue seeing this healthy clip?

Lary Hutchison - Torchmark Corporation - Co-CEO

At American Income we're not expecting a significant drop in the agent count. However, historically, we've seen an increase in agent terminations in fourth quarter. At Liberty National, the same phenomena.

I think for both distribution, it's too early to give guidance for 2015 in terms of the agent counts. We'll be in a better position at the time of the next earnings call. We'll be able to see what terminations occurred in the fourth quarter in both distributions, and also what recruiting momentum we have through the month of January 2015.

Yaron Kinar - Deutsche Bank - Analyst

Okay, appreciate the answers. Thank you.

Steven Schwartz - Raymond James & Associates, Inc. - Analyst

Hey, good morning, everybody. First, on the excess investment income 2015, what are you assuming -- are you assuming, I guess, first question, that the new money rate will continue at that 4.75% level?

Gary Coleman - Torchmark Corporation - Co-CEO

No, Steven, we're assuming that we'll be investing a little over 5% at the midpoint.

Steven Schwartz - Raymond James & Associates, Inc. - Analyst

Okay.

Gary Coleman - Torchmark Corporation - Co-CEO

It may start out a little bit lower than that at the beginning of the year. We expect the rates to increase as the year goes on.

Steven Schwartz - Raymond James & Associates, Inc. - Analyst

From your mouth. So given that, how should we think about the rate on the portfolio coming down over the year?

Gary Coleman - Torchmark Corporation - Co-CEO

I think that the rate on the portfolio will come down around 3 to 4 basis points.

Steven Schwartz - Raymond James & Associates, Inc. - Analyst

For the year or for quarter?

Gary Coleman - Torchmark Corporation - Co-CEO

For the year.

Steven Schwartz - Raymond James & Associates, Inc. - Analyst

For the year, okay. And then I want to go back to Part D. So my understanding is that you price for the non-auto-enrollees, and depending upon your pricing then you get assigned auto-enrollees. Is that correct?

Frank Svoboda - Torchmark Corporation - CFO

We would actually, within a particular region, we would end up putting in a bid that would anticipate whether or not we would get auto-enrollees for that particular region.

Steven Schwartz - Raymond James & Associates, Inc. - Analyst

Okay, Frank, I guess what I'm imagining here, and maybe I'm wrong, but what I'm imagining here is that if you price not to get auto-enrollees, doesn't that mean that your rate on non-auto-enrollees is going to be very, very profitable? Maybe more so than it had been in the past?

You see what I'm saying? Because you're raising rates not to get, so the remainder, I would think the margin would be very high.

Frank Svoboda - Torchmark Corporation - CFO

Well, you're ultimately pricing overall with respect to whether you're getting auto-enrollees or not. You're still not -- the experience overall, between the non-auto-enrollees, we aren't -- I guess I'll just say that the experience that we're seeing is not necessarily resulting in excessively high margins on the non-auto-enrollees.

Steven Schwartz - Raymond James & Associates, Inc. - Analyst

Okay, alright. And then the S&P issue with regards to the financing, is that correct that it has to do with the preferred share financing? It has to do with the internal financing of reserves?

Frank Svoboda - Torchmark Corporation - CFO

Well, it's internal financing of the overall capital, in that back in 1998 we had, at the time that we spun out Waddell & Reed, we actually had put some preferred stock into the capital structure, the insurance companies - and had exchanged out some debt at that point in time.

It was really done in connection with that, the spinout of Waddell & Reed back at that point in time. And then they've been in place ever since.

Steven Schwartz - Raymond James & Associates, Inc. - Analyst

Okay, so this doesn't have to do with captive financing or anything like that?

Frank Svoboda - Torchmark Corporation - CFO

Correct.

Steven Schwartz - Raymond James & Associates, Inc. - Analyst

Okay, thank you that’s what I wanted to know.

Seth Weiss - Bank of American Merrill Lynch - Analyst

Great, thank you. If I could just ask a follow-up question on the timing of the CMS reimbursement question. If we look out into 2016, does that $6 million of lost income, does that just subside or does that actually reverse?

Frank Svoboda - Torchmark Corporation - CFO

I think it should subside. We'll end up having better than reversing. We are expecting to receive that around $115 million in the fourth quarter. Typically it ends up being in November, but that can change just a little bit. And so then it'll be there in the final invested assets as of the end of 2015, which will impact your 2016 earnings.

Seth Weiss - Bank of American Merrill Lynch - Analyst

And I suppose with a mix shift of auto-enrollees and what's spent on Hep C and I guess what I was trying to get out with this question, if there's any maybe excess cash flow that comes in in 2015 in terms of reimbursements that would cause 2016 million to be a little bit not normal in terms of investment growth there.

Frank Svoboda - Torchmark Corporation - CFO

What we're anticipating with respect to the 2015 plans, we always estimate -- we do attempt to estimate what the settlement with CMS is going to be every year. Right now our estimate for 2015 is that we'll actually be growing that receivable, if you will, by about another $30 million.

So over the course of 2015, which is also built into our guidance, we will be funding about $30 million worth of claims on behalf of CMS over the course of the year. And then in 2016 we'll be -- at the end of 2015 then we would have a net receivable from them at about $30 million that will be impacting 2016 earnings.

Seth Weiss - Bank of American Merrill Lynch - Analyst

And then if I could ask just one other question on sales growth guidance. If I look across the different life channels sort of mid-single-digits as opposed to upper single-digits, last year, I mean in 2014, excuse me, maybe just some commentaries on setting those -- what's causing the decline there. And if maybe 2015, that's a more normalized growth number and 2014 is coming off of an easy comp. What led to that maybe more conservative growth guidance?

Larry Hutchison - Torchmark Corporation - Co-CEO

As you know, on the agency, it's agent growth that drives the growth of the sales. We've seen a pattern historically in each of the companies that we have stair-step growth in the agency.

So when you have 20% agency growth at American Income and you have similar growth at Liberty National this year, you wouldn't expect to have 20% growth next year. Don't forget the sales guidance of 6% to 10% at American Income.

We model within that different levels of agency growth, different levels of percentage of agents submitting. That's what gives that range.

As the year moves on, if we have stronger agency growth, it'll be closer to 10% growth. If the agency growth slows, it'll be closer to the 6%.

Seth Weiss - Bank of American Merrill Lynch - Analyst

Okay, thank you very much.

Colin Devine - Jefferies & Company - Analyst

Good morning. In looking at the life, I guess in the underwriting ratios and the benefit ratios, the one that stuck out for me was Direct Response. And you really haven't talked about that.

And yet it seemed to be at its highest in the last 9 to 10 years, earning probably two standard deviations above its average over that period. Was there something particular that happened there?

Gary Coleman - Torchmark Corporation - Co-CEO

Well Colin, as I mentioned earlier that we have had higher claims in the third quarter than expected. As a result of that, we may be more than 47% to 47.5% as a percentage of policy obligations, whereas last year it was 46.4%. And I think it's been around that for several quarters.

Going forward, we'll be in that 46% to 47% range, we feel like. So again, I think it's more of a fluctuation and then we've been trending to that 46%, 47%, that number for several quarters now.

Colin Devine - Jefferies & Company - Analyst

I mean that's what I wondered. It looks like it was over 48% that just seemed --

Frank Svoboda - Torchmark Corporation - CFO

What I think you're seeing there a little bit is the catch-up effect of the first couple quarters we're in that 46% range. But we're seeing over the course of the year that we're now seeing it should be in that 47%, or as Gary said, 47% to 47.5%. So you're seeing a little bit of a catch up there in the third quarter.

Colin Devine - Jefferies & Company - Analyst

Okay. And then with respect to the agent recruiting this quarter, which I thought was quite strong, can you talk a little bit more about what was behind that? And obviously what you're doing to put in place to really hold on to those agents as we go forward? Have you changed anything there?

Larry Hutchison - Torchmark Corporation - Co-CEO

We mentioned in prior calls that we had changed our agent compensation, as we put a greater emphasis on recruiting. We've seen this year versus last year, we've actually had a quarter-over-quarter increase in our recruiting. We've also seen strong growth in our middle-management count this year, and that growth in middle management has helped support the agent growth. In addition, we've seen a slight increase in our agent retention, which is another positive factor if you grow your total number of agents.

Colin Devine - Jefferies & Company - Analyst

I was looking at that and that's why I was a little surprised when you took the sales guidance down, given what you've done recruiting. Is there something there? Are you just being cautious?

Larry Hutchison - Torchmark Corporation - Co-CEO

I'm being cautious based on the history of each of the agency forces. When you think about agency, it doesn't grow in a linear fashion. It really is a stair-step growth.

When you have a surge in agents, you would expect to see some increase in terminations in the following several quarters. But more important, you have to adjust your systems.

You have to look at your compensation to see what's driving that agent force. And make those changes to continue that level of growth.

We would like to think we're going to have back-to-back 10% to 15% increases in the agent count. I think that's not realistic on a historical basis. I think you'd expect a little lower agent growth in 2015 than 2014.

Colin Devine - Jefferies & Company - Analyst

Okay, thank you. And then the final one. You haven't talked in many quarters about what's been going on sort of in First Command and such. Can you give us any update on that? Since it's still a meaningful part of your overall premiums?

Larry Hutchison - Torchmark Corporation - Co-CEO

We've seen some positive results from First Command. We've seen an increase in the sales at First Command, but while it's an important part of our business, it's not core. We really focus our growth in our Direct Response, American Income and Liberty National, with respect to the life operations.

Colin Devine - Jefferies & Company - Analyst

Okay, thank you.

John Nadel - Sterne, Agee & Leach, Inc. - Analyst

(laughter) Good morning, everybody.

Larry Hutchison - Torchmark Corporation - Co-CEO

Good morning, Mr. Nadel. (laughter)

John Nadel - Sterne, Agee & Leach, Inc. - Analyst

You know, it'll happen. The question I really want to talk about was just, I really wanted to understand some of the thoughts and maybe some of the risks that you might be seeing around the lower end of 2015's guidance.

I mean if I -first of all, it's a wider range of guidance than I think we've historically seen from you guys. But the lower end of the guidance implies, I believe, 3% year-over-year EPS growth from your midpoint of 2014.

And if I assume your buybacks you know at or around the current pace, that actually suggests to me that at the lower end of your EPS range, it might actually contemplate actual earnings being down on a year-over-year basis. I guess I'm just trying to understand where is the caution there?

Gary Coleman - Torchmark Corporation - Co-CEO

Frank --

Frank Svoboda - Torchmark Corporation - CFO

Yes, I was going to say, as we look at the ranges, I think it's taking in, well let me step back, it’s taking into account that it's very early in the process, and we haven't finalized the statutory income. So clearly one piece is, if statutory earnings were to come in a little bit differently, and we have less free cash flow available for the buybacks, and then of course, volatility in the marketplace. And so, we do tend to, as we're looking at our ranges at this beginning, at this point in time, we're trying to take a look at -- if a lot of really bad things happen or if a lot of really good things happen, those kind of set the outside boundaries.

John Nadel - Sterne, Agee & Leach, Inc. - Analyst

Okay.

Frank Svoboda - Torchmark Corporation - CFO

We don't spend an awful lot of time there. We're more focused on, clearly, around the midpoint of that. But we're recognizing that there's some extreme events that could impact on either side.

And if we have that unfortunate confluence of events where you have really bad claims experience on the life side, and we don't get that offset with some positive on the health side. So you have really bad on the health side as well, Part D ends up being at the low end of their margin. And if rates stay really low and those type of things, so we're just trying to -- there's no specific changes, if you will, that we're anticipating that would kind of pop into there.

John Nadel - Sterne, Agee & Leach, Inc. - Analyst

Okay. I don't want to necessarily put words in your mouth, but if I were going to paraphrase, I'd say the lower end of the guidance is essentially just the opportunity that if a bunch of things just go against you in 2015, weaker underwriting margins generally, and maybe slightly lower buyback, there you go.

Frank Svoboda - Torchmark Corporation - CFO

That's right.

John Nadel - Sterne, Agee & Leach, Inc. - Analyst

Okay, it seems-- I guess that makes sense because if I look at the top-line trends, particularly here in the first nine months of 2014, top-line growth has accelerated a little bit. Your sales growth has been certainly very strong, stronger I think then even you guys had expected it might be.

With that as a backdrop, recognizing long-term investment rates are challenging. But with top-line growth starting to pick up a bit, it seems difficult to assume that earnings, not EPS but earnings, could be down on a year-over-year basis. Unless, I guess, you get some underwriting issues like claims. So that's the way you're thinking about it?

Frank Svoboda - Torchmark Corporation - CFO

Yes. It would have to take some unusual events.

Gary Coleman - Torchmark Corporation - Co-CEO

John, first of all, it's very early to be projecting 2015. We'll tighten this up when we get to the fourth-quarter call. But I think we feel that the midpoint is really what we're thinking we're going to be.

At that midpoint, at the $4.35, if we weren't losing that $6 million of investment income because of this Part D thing, that'd add another $0.03. That'd get us up to $4.38; that'd be over a 9% increase. We feel like it's going to be more around that midpoint than either the high or the low.

John Nadel - Sterne, Agee & Leach, Inc. - Analyst

Got it, okay. That is very helpful color. That's really all I was looking for. Thank you.

Ryan Kreuger - KBW - Analyst

Hey,good morning. I just had a couple more questions on 2015 guidance. Can you give us what your administrative expense growth expectation is next year? And then also, I don't think you've said this yet, what percentage growth do you expect in excess investment income in 2015?

Gary Coleman - Torchmark Corporation - Co-CEO

Okay, for administrative expenses, we're thinking it'll grow 3% to 5% next year. The investment income, we think the growth rate there will be, at the midpoint, I think we have it assumed at 2.5%. That's lower than what we have in 2014.

As I mentioned to John a while ago, if you add back what we're losing on the Part D, the increase in investment income would be over 3%. That's going to be in line with what we would expect.

Ryan Kreuger - KBW - Analyst

Got it, and then your admin expense growth has been growing in the 1% to 2% range, probably, for a little while now. Why are you expecting that to increase more going forward?

Frank Svoboda - Torchmark Corporation - CFO

Ryan, in 2014 it grew about, you're right, it grew about 1%. That's largely because of our pension expense. It was very high in 2013 and it dropped in 2014 with the change in the discount rate.

Without that change in the discount rate, it would've grown more in that 3% range. Excuse me, without the decrease of the pension expense in 2014. So looking forward, 2014, 2015, you don't have that kind of an offsetting impact on it and it will be growing at a more normal, I would say, as Gary said, 3%, 4%, 5% level.

Ryan Kreuger - KBW - Analyst

Got it, thanks. And then last one, on the S&P issue. Is there any real reason for you to react at all to this? I think S&P's rating is already one to two notches above the other rating agencies. I guess the question is, would you just take the downgrade? Or do you actually feel like you need to react?

Frank Svoboda - Torchmark Corporation - CFO

Well, it's clearly one of the factors that we're evaluating as we look at our options. We do recognize that the S&P rating does not have a particular substantial impact, or really any impact, on our marketing efforts.

And we do recognize that many of our peer companies, or most of our peer companies, do have their S&P rating below ours. It's something that we're taking into consideration, and thinking about, as we look at those options.

Gary Coleman - Torchmark Corporation - Co-CEO

And Ryan, I would say we would like to maintain the ratings. But as Frank made a good point, from a marketing standpoint the S&P or the Moody’s ratings aren't that important. In our business the rating that's important is the A.M. Best rating where we have A+. That's far more important in our marketing our products than the other ratings.

Ryan Kreuger - KBW - Analyst

Got it, thanks a lot.

Eric Berg - RBC Capital Markets - Analyst

Thanks very much. So I've had a chance to look at the exhibit that you filed on your website entitled Medicare Part D margins. And it does indeed contemplate a much smaller business, but a more profitable business next year than this year.

Can you review with us, you sort of touched on this, but could you go directly to the question, how does the government assign these auto-enrollees? And how can you be as confident as you are right now that the auto-enrollees will be down so sharply next year from current levels?

Frank Svoboda - Torchmark Corporation - CFO

There is a -- When you submit a bid into a particular region, for a particular plan -- so you'll file a plan. We know already for 2015 whether or not the bid that we put in, how that compares to a benchmark premium.

So essentially CMS takes all the bids from all the different insurance companies that are covering low-income subsidy individuals, and comes up with what they call a benchmark premium. And if your submitted premium is less than that benchmark premium, then you are automatically given auto-assigns.

Everybody, all the insurance companies that have qualifying bids, are then, on a proportional basis, assigned the auto-assigns and the low-income individuals. If your bid is above that benchmark premium by more than $2, then you're out, and you're not going to be put back in.

So for the bids that we submitted for 2015, we've already been notified that our bid was too high compared to the benchmark premium. Again, you don't know what that benchmark premium is going to be at the time you submit your bids. But at this point in time, we know that we're out in all but 4 regions versus the 22 that we were in in 2014.

Eric Berg - RBC Capital Markets - Analyst

And so in short, just to go through this in a little bit more detail, you know you will have far fewer auto-enrollees next year than this year.

Frank Svoboda - Torchmark Corporation - CFO

Yes

Eric Berg - RBC Capital Markets – Analyst

You know that the auto-enrollees have been the preponderance of the higher than expected Hepatitis-related claims.

Frank Svoboda - Torchmark Corporation - CFO

Yes. These account for about 85% of the Hepatitis C claims.

Eric Berg - RBC Capital Markets - Analyst

And so with fewer -- in short, with far fewer higher claimants on the rolls next year than this year, do you expect a smaller business but a more profitable business in percentage terms of profit margin percentage terms? Is that it in a nutshell?

Frank Svoboda - Torchmark Corporation - CFO

Correct, and with less volatility because of the far fewer auto-assigns.

Eric Berg - RBC Capital Markets - Analyst

Thank you.

Mike Zaremski - Balyasny- Analyst

Hey, thanks. It's Mike Zaremski from Balyasny. Liberty National life sales accelerated again this quarter to now very strong levels. Should we expect total premium growth to move into positive territory soon? I guess I would've expected it to be closer to break even by now, so maybe I'm missing a slightly higher lapse component or something.

Larry Hutchison - Torchmark Corporation - Co-CEO

I think if you take this fundamental sales growth and project it forward, could expect to be in a positive premium mode sometime in 2017.

Gary Coleman - Torchmark Corporation - Co-CEO

Yes, Mike, one reason it's taken a while to show that premium growth, we have a very large in-force block. There's nothing unusual about the lapse rates, it's just it's a big block and it's just taking -- we've had ups and downs and mostly downs in sales in the past few years.

Now we've had sales growth. It's just going to take a couple of years to let sales grow to get to where we can at least break even on the premium.

Mike Zaremski - Balyasny- Analyst

Got it. That's helpful. And lastly, and we can take this off-line if I'm missing something, I think, Larry, during the prepared remarks, spoke to the big jump in Direct Response health sales.

Could you give us some more color on what took place and why you expect the sales to fall off next year? Maybe it's the whole auto-enrollment thing you guys are talking about. Thank you.

Larry Hutchison - Torchmark Corporation - Co-CEO

The Direct Response health jump is the Medicare supplement that we offer to the direct mail offers. It's an existing channel of distribution. We include those Medicare supplements sales in the Direct Response category.

And we had a very large group that was added in the third quarter. And next year we're not expecting another large group, and that's why the sales guidance for next year is a much smaller percentage than this year.

Mike Zaremski - Balyasny- Analyst

Got it. So would the recent new marketing with the baseball stadium, is that helping out there? Is there any correlation there?

Larry Hutchison - Torchmark Corporation - Co-CEO

I'll tell you, the overall results are better than what we anticipated for the first season. The name awareness sales have improved our brand awareness and that's resulted in a growth in inquiries in most of our media channels. We've also seen a growth in our net sales in the five-state marketing territories compared to the rest of the country. So we're very pleased with the results after the first year.

Mike Zaremski - Balyasny- Analyst

Got it, thank you.

Operator

It appears there are no further questions. I'll turn the conference back over to our presenters for any additional or closing remarks.

Mike Majors - Torchmark Corporation - VP of IR

Alright, thank you for joining us this morning. Those are our comments and we'll talk to you again next quarter.