FBL Financial Group, Inc.
2Q16 Conference Call

Jim Brannen
Chief Executive Officer

Thanks Kathleen. Good morning, and thank you to everyone who joined us on the call today. I'm glad you are here.

I am pleased to report that FBL Financial Group once again posted strong earnings results. Net income for the second quarter came in at $0.97 per share and operating income was $1.02 per share.

Overall, sales for the second quarter were strong, with premiums collected up 18% over the prior year quarter. Sales were mixed with annuity premiums collected up 43%, and life insurance premiums collected down 1% compared to the second quarter of 2015.

Earlier this year we reintroduced our 4-year guarantee annuity product. We regularly update the rates on this product to reflect changes in the marketplace. This allows us to provide appropriate credited rates based on available investment opportunities, while meeting our pricing objectives. During the month of April we offered a first-year bonus on the 4-year product – and it was well-received. Since then, given the current investment environment, we have lowered rates a couple of times.

In addition to strong fixed rate annuity sales in the second quarter, premiums collected on our indexed annuity product also grew. We saw an increase of 78% in the second quarter compared to the second quarter of 2015.

Our index annuity is attractive to customers because of the potential for market gains along with protection from loss with guaranteed minimum interest rates. We recently completed a direct mail campaign on this product directed at existing Farm Bureau Financial Services clients – and the momentum continues.

Life premiums collected were down 1% compared to the second quarter of 2015. Sales of whole life products have been strong, but were overshadowed by declines in sales of some other life products.
We've taken several actions recently to increase life sales.

Last week we began an external term life insurance replacement offer. Agents are excited to have this in place. It's targeted toward existing property casualty policyholders who own a life insurance product with another carrier. It is a way for customers to move their life policy to a permanent plan without having to undergo full new underwriting. A select group of carriers' term policies are eligible for this new coverage replacement offer. And, a number of limitations and requirements are in place to maximize the success of the term conversion program.

Another recent change that has been well-received is the increase in the index cap to 12% on our indexed universal life product. This increase is part of our ongoing monitoring of crediting rates and index caps. We were able to make this change while continuing to meet our profitability targets.

At recent sales rallies, we also announced greater support for our agents' licensed sales people. Our most successful agents have multiple sales and service associates who assist them to meet the needs of their clients. We now offer certain sales incentives and recognition programs for the employees of our agents.

Turning to our agency force, as of June 30, we had 1,872 total agents and agency managers, plus 81 active reserve agents working to complete the steps necessary to become full time Farm Bureau agents. This is an increase of 24 agents during the quarter and is very positive. It is critical that we continue to grow our agency force – to contract more agents and sales associates, to grow agent productivity and increase agent retention.

During the second quarter we tactically sold some energy investments in a move to lower our exposure to the energy sector. We were able to manage the impact by selling securities at both gains and losses. It was a good time to execute these trades as crude oil prices had rebounded a bit. As of June 30, our energy portfolio had a carrying value of $486 million, and was trading at 100% of amortized cost. This exposure represents 5.8% of our total investments and is well diversified across subsectors.

Our investment area continues to do a superb job in managing our investments through the challenges of the last several years. During the second quarter of 2016, the average tax-adjusted yield on investments acquired backing our long-term business was 4.46%.

Next I'll comment on our progress in planning for the Department of Labor Fiduciary Rule.

We have a project team with internal subject matter experts and consulting resources working to make sure we will be in compliance with the fiduciary rule. The work covers a wide range of initiatives such as system work from our eApp vendor, internal systems development for recordkeeping, development of disclosures and contracts, and agent and staff training.

Based on our work and analysis, we've determined that our current proprietary product offerings and agent compensation models will not change substantially. We expect to sell all our proprietary qualified annuities: indexed and fixed, under the Best Interest Contract Exemption, or BICE, rather than using PTE 84-24. Having a single process creates uniformity, which we believe is less of a regulatory burden for our agents than the time savings of using 84-24 for fixed rate annuities only.

If consumer behavior remains constant, we don't expect a material change in sales. We expect to comply with the rule and will do so in the least intrusive way possible. Having said that, some consumers may not appreciate a more lengthy sales process – new disclosures, additional fact finding for the investment recommendation, signing the BICE, etc.

We don't anticipate that expenses will change materially as a result of this rule. We estimate that the initial implementation of this rule will range from $1-2 million. The range is primarily due to a phased approach to decisions about how much automation to develop. We are developing what we need to meet the first compliance date in April of 2017.

The additional cost is somewhat mitigated as many activities, such as disclosure updates and ongoing agent training, are expected to be handled by existing staff.

In summary, we are working our way through the DOL process. We will incur some additional expenses, change the way we market certain products, but will comply with the new rules and continue to sell all of our proprietary products.

Before I conclude, I want to mention a couple of things we celebrated recently.

First, our companies were named to the 2016 Ward's 50 group of top performing companies. The Ward's 50 recognizes outstanding financial results in the areas of safety, consistency and performance over a five-year period. FBL Financial Group is one of only six organizations that have affiliated companies named to both the property-casualty and life-health Ward's 50 group of companies.

Lastly, on July 19th, we celebrated 20 years as a publicly traded company. I look back on those 20 years and note FBL's success that comes from a steadfast focus on the fundamentals. We serve the needs of the Farm Bureau niche market and provide products and services to protect what our clients value most. We are dedicated to having best-in-class distribution with our growing exclusive Farm Bureau agency force. This focus on our Farm Bureau niche, coupled with financial discipline, has allowed us to grow and deliver strong earnings results over these 20 years. Despite the challenges that surround us, I feel confident as we move forward with FBL Financial Group because of that focus and discipline.

Now I'll turn the call over to Don Seibel to review of our financial results. Don.

Don Seibel
Chief Financial Officer

Thanks, Jim, and good morning everyone.

I'm glad to be here today to share insights with you regarding our financial results and capital position.

Despite the challenges of the volatile economic environment and persistent low interest rates, second quarter results were strong. As Jim indicated, net income for the quarter was $0.97 per share and operating income was $1.02 per share.

During the quarter our operating income adjustments totaled $0.05 per share and consisted primarily of net realized losses on the sale of investments in fixed maturity securities.

Next I'll turn to operating income. At a high level I would characterize our second quarter operating income as in line with our expectations, although there were some moving pieces with unlocking, favorable mortality experience and investment fee income.

In the second quarter we updated the interest rate related assumptions used in the calculation of deferred acquisition costs, value of insurance in force acquired, unearned revenue reserves, and certain reserves on interest sensitive products to better reflect the current low interest rate environment. This unlocking negatively impacted earnings by $0.15 per share. We typically perform our annual review of assumptions and unlocking analysis in the third quarter. However, the disruption in interest rates influenced by Brexit and other factors caused us to reconsider our long term interest rate assumptions and perform an unscheduled unlocking in the second quarter. We have been proactive in analyzing the impact of interest rates and have unlocked interest rate assumptions six times in the last four years. We plan to conduct a full review of all assumptions in the third quarter as usual. The unlocking impacted all segments, with the most significant impact in the Life Insurance segment.

Mortality experience this quarter was favorable due to a lower-than-expected number of claims. We had lower death benefits in the Life Insurance segment, but did have higher death benefits in our closed block of variable universal life business, which is in the Corporate & Other segment.

Investment fee income was at an elevated level again this quarter, totaling $3.1 million. It was mostly in the Annuity segment. While this is a short-term contributor to income, it does further compress future spreads due to the loss of higher yielding securities.

Next I'll comment on our spreads and spread targets.

During the quarter the point-in-time spread on our annuity business increased by two basis points to 203 basis points. This is primarily due to changes in our default assumptions. We periodically refine long term default charge estimates for our investments based on an annual study by Moody's. We use these point-in-time spreads as we make crediting rate decisions, so we believe it's appropriate and conservative to include a level of assumed defaults. The total spread for the annuity business of 203 basis points at June 30 is above our target of 201 basis points. Given the persistent low market rates, I'm pleased that we are exceeding our spread targets. However, it's an ongoing challenge to earn the desired target spread. We have 33% of our annuity business receiving a crediting rate above the minimum guarantees, but there are competitive pressures that make it difficult to be aggressive in taking further rate actions.

Results for our Life Insurance segment were strong this quarter. In addition, our point-in-time spreads on our universal life business improved during the quarter. This is due to a decline in assumed long-term default charges as well as a decline in credited rates. On May 15 we implemented a 25 basis point decrease on one of our primary universal life products. These actions resulted in an 8 basis point increase in the point-in-time spreads on our UL business to 147 basis points at June 30. This is positive, but these spreads remain below our target for this business of 152 basis points.

Like the Annuity segment, it will be difficult to increase universal life spreads going forward given today’s interest rate environment. For this block, we have 20% of the business receiving a crediting rate above the minimum guarantees.

I’ll also comment on the results for our Corporate & Other segment. They were below our expectations due primarily to a higher level of death benefits and the impact of unlocking. Death benefits overall for the company were lower, but we did see a higher number of claims and a higher average claim size with our variable universal life business. Given the nature of mortality experience, and the small size of this block, fluctuations on a quarterly basis are expected.

Next, I’ll comment on our financial strength.

At June 30, the capital position of our wholly-owned subsidiary, Farm Bureau Life, remained excellent with an estimated company action level risk based capital ratio of 541%. This is an increase from the March 31 level of 539%.

Using 425% RBC as a base, Farm Bureau Life had excess capital of approximately $145 million at June 30. At the holding company level we also have more than adequate liquidity and capital with excess capital at the parent company of approximately $35 million at June 30.

Jim mentioned our recent 20-year anniversary as a public company. During this time, FBL Financial Group has delivered consistent earnings results and maintained a strong capital position. In addition, we pay a relatively high dividend. I’m confident that we’ll continue to maintain our financial discipline.

That concludes our prepared remarks. We will now turn the call over to the operator and open it up to any questions you may have.