Torchmark Corporation

2nd QUARTER 2015 CONFERENCE CALL

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Thank you. Good morning, everyone. Joining the call 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 2014 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 *- Torchmark Corporation - Co-CEO*

Thank you, Mike, and good morning, everyone. Net income operating income for the second quarter was $133 million, or $1.05 per share, a per share increase of 3% from a year ago. Net income for the quarter was $127 million, or $1.00 per share, a 2% increase on a per share basis.

With fixed maturities that amortized costs, our return on equity as of June 30 was 14.7% and our book value per share was $28.91, a 7% increase from a year ago. On a GAAP reported basis with fixed maturities at market value, book value per share was $33.94, approximately the same as a year ago.

In our life insurance operations, premium revenue grew 5.7%, to $520 million, while life underwriting margin was $139 million, down 1% from a year ago. Despite the growth in premium, underwriting margin declined, primarily due to higher claims in Direct Response. For the full year, we expect life underwriting margin to increase 1% to 3% over 2014. Life sales increased 6%, to $108 million.

On the health side, premium revenue grew 8%, to $232 million, and health underwriting margin grew 4%, to $52 million. The growth in underwriting margin lagged the growth in premium due to the large amount of group business added in 2014, which has lower margins than our other health business. For the full year, we expect health underwriting margin to increase 2% to 4%. Health sales increased 8%, to $31 million.

Administrative expenses were $47 million for the quarter, up 3% from a year ago and in line with our expectations. As a percentage of premium, administrative expenses were 5.7%, the same as a year ago. For the full year, we anticipate that administrative expenses will be up around 6% to 7% and around 5.8% of premium. I will now turn the call over to Larry

Hutchison for his comments on the marketing operations.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Thank you, Gary. I will now go over the results for each company.

At American Income, life premiums were up 9%, to $207 million, and life underwriting margin was up 6%, to $64 million. Net life sales were $50 million, up 13%, due primarily to increased agent counts. The average agent count for the second quarter was 6,603, up 15% over a year ago and up 5% from the first quarter. This producing agent count at the end of the second quarter was 6,516. We expect life sales growth for the full year 2015 to be within a range of 11% to 13%.

Our Direct Response operation at Globe Life, life premiums were up 7%, to $188 million. Life underwriting margin declined 16%, to $37 million. Net life sales were flat, at $45 million. We expect 4% to 6% life sales growth for the full year 2015.

At Liberty National, life premiums were $68 million, approximately the same as a year ago, while life underwriting margin was $18 million, down 3% from the year-ago quarter. Net life sales grew 6%, to $9 million, while net health sales increased 4%, to $4 million. The average producing agent count for the second quarter was 1,550, up 4% from a year ago and up 6% from the first quarter. The producing agent count at Liberty National ended the quarter at 1,550. Life net sales growth is expected to be within a range of 5% to 7% for the full year 2015. Health net sales growth is expected to be within a range of 2% to 4% for the full year 2015.

At Family Heritage, health premiums increased 8%, to $55 million, while health underwriting margin increased 5%, to $11 million. Health net sales were up 4%, to $13 million. The average producing agent count for the second quarter was 960, up 27% from a year ago and up 22% from the first quarter. The producing agent count at the end of the quarter was 969. We expect health sales growth to be within a range from 8% to 10% for the full year 2015.

At United American general agency, health premiums increased 16%, to $88 million. Net health sales increased from $9 million to $10 million. Individual sales grew 21%, to $7 million, while group sales declined 6%, to $2.8 million. For the full year 2015, we expect growth in individual sales to be around 15% to 20%. As we discussed last quarter, we expect lower group sales in 2015 due to the unusual number of large group cases we acquired in 2014.

Premium revenue from Medicare Part D declined 11%, to $75 million, while the underwriting margin declined from $9 million to $5 million. The decline in underwriting margin was in line with our expectations and was due to the increase in Part D drug costs discussed in our previous call. We expect Part D premiums of $305 million to $315 million for the full year 2015 and expect margin as a percentage of premium to be approximately 6% to 8%. I will now turn the call back to Gary.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

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 $57 million, approximately the same as the second quarter of 2014. On a per share basis, reflecting the impact of our share repurchase program, excess investment income increased 5%.

We have discussed on previous calls the effect of Part D on excess investment income. Excess investment income was negatively impacted by Part D to the extent of $2 million in the second quarter of 2015. Excluding the negative impact of Part D, excess investment income would have been up 2% compared to the year-ago quarter and up about 7% on a per share basis. For the full year 2015, we expect excess investment income to decline by about 1% to 2%; however, on a per share basis we should see an increase of about 3% to 4%. At the midpoint of our 2015 guidance, we're expecting a drag on excess investment income from Part D of approximately $8 million.

Now, regarding the investment portfolio

Invested assets were $13.6 billion, including $13.1 billion of fixed maturities at amortized cost. Of the fixed maturities, $12.5 billion are investment grade, with an average rating of A-. And below investment grade bonds are $580 million, compared to $563 million a year ago. The percentage of below investment grade bonds for fixed maturities is 4.4%, the same as a year ago. With a portfolio leverage of 3.6 times, the percentage of below investment grade bonds to equity, excluding net unrealized gains on fixed maturities, is 16%.

Overall, the total portfolio is rated A-, the same as a year ago. In addition, we have net unrealized gains in the fixed maturity portfolio of $1 billion, approximately $935 million lower than at the end of the first quarter. The decline in unrealized gains was generated by higher interest rates, not by concerns over credit quality.

Due to the recent events in Greece, I would like to remind everyone of our limited exposure there. We have no direct exposure to Greek sovereign debt and we have no exposure to companies that do business primarily in Greece. We don't expect to realize any losses should Greece exit the euro zone.

To complete the investment portfolio discussion, I would like to address our investments in the energy sector. We believe the risk of realizing any losses in the foreseeable future is minimal for the following reasons. Over 96% of our energy holdings are investment grade. At the end of the second quarter, our energy portfolio had net unrealized gains of $69 million. Less than 8% of our energy holdings are in the oil field, service and drilling sector. And we have reviewed our energy holdings and concluded that while we may see some downgrades, we believe that the companies we've invested in can withstand low oil prices for an extended duration.

Now to investment yield

In the second quarter, we invested $250 million in investment grade fixed maturities, primarily in the industrial and financial sectors. We invested at an average yield of 4.7%, an average rating of A-, and an average life of 30 years.

For the entire portfolio, second quarter yield was 5.85%, down 7 basis points from the 5.92% yield in the second quarter of 2014. At June 30, the portfolio yield was approximately 5.83%. The midpoint of our guidance for 2015 assumes a new money yield of 5.0% for the last two quarters of the year.

And one last thing; we are encouraged by the potential for higher interest rates. As discussed previously on analyst calls, rising new money rates will have a positive impact on operating income by driving up excess investment income. We are not concerned about potential unrealized losses that are interest rate driven reflected on the balance sheet, since we would not expect to convert them to realized losses. We have the intent and, more importantly, the ability to hold our investments to maturity. Now I will turn the call over to Frank to discuss share repurchases and capital.

Frank Svoboda ***- Torchmark Corporation - CFO***

Thanks, Gary. First, I would like to briefly discuss a few items impacting our 2015 earnings guidance.

As Gary mentioned, growth in life underwriting income lagged behind the growth in premium in the second quarter, due to higher policy obligations in our Direct Response operations. In the second quarter this year, policy obligations at Direct Response were 52% of premiums, versus 49.1% in the first quarter and 48.1% for all of 2014.

As discussed on our last call, we thought the percentage would trend higher during 2015 and be around 49% for the year, primarily due to anticipated higher claims relating to policies issued in calendar years 2000 through 2007. With claims data through June 30, we are now seeing higher claims than anticipated on policies issued in 2011 through 2013, as these policies exit a two-year contestability period.

Beginning in 2011, we introduced the use of prescription drug database information into our underwriting procedures for certain adult policies, with an expectation that our mortality experience would be better on such policies than historical experience. While actual mortality related to policies issued in 2011 through 2013 has not been greater than historical levels, they are higher than we assumed when the policies were issued. Approximately 9% of the premium collected in 2015 relate to policies issued in 2011 through 2013, where we used the prescription drug database.

We believe the higher than anticipated claims will continue throughout the year and thus, we are now revising our estimate of policy obligations for the full year 2015 to a range of 50% to 51% of premiums. At the midpoint of this range, the Direct Response obligations will be approximately $12 million higher than previously estimated. This increase is in the expected policy obligations at Direct Response is the primary driver of the $0.05 reduction in the midpoint of our guidance from $4.28 to $4.23.

Now regarding our share repurchases and capital position

In the second quarter, we spent $86.3 million to buy 1.5 million Torchmark shares at an average price of $56.93. So far in July, we have used $15.8 million to purchase 269,000 shares. For the full year through today, we have spent approximately $192 million of parent company cash to acquire 3.5 million shares at an average price of $55.25.

The parent started the year with liquid assets of $57 million. In addition to these liquid assets, the parent will generate additional free cash flow during the remainder of 2015. 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 2015 to be in the range of $355 million to $360 million. Thus, including the $57 million available from assets on hand at the beginning of the year, we currently expect to have around $417 million of cash and liquid assets available to the parent during the year.

As previously noted, to date we have used $192 million of this cash to buy 3.5 million Torchmark shares, leaving around $225 million of cash and other liquid assets available for the remainder of the year. As noted before, we will use our cash as efficiently as possible. 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 million to $60 million of liquid assets at the parent company.

Regarding RBC at our insurance subsidiaries

We plan to maintain our capital at the level necessary to retain our current ratings. For the last two years, that level has been around an NAIC RBC ratio of 325% on a consolidated basis. This ratio is lower than some peer companies, but is sufficient for our companies in light of our consistent statutory earnings, the relatively lower risk of our policy liabilities, and our ratings. As of December 31, 2014, our consolidated RBC was 327%. We do not anticipate any significant changes to our targeted RBC levels in 2015.

As we've discussed on prior calls, S&P changed their view last year as to the treatment of certain inter-company preferred stock and requested additional capital be contributed to our insurance subsidiaries to retain our current ratings. We have reviewed various alternatives available to us and are scheduled to meet with S&P in August or September, where we will discuss potential solutions and courses of actions with them.

Based on our analysis to date, should we decide to add additional capital, we believe we will be able to address the additional capital needs without significantly impacting our free cash flow available for buy back. One option available is for Torchmark to issue additional hybrid securities treated as debt for financial reporting purposes, but equity for S&P capital purposes. If we were to issue such securities in an amount sufficient to meet the entire shortfall, we estimate that the overall impact on EPS would be less than $0.01 per share. Those are my comments. I will now turn the call back to Larry.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Thank you, Frank. For 2015, we expect our net operating income to be within a range of $4.18 per share to $4.28 per share, a 5% increase over 2014 at the midpoint. Those are our comments. We will now open the call up for questions.

QUESTION AND ANSWER

Jimmy Bhullar ***- JPMorgan - Analyst***

Hi. First, I had a question on the Direct Response claims. And you give the amount and the impact on the benefits issued. It seems like the amount on an annual basis should be about $0.06 a year. So if you could confirm whether that's right. And then should we expect that that will continue into next year and at least for the next few years?

And then secondly, on the agent count at American Income, it dropped from beginning to ending, obviously, on an average basis, it was up. Maybe you could discuss what drove the decline and what your expectations are for agent count growth at American Income.

Frank Svoboda ***- Torchmark Corporation - CFO***

Jimmy, on the Direct Response, the $0.06 impact for 2015 is right. That's what we see, as far as the additional impact overall. For 2015, as we had indicated, we see the policy obligations being in that 50% to 51% range. And as far as trying to see, our best estimate at this point in time for where that might go in 2016, we see that overall, the policy obligation for Direct Response maybe being in that 51% to 52% range, and bringing the Direct Response margin maybe down in that 20% to 21%. So that's really just based on you know the data that we have available to us today and where we see that going.

Jimmy Bhullar ***- JPMorgan - Analyst***

Okay. And on the agent count at American Income?

Operator

And our moderator's line has disconnected. I will have to dial back out to them. And you are reconnected.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Yes. Can you hear us?

Operator

Yes. You are reconnected. And we still have Mr. Bhullar on from JPMorgan.

Jimmy Bhullar ***- JPMorgan - Analyst***

Yes, and just to be clear on the Direct Response business, it's not that you have seen a sudden spike in claims, but it's more that you had assumed that claims would get better, or that the margins would be better because of the use of prescription drug information, and in reality, they just have not been, right?

Frank Svoboda ***- Torchmark Corporation - CFO***

Jimmy, that is exactly correct.

Jimmy Bhullar ***- JPMorgan - Analyst***

And this is -- it's mostly related to, the decline this quarter was related to one discrete block as opposed to spread across the block, or those policies as opposed to spread across various vintage years or other parts of the business?

Frank Svoboda ***- Torchmark Corporation - CFO***

Yes, largely that's correct. There's a little fluctuation. We had some seasonal fluctuations, but largely the case.

Jimmy Bhullar ***- JPMorgan - Analyst***

And those--the fluctuations are just normal volatility in claims from quarter to quarter, right?

Frank Svoboda ***- Torchmark Corporation - CFO***

That's correct.

Jimmy Bhullar ***- JPMorgan - Analyst***

Okay. Thanks. And then lastly, just on the agent count drop at American Income. It did grow on an average basis, but it was down from the end of the previous quarter. So maybe, just if you could discuss what drove that and your expectations for growth at American Income.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Jimmy, this is Larry. Again, the ending agent count is less important than the average agent count. There are some fluctuations every quarter. And just on the last day, it depends on the terminations that come through. If you look at the overall results for the last year, we've had significant agent growth. We still expect to meet our producing agent count projection of 6,800 to 7,000 agents for 2015.

Jimmy Bhullar ***- JPMorgan - Analyst***

Okay. Thank you.

Erik Bass ***- Citigroup - Analyst***

Hi. Thank you. I just had one follow-up, first on Direct Response. Now you have identified the two blocks of issue, or the policies from 2000 through 2007, and then the 2011 through 2013. So was there any difference in kind of your underwriting or pricing assumptions from that 2007 through 2011 period that gives you comfort that you won't see any higher incidence of claims there? And I guess the same question would be for 2014-2015. Were there any changes that you made to your either pricing or to your assumptions for the most recent years?

Frank Svoboda *- Torchmark Corporation - CFO*

Yes, Erik, with respect to 2011 to 2013, really the change that had taken place, you know again, was a lowering of the overall mortality assumptions, because we had started using that prescription database. And that assumption will carry through, through the 2015 issue years. Those have not -- 2014 and 2015 are not out of the contestability phase yet, so we really haven't seen any claims emerging on those.

And you know of course, we're tweaking a little bit over time how we use the Rx. But clearly we'll be taking a look at how we're using the Rx, why we're not getting the benefits that we had anticipated, and be making the appropriate decisions with respect to 2016. So we do see that being contained within the 2011 through 2015 block. But it really is different than the 2000 to 2007. And some of the higher mortality that we were seeing in 2000 that earlier block has been built in – you know that portion has been built into the overall assumptions in those later years.

Erik Bass *- Citigroup - Analyst*

Got it; so there was a change in your assumptions kind of in the 2008 period?

Frank Svoboda *- Torchmark Corporation - CFO*

Yes, overall, with regard to some of those earlier years.

Erik Bass *- Citigroup - Analyst*

Got it. Okay. So you don't expect the issues you're seeing in the 2007 -- or the 2000 through 2007 block to continue into any of the later issue years?

Frank Svoboda *- Torchmark Corporation - CFO*

That is correct.

Erik Bass *- Citigroup - Analyst*

Okay. Thank you, and then just one question. You gave the target, I think, for the year end agent count for American Income. Would you mind providing any update for Liberty National, as well as Family Heritage, given the strength that you've seen in recruiting in the past couple of quarters there?

Larry Hutchison *- Torchmark Corporation - Co-CEO*

Sure. We expect the year-end agent count at Liberty National to be in a range of 1,630 to 1,660 agents. At Family Heritage, we expect the year-end agents count to be in a range of 975 to 1,000 agents.

Erik Bass *- Citigroup - Analyst*

Thank you.

Yaron Kinar *- Deutsche Bank - Analyst*

Good morning. I want to go back to the Direct Response business, if I could. A couple of questions there. One is, on the previous call, I think you had talked about the early 2000 vintages being the ones that showed elevated claims activity. Now you are talking about 2000 to 2007. So does that suggest that you've seen elevated claims activity now really move a little further to newer vintages, as well, beyond the 2011 to 2013 issue that we discussed?

Frank Svoboda *- Torchmark Corporation - CFO*

Yes, Yaron, on the –yes we had talked on the previous calls, we did see some of the elevated claim activity in that 2000 to 2007. But as we now have the full claim experience here for the first and second quarters of 2015, we're able to go back. We basically have been able to close out the 2014 calendar year and all the claims associated and paid within that year. We can--you know see the higher claims than what we had anticipated.

Again, in that 2011, that third policy year, that first year that comes out of the contestability period, you know we can now identify that some of the higher claims that we were incurring really related to the 2011. And now we're seeing some of the same patterns taking place with respect to the 2012 accident year, as well. Really at the end of last year, we just didn't have enough claim experience to see and make the jump that it was going to continue for some of those later policy years. Some of the indications that we have now with the new – you know with updated claims experience, we see that trend probably continuing.

Yaron Kinar *- Deutsche Bank - Analyst*

Okay. I guess just to clarify, on the last call, you talked about the early 2000 vintages, and I think you had also said that those were vintages that were over a decade old. Now you're talking about 2000 to 2007. So the 2005, 2006, 2007 years seem to not quite fall into that category.

Frank Svoboda *- Torchmark Corporation - CFO*

No, when I talk about the 2000 to 2007 issue years that is the same vintage that we were referring to on the prior calls. That part hasn't changed. We really haven't changed our outlook right now with respect to additional claims on that particular block.

Yaron Kinar *- Deutsche Bank - Analyst*

Okay. And had the 2011 to 2013 vintage data not developed the way it had, would you still have expected the benefits ratio to fall in within the 48.5% to 49% range that you had previously offered?

Frank Svoboda *- Torchmark Corporation - CFO*

Yes, it would have been really close to that 49%.

Yaron Kinar *- Deutsche Bank - Analyst*

Okay. And maybe one last question on this Direct Response business. How quickly do you expect the 2000 to 2007 and the 2011 to 2013 vintages to run off? What's the rate of decay there?

Frank Svoboda *- Torchmark Corporation - CFO*

I'm not sure. They'll obviously run off over a really long period of time. But what we see right now is that probably the peak of the adverse experience over what we had expected probably going to you know be maybe 2017, and that's as those years, as the 2015 comes out of its contestability period. So we see that as being the low point, as far as Direct Response margin is concerned, and then being able to improve after that.

Yaron Kinar *- Deutsche Bank - Analyst*

Okay, and I'm sorry, maybe I'll sneak in one last one. In Direct Response, we're also seeing a bit of a slowdown in sales. Is that just attributable to repricing of that business now that mortality data has come in a little higher than expected?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

I think if you recall, the second quarter of 2014 was the largest production quarter in the history of Direct Response. So actually, we're pleased with the slight increase this quarter. We still expect an increase in sales in Direct Response this year in the range of 4% to 6%.

Yaron Kinar ***- Deutsche Bank - Analyst***

Okay. Thank you.

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

Hey. Good morning everybody; just a little bit more on the Direct Response. First, Frank, the earlier years, 2000 through 2007, did that perform in line with your current expectations for the quarter?

Frank Svoboda ***- Torchmark Corporation - CFO***

For the quarter, we saw a little bit higher seasonal fluctuations that we really do anticipate coming back to the normal trend over the course of the year. Our expectation for the full year is still in that—kind of in that range we talked about last time, probably increasing the overall obligation percentage by 0.4%, 0.5%. So we really haven't changed our overall outlook for that.

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

Okay. Great. And then on the newer stuff, could you explain the importance of the contestability period ending in this calculation or how you see things? Why is that so important?

Frank Svoboda ***- Torchmark Corporation - CFO***

Sure. Well, for the first two years after issue, we have the ability to contest any claims that come in during that period of time. But after the end of that two-year contestability period, the claims now become non-contestable unless we can prove certain things with respect to that application. But-- so if you look at the history of this product, that third year tends to be one of the highest claim years, and then it tends to trend down after that. So that's when you start seeing those really early claims.

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

Okay. Is that just timing, or is that -- anyway, all right, so 2011 -- pardon me.

Frank Svoboda ***- Torchmark Corporation - CFO***

Yes, it is just the timing of that. That's just the way that that particular product seems to behave.

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

Okay. So 2011, you would have seen the losses occur in 2014. Would you have seen losses beginning to occur in 2012 or 2013? I guess I'm a little bit confused about why you are confident that those are going to be bad, as well, going forward.

Frank Svoboda ***- Torchmark Corporation - CFO***

Sure. So for the 2011 issue year, we have seen very little claim activity prior to you know really the end of 2013 and then into 2014. And so 2014 is when you really start seeing the claims activity for that third policy year really developing. And then, of course, you're starting to see some of that claim activity for the fourth policy year, as well, for the 2012. But--so during 2014 you see some higher claims but again, you're limited to just a very small piece of information on one particular policy year. Late in 2014, now in 2015, you're starting to see some of those -- the claims for that third policy year, for the policies that were issued in 2012.

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

Okay

Frank Svoboda ***- Torchmark Corporation – CFO***

And we're starting to see some of those same patterns. And then, of course, 2013, they're just starting to enter that third—you know third issue year, third year after the issue year. And so you're just barely starting to see some of those. But it's getting some of that additional data with respect to 2012, some very early returns on 2013, where you're starting to see some consistency that we can rely upon.

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

Okay. Alright. That makes sense. Thank you.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Steven, I would add that Frank has mentioned 2011. We didn't start using the Rx information until late in 2011. So really 2012 is the first year where we really had enough issues where we could start seeing experience in late 2014.

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

Alright, Gary. Thank you very much.

Randy Binner ***- FBR & Co. - Analyst***

Hey, I'm going to stick with that topic, because after Schwartz asked those questions, I guess I'm not clear. This type of direct type of coverage, would you describe this as final needs-type coverage? And the reason I ask is that it seems like you're having mortality events relatively quickly. Is that the right way to characterize this type of coverage?

Frank Svoboda ***- Torchmark Corporation - CFO***

It definite--in general, yes.

Randy Binner ***- FBR & Co. - Analyst***

okay

Frank Svoboda ***- Torchmark Corporation - CFO***

Those tend to be very quick.

Randy Binner ***- FBR & Co. - Analyst***

And so when you all said that you were exiting the contestability period, what is it that you have been successful on disputing in that period, and does that have anything to do with the Rx data?

Frank Svoboda ***- Torchmark Corporation - CFO***

I'm sorry, Randy, on that, you just kind of cut out on that little bit. I didn't quite catch that whole question.

Randy Binner ***- FBR & Co. - Analyst***

In the contestability period, what is it that you were contesting, and does that have anything to do with the Rx data or is it more typical contestability type stuff?

Frank Svoboda ***- Torchmark Corporation - CFO***

It's more normal contestability type stuff. So obviously, you're looking at how the answers and what information they provided to you and whether or not there was any misrepresentations with respect to the application. The Rx data, we just simply use, to the extent that we have authorization from them, we can verify whether or not some of that information on the application is, in fact --

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

This is Larry, I think some of the timing with the Rx is not in the contestability period, but it's the time of issue. You have a bigger running picture. And so you either decline some of the business you otherwise would have issued, where some of that is rated as substandard business. So it's not really just a contestability period, it's evaluating the risk that you're underwriting for the life insurance.

Frank Svoboda ***- Torchmark Corporation – CFO***

We're really not—

Gary Coleman ***- Torchmark Corporation - Co-CEO***

We didn't see that much difference during the contestable periods for these claims. And remember, the issue here is not that the mortality is worse than what we experienced in the past. What has happened is we've experienced about the same mortality as we did before we started using the prescription drug information. But the problem was, we assumed that we were going to have better mortality in our reserves, and that's why you're seeing you know the increase in the policy obligations.

That's in the overall. What we need to look at is the Rx. In certain segments, we think it's probably benefiting, in others, it's not. And we'll have to evaluate those and determine how we use that going forward. But I do want to emphasize, we're not seeing worse mortality than we saw before. We're seeing about the same. The problem is, we thought the Rx would lead to us better mortality.

Randy Binner ***- FBR & Co. - Analyst***

Ok, understood. I just wanted to clarify some of those concepts. And then if I can sneak in another one, just going over to the investment yield. So Gary, I think you said that the midpoint of your EPS guidance assumption is for a new money rate of 500 basis points in the back half. Did I get that number right, the 500 basis points?

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Yes, that is correct.

Randy Binner ***- FBR & Co. - Analyst***

And so when we discussed the same topic last quarter, I think that similar assumption was 475 basis points. So I guess you're 25 basis points higher, and is that because the 10-year, even though it's only up like 15 basis points year-to-date, it's about 25 basis points higher than where we were three months ago? Is that the right way to think of it? And the follow-up there is, are you actually seeing 500 now when you're investing today?

Gary Coleman ***- Torchmark Corporation - Co-CEO***

First, to answer your question, it is because of the uptick in Treasury rates. We look at more the 30 years than the 10-year, because of how long we invest.

Randy Binner ***- FBR & Co. - Analyst***

Okay

Gary Coleman ***- Torchmark Corporation - Co-CEO***

But also, to answer your question to what we've invested so far this quarter, we're above 5%.

Randy Binner ***- FBR & Co. - Analyst***

And is that still A or is that in the BBB area?

Gary Coleman ***- Torchmark Corporation - Co-CEO***

I believe that's in the A-, BBB+ area.

Frank Svoboda ***- Torchmark Corporation - CFO***

Right, BBB+.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Is that right Frank?

Randy Binner ***- FBR & Co. - Analyst***

BBB+? I'm going to ask one more. Then on this notching proposal within NAIC level 1 and 2 securities, potentially, do you have any thoughts for us on that, how that could affect your RBC ratio or how the industry might potentially deal with more categories within NAIC level 1 and 2 from an RBC ratio perspective?

Frank Svoboda ***- Torchmark Corporation - CFO***

I know-- the industry as a whole and the industry associations are working pretty closely with the NAIC, trying to limit the number of categories you know for where additional factors might come in play. So that's clearly a work in progress. I think I said before we kind of see that as a 2017 or 2018 event. And the latest information that we have, that's still the best estimates.

From an impact -- our preliminary -- using some of the information they have out there that is, of course, subject to change, you know it could mean maybe a 20 to 25 basis point change, pure reduction in the overall RBC percentage. What we don't know is for sure is then how do the rating agencies and how do the users of the RBC data, how do they react to that. And this is what we'll have to do from that perspective.

Randy Binner ***- FBR & Co. - Analyst***

But it is not affecting your thoughts -- I mean, you are buying BBB+ because that's where you see good economic value and asset liability matching, and this change has no impact on that, right?

Frank Svoboda ***- Torchmark Corporation - CFO***

That's exactly right.

Randy Binner ***- FBR & Co. - Analyst***

Thanks so much.

Mark Hughes ***- SunTrust Robinson Humphrey - Analyst***

Thank you. Good morning.

Frank Svoboda ***- Torchmark Corporation - CFO***

Good morning, Mark.

Mark Hughes ***- SunTrust Robinson Humphrey - Analyst***

Have there been any changes in pricing or your underwriting criteria that are going to impact sales in the Direct Response business?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Mark, as we've done in the past, we always adjust our segmentation modeling to maximize sales with profit. So that's a constant process as we market in Direct Response.

Mark Hughes ***- SunTrust Robinson Humphrey - Analyst***

Right, is that to say given what you've seen in terms of the claims activity, that you will be raising prices or tightening up your underwriting?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

It depends on the segment that you're talking about. We wouldn't necessarily raise all prices, but certain segments, as we see differences, not just claims, but response rates, inquiries, we adjust our pricing, and we adjust our modeling and our marketing to fit that data that comes back to us.

Mark Hughes ***- SunTrust Robinson Humphrey - Analyst***

Right, and this would normally be the circumstances that would lead to adjustments that might constrain sales going forward?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

It might constrain sales on a certain segment, but I don't think it would be fair to say it would constrain sales overall. You just reemphasize your marketing.

Mark Hughes ***- SunTrust Robinson Humphrey - Analyst***

Got you, and then in the third quarter of last year, the Med Supp sales within Direct Response, you had a very big quarter. Is there any reason to think that might recur again this year? I know you've said you've got tough comparisons or you wouldn't necessarily trend line that, but 3Q was very big last year. Is any of that renewing? How should we think about that?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Probably renewing; in terms of new cases, we think we will see a decline in new cases, since we had an unusual number of new cases last year in the group. In the individual, we're predicting 15% to 20% growth for the entire year in our Med Supp sales.

Mark Hughes ***- SunTrust Robinson Humphrey - Analyst***

Okay. And then a final question. The impact of the Medicare Part D, I think you said it was a $8 million drag, how will that play out in 2016? Will it be an equivalent drag, or will the drag lessen up?

Frank Svoboda ***- Torchmark Corporation - CFO***

Yes, Mark, at this time, the best estimates are that we'll end up with a receivable as of the end of 2015 approximately the same as where we're at, where we were at the end of 2014. So I would think the drag would be somewhere in that same area.

Mark Hughes ***- SunTrust Robinson Humphrey - Analyst***

So as we think about 2016, you think it would be similar?

Frank Svoboda ***- Torchmark Corporation - CFO***

Correct.

Mark Hughes ***- SunTrust Robinson Humphrey - Analyst***

Okay. Thank you.

Eric Berg ***- RBC Capital Markets - Analyst***

Thanks very much. Two questions related to Direct Response. Do I have it right when I say that with respect to the 2000 to 2007 block, that in contrast to the 2011 to 2013 block, in which you are not experiencing higher than expected mortality, you're just not getting the improvement that you had anticipated, in the earlier block you are experiencing higher than expected mortality?

Frank Svoboda ***- Torchmark Corporation - CFO***

That's correct.

Eric Berg ***- RBC Capital Markets - Analyst***

Is that right?

Frank Svoboda ***- Torchmark Corporation - CFO***

That's right.

Eric Berg ***- RBC Capital Markets - Analyst***

And what’s your-- and it seems to me, when an insurance company has higher than expected number of death claims or larger claims, it could be for any of a number of reasons. As you have studied these claims from these seven issuance years, what's your initial or best sense of what is at the root of the problem?

Frank Svoboda ***- Torchmark Corporation - CFO***

You know, as we have really taken a look at those claims, interestingly enough, there really isn't one particular area that seems to be sticking out, if you will, as far as where those additional claims might be coming from. The only thing that tends to maybe be a little bit higher than what would be normal average would be some deficit as relating to respiratory illnesses. Other than that, there really is not -- and we've looked at how we've segmented it in different areas. Really is very little that sticks out.

Eric Berg ***- RBC Capital Markets - Analyst***

My second question relates to this pharmacy, the Rx thing. I'm just really scratching my head here on the following sense. I would think that if you took two individuals of identical health, non-smokers, same height, same weight, same body mass, let's just assume they have identical health, and you tell me that person A is taking seven different medications for heart and maybe cancer and blood pressure and what have you, and the other person is prescription-free, drug-free, that there's no information content in that at all? There's no value in knowing that person A is taking many medications? I just find that -- I'm just scratching my head like you guys are. What do you think is going on here? What's your initial sense of what's going on here?

Frank Svoboda ***- Torchmark Corporation - CFO***

It is a good question because that is -- when we have -- when we've been using the Rx, we would-- that's exactly why we assume that we would be having the better mortality. So we're taking a look at that now to really understand why we're not seeing the benefits that we really saw. Is it just in the type of data that we're getting? Is it just simply how we're using that data? Obviously, on some, we do have some more rejects, applications that are rejected using the Rx than we would have otherwise. So it's helped in that standpoint. But that's really the question we're trying to get an answer to so that we can make the appropriate decisions.

Eric Berg ***- RBC Capital Markets - Analyst***

And you don't even have an initial hunch as to what's going on here, why this didn't help you?

Frank Svoboda ***- Torchmark Corporation - CFO***

Not yet at this point in time.

Eric Berg ***- RBC Capital Markets - Analyst***

Okay. Thank you.

Bob Glasspiegel ***- Janney Montgomery Scott - Analyst***

Good morning everyone, just a quick question on follow-up to Mark Hughes. If the receivable stays constant on the recovery from the government, wouldn't it be a neutral next year on investment income? At some point, this reverses. But if you reverse it, once you got up and put new stuff up, it seems like it would be a neutral to investment income.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Bob, you're right, it would be neutral. It would be about the same drag next year as it is this year.

Bob Glasspiegel ***- Janney Montgomery Scott - Analyst***

Okay. And at some point, it would reverse, right? Do you have a sense on what year that would be?

Frank Svoboda ***- Torchmark Corporation - CFO***

It should reverse by the end of 2016. And then, of course, depending upon what happens with 2016 claims activity and the receivable, and whatever is generating new in 2016.

Bob Glasspiegel ***- Janney Montgomery Scott - Analyst***

Right, so the drag stays the same, but it's not an incremental drag, so investment income should move up with cash flow and yields and not be impacted in 2016, and then it becomes an equivalent positive in 2017 to the negative it's been in this year?

Frank Svoboda ***- Torchmark Corporation - CFO***

Yes, that's correct. When I had answered it, I was looking at just from a drag, not an incremental drag. But it's correct, it would be the similar drag in 2016 as it is in 2015, but then presuming that the receivables actually get to go down by the end of 2016, you would see the real incremental benefit in 2017.

Bob Glasspiegel ***- Janney Montgomery Scott - Analyst***

Okay, buyback. Last year's annual report, I think you said you were getting near, but hadn't reached intrinsic value where buyback was the first best use. But you sent a warning that if the stock kept running, last year it was up 4%, it's up, even with the correction today, 10%. Are we anywhere near the point where the warning has to be sent out that dividends might be a use, or is buyback still below intrinsic value?

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Bob, we still believe the buyback is below the intrinsic value. We are trading at the higher -- even when we wrote the annual report, we are trading at higher multiples. But we still believe we haven't reached intrinsic value, and so we'll continue to buy. because still, the return that we're getting is in excess of our cost of the capital by a good margin, and also the return we're getting exceeds return that we could get on alternative uses. So we'll continue on. As we've said before, if we think the price does get to at or above the intrinsic value, then we'll have to reassess at that point.

Bob Glasspiegel ***- Janney Montgomery Scott - Analyst***

Frank's speech was the same as it's been the last 36 quarters, so it seemed like that was the case. But appreciate it.

Ryan Krueger ***- Keefe, Bruyette & Woods - Analyst***

Thanks. Good morning. First one, I wanted to follow up on the prescription drug data. I guess just to be clear, do you only use that when you price Direct Response business, or did you also use that in that some of your other businesses when you were underwriting those?

Frank Svoboda *- Torchmark Corporation - CFO*

Yes, it's been used in very limited situations with respect to some older age issuances in the other agencies. And again, I will stress, it's very limited circumstances, and we have not reduced any of our mortality assumptions for the use of Rx in those other agencies. So it's just simply been just an added tool in the underwriting process there.

Ryan Krueger *- Keefe, Bruyette & Woods - Analyst*

Ok, so it's really isolated to Direct Response at this point, for the most part, is that correct?

Frank Svoboda *- Torchmark Corporation - CFO*

Correct. That is correct.

Ryan Krueger *- Keefe, Bruyette & Woods - Analyst*

Okay, and then just follow-up to Randy's question on the RBC changes. I mean at this--I know it's early on still, but it seems like the rating agencies tend to use higher capital charges than the RBC formula already. So is it your best guess that even though RBC ratios will change and go down for the industry, that it won't necessarily change the way that you and others are managing capital?

Frank Svoboda *- Torchmark Corporation - CFO*

I think that's a very real possibility. And you're right, S&P has their own capital you know factors that they use, and which are higher and would really be more similar to what the NAIC is looking to move towards. And then Moody's and A.M. Best, then how they would look at it. But we would anticipate that, or at least it would be a possibility that no changes at all would be necessary.

Ryan Krueger *- Keefe, Bruyette & Woods - Analyst*

Got it. Okay. Thanks.

Colin Devine *- Jefferies & Co. - Analyst*

Thank you. Just to come back, one more thing on this Rx issue. It seems to me, if I am understanding what you're saying, when you went to that, you assumed mortality would improve. And so I would presume that had some impact on your pricing decisions. Now that it hasn't, it would suggest, I guess, that you're underpriced. How much are you thinking right now you may need to raise prices, if the Rx data just isn't giving you what you need?

Gary Coleman *- Torchmark Corporation - Co-CEO*

Well, Colin, it's too early to answer that. That's one thing we'll be looking at. But it's not necessarily we would have to raise prices. It may mean there are certain segments, certain age groups, certain –

Larry Hutchison *- Torchmark Corporation - Co-CEO*

Circulations---

Gary Coleman *- Torchmark Corporation - Co-CEO*

circulations that we either have to raise price or we determine that we don't want to sell in those again. So it's more -- we have to do a little bit more work on that before we can decide whether we raise prices or just discontinue in certain segments.

Colin Devine ***- Jefferies & Co. - Analyst***

Okay. And then a second question. You know, in looking at the premium growth this quarter, not only was it, I think, the strongest we've seen in over 10 years on the life side, but also on the supplemental side. Has some of your strategy changed there because of growing this up beyond Family Heritage, and really how much longer do you think you can keep this growth rate going? Because I think you've probably got about the strongest organic growth rate in the industry today.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Well, as far as, on the life side, we have been pleased to see the higher premium growth, and we think we can continue that. Our confidence there is that at American Income, where we have the largest amount of our business, we're growing premiums there around a 9% range. And we expect to continue growth there. Also, Direct Response is the second largest premium block that we have. We're growing in excess of 5% there. So we feel confident that we can -- that we've reached this level where we can at least stay at this 5% level.

On the health side, we feel that Family Heritage has growth prospects that will help keep that premium growth on the health side. And that's important because, Colin, you go back just a couple of years ago, we had declining health premiums as we had exited some health blocks in the past. So we feel positive about the future, as far as growing the premiums.

Colin Devine ***- Jefferies & Co. - Analyst***

What about the general agency this quarter on the supplemental side? It seemed to be surprisingly strong.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Well, as Larry mentioned earlier, we've had good growth on our individual Med Supp sales. And really, we had good growth last year, we're having stronger growth this year. So that's contributing to that other health line.

Colin Devine ***- Jefferies & Co. - Analyst***

Okay, and then a final one; again this quarter, further improvement in persistency, particularly thinking on the renewal year. How much stronger is that now than what you're pricing for, and what does this say really about your underlying core earnings growth rate? Since I would assume this is a you know a significant benefit.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Colin, I'm not sure I can answer how that differs from what we were pricing. I know we've seen improvements over what we priced. I just can't quantify it here on the call.

Colin Devine ***- Jefferies & Co. - Analyst***

Okay. Perhaps we can follow up afterwards. Thank you very much.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Okay

Tom Gallagher ***- Credit Suisse - Analyst***

Hi, The first question is did you -- I just want to make sure I had this right -- did you say 9% of your total in force Direct Response block was the Rx-related underwriting? Was that the right quantification?

Frank Svoboda ***- Torchmark Corporation - CFO***

That's correct. It was the premium received on the 2011 through 2013 years, actually, just to clarify.

Tom Gallagher ***- Credit Suisse - Analyst***

Okay. So that's premium received on the 2011 through 2013 years.

Frank Svoboda ***- Torchmark Corporation - CFO***

Right.

Tom Gallagher ***- Credit Suisse - Analyst***

As a percent of the total of the entire Direct Response in force block, or just of those years?

Frank Svoboda ***- Torchmark Corporation - CFO***

Of the total Direct Response block.

Tom Gallagher ***- Credit Suisse - Analyst***

Got you. Okay. So how do we think about, of your new sales this year so far, how much are Rx, you know using that Rx data? Can you quantify that? Is it 50%? Is it 100% of Direct Response sales that are relying upon this data?

Frank Svoboda ***- Torchmark Corporation - CFO***

Yes, it's around 50%, Tom.

Tom Gallagher ***- Credit Suisse - Analyst***

Okay.

Frank Svoboda ***- Torchmark Corporation - CFO***

50% of 2015 sales would be going out using the Rx.

Tom Gallagher ***- Credit Suisse - Analyst***

Okay. And at this point -- so it's possible you are going to be repricing 50% of your sales for Direct Response, or is that not the right way to think about it? Is it somehow isolated that the problematic parts are not the entirety of the 50%? How do we think about that?

Frank Svoboda ***- Torchmark Corporation - CFO***

Well, that's right. What Gary and Larry had mentioned earlier is that we still have to finish the work to determine exactly which segments that we're really not getting the benefit from and where that kind of all lies within that 50%. Some portion of that, maybe you are getting at least some incremental benefit from, but that's where the work really has to -- so it won't be that big.

Tom Gallagher ***- Credit Suisse - Analyst***

So it's going to be some fraction of that 50% of total sales. And if I --

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

This is Larry. You have to be careful, too, that the Rx in 2011 was less sophisticated than the Rx in the later years. As you develop models to get information, you have better combinations of drugs you look at as an indicator of health history. So I don't think you can assume that 2011 and 2012 will be the same experience as 2013 and 2014. We have to let some of these facts develop. And we're really early in this process. So in fact, the 2013 and 2014 years may be a difference experience over the 2011 and 2012 years were.

Tom Gallagher ***- Credit Suisse - Analyst***

Understood, and just to put this in context, when you look at the block, if you will, that you have identified thus far that you deem to be underpriced, are we talking about a block that's actually losing money? Is it just sub-par returns? Can you provide some context around that?

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Tom, we're definitely not losing money. We're pressuring the margins. Overall margins are being pressured. We're--we've been in the 23% to 25% underwriting margin for Direct Response over the last few years. This year, it's going to be closer to 21%, and you know it's early, and our preliminary estimates of how this plays out, we don't see that profit margin going below 18%, 19%.

So even if that all develops on that basis, we still are going to have 18% to 19% profit margin. We're not in a position of losing money at all. It's just that margin is not as high as it has been in the past.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

So that's at the low end of that range. It could be higher than the 18% or 19%.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Yes. The low end is 18% to 19%. We think that's the worst. So it's going to be somewhere between that and the 21%. And then over time, as we price, it will get better.

Tom Gallagher ***- Credit Suisse - Analyst***

Okay. And then my last question on that is, is this--when you look back to when you began to use the Rx data and pricing on that basis, was it done in response to the market becoming a lot more competitive for you? Had it become more price elastic than it was historically? Like what was the driver of starting to use this, and has that overall part of your business become more price sensitive?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

As we look at 2011, we saw this as the tool that we could use to better quantify and better look at the risk we're going to underwrite. And the difference is, we assumed it would have a more positive impact than it actually did. So it wasn't a mistake. It was just the actual experience is not as profitable as we anticipated. That affects your marketing as you go out in those lower performing deciles. So I don't think this was a huge surprise. It's just we -- the business is profitable. We just anticipated a higher profit level for the 2011 year than what's actually developed.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Yes Tom, we've always looked at the Direct Response side, because we haven't -- on Direct Response, we just can't, from the cost standpoint and a time standpoint, do a great deal of underwriting. That's just been the history of Direct Response. What we thought when this came out, the use of the prescription drugs, as Larry mentioned, we thought this was a low-cost way of getting better information and then to better underwrite; and if we could better underwrite, then we could venture into maybe segments that we hadn't before. So the whole process there was just -- it wasn't from a competitive standpoint to meet competitors. It was more a standpoint to give us a better underwriting than we had had before.

Tom Gallagher ***- Credit Suisse - Analyst***

Understood. Thanks.

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

Hi, thanks for extending the call for a moment for a quick question or two. Just following up a little bit on Tom's question, if we think about Direct Response overall, maybe it was a low to mid-20s margin, and maybe it's got downside for one or two particular years, you know down to the very high teens. So if we call it about a five-point swing in that margin, can you translate that to ROE of the business?

Gary Coleman ***- Torchmark Corporation - Co-CEO***

We don't really calculate an ROE on the business. With our return on investment, it might be lower. But we really -- I don't think it really has -- haven't really calculated that. I don't have an answer for that.

Frank Svoboda ***- Torchmark Corporation - CFO***

John, do you mean for that business as a whole or just the overall ROE for the impact that it would have on

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

Well, I guess either way, you would be able to -- if you could give us some color on that, whether it's for the Direct Response life business, or whether you know it's the overall impact to Torchmark. Obviously, for the overall impact to Torchmark, it would be considerably less.

Frank Svoboda ***- Torchmark Corporation - CFO***

Yes, that's what you're probably looking at, 0.5% or something to that effect there, I would guess. But I agree with Gary, as far as looking at the business, we don't really look at it in that, or don't have that, anyway, right now.

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

Okay. And then if I think –if following up on the question about the percentage of sales that have been sort of prescription-backed, if you will, in the underwriting process, so I think you mentioned about 50% of sales, but maybe it's some smaller portion of that that's actually become a little bit problematic here. If your decision you know were, we just don't want to play -- we don't want to underwrite in this particular segment, looking out to 2016, let's say, in terms of your pricing decisions, you just-- you know you just don't feel like you can get enough price or you won't be able to write any business at the price you need anyway, and so you just decide, this particular piece of the business you're just not going to go after any more, how –you know if I think about the dollar amount of sales that that's contributed in 2015 or in 2014, you know how do we think about the headwind that that causes for Direct Response sales?

Frank Svoboda ***- Torchmark Corporation - CFO***

I would say that that's information that we'll be able to provide better guidance on in the next call, as we kind of really get our arms around maybe which segments that that might have. You know the total premium using Rx in 2015, probably around $30 million. But again, as we've said, there's -- not that that whole $30 million is going to go away and you're going to change your strategy and rethink about which segments you market into and what your circulation is going to be. So it will be a change,

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

Okay

Frank Svoboda ***- Torchmark Corporation - CFO***

but I really couldn't say that we would expect any of that to go away.

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

Ok alright understood. We can stay tuned as you guys hone the data. I guess the last question for you, and I realize this is maybe a little nit-picky, but turning to health in American Income, I know it's mid-teens, maybe mid- to upper teens percentage of premium in the health segment, but or maybe a percentage of underwriting income, but it looked like the margin there was pressured by a couple of points this quarter. Is there anything, you know more than maybe just some seasonality or normal volatility there?

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Yes I think its seasonality, for --because on a year-to-date basis, the margin there is about the same as it was last year for the full year. I think that's more just a quarterly fluctuation in the claims.

Frank Svoboda ***- Torchmark Corporation - CFO***

Yes you do look -- second quarter of 2014 at that, around 30% actually tended to be a little low, and then the 32% this year is you know a little bit on that high side, just with the quarterly fluctuation. I think we're estimating around 31% for the year on the loss ratio.

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

On the loss ratio?

Frank Svoboda - ***Torchmark Corporation - CFO***

Yes, on the loss ratio.

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

Got it. Okay. Perfect. Thank you very much. That's helpful.

Seth Weiss - ***BofA Merrill Lynch - Analyst***

Hi, good afternoon. Thanks for allowing me to sneak one in. I just want to understand the duration of the business that's on in Direct Response, just to get a sense of what the pressure could be in the long term here. I think it comes back to the contestability period. Is it really the third year that will you or won't see the spike in claims, so we're talking about a three-year delay from the business that was written. So if we look out three years from today, 2018 or so, 2019, this will all be corrected, or is it a longer duration that Direct Response business could be pressured in terms of sub-optimal returns?

Frank Svoboda - ***Torchmark Corporation - CFO***

Yes, we really see the higher incidence in claims are really in that third, and then a little bit less in the fourth, and then it tends to trail from there. Now ultimately it will carry on for quite some time. I do think when the 2014 and 2015 blocks come in, overall that probably gets up to where that's maybe 19% of our total Direct Response premium; and then, of course, the premium from there will start to go down, and as you put new business on the books, it will become less and less – you know have less and less of an impact overall. So we really see the impact of this having for the next couple of years, and then kind of bubbling. It should bubble in 2017 and then really become less of an issue after that.

Seth Weiss - ***BofA Merrill Lynch - Analyst***

Okay. And then also just to level set, I think earlier in the call you talked about 51% to 52% benefit ratio in Direct Response as maybe a run rate for next year. As 2014 and 2015 business comes in, there could be some risk to that number? Am I understanding that right?

Frank Svoboda - ***Torchmark Corporation - CFO***

It could be. You do have a base that's in there already, with respect to the higher claims for 2012 and 2013 that we're anticipating in there. So it does include, though, an estimate for -- the impact of 2014 and 2015 is included in that.

Gary Coleman - ***Torchmark Corporation - Co-CEO***

Well, it should not have that much of an impact on 2015, because we're revising our reserves for the 2015 issues to where we're not reflecting the expected improved mortality from the Rx. So it's really more of an issue for 2014, but not necessarily 2015. Because remember, where this has popped up is the fact that the claims, the mortality is higher than what we had anticipated in the reserves.

Seth Weiss *- BofA Merrill Lynch - Analyst*

Okay. Thank you.

Colin Devine *- Jefferies & Co. - Analyst*

Thank you, one quick follow-up. Is it fair to say with Direct Response that you've got the most flexibility compared to your other channels if you just decide to exit a segment because you just can't get you know the returns you want, or to take more aggressive pricing actions?

Gary Coleman *- Torchmark Corporation - Co-CEO*

Yes, we have much more flexibility there than we would on an agency side. We don't have infrastructure of agents you know that would be shocked by changes in products, premiums. You just don't have that in Direct Response. That's been one of the things that we've benefited over the years is the flexibility we have.

Colin Devine *- Jefferies & Co. - Analyst*

Great. Thank you.

Operator

It appears there are no further questions at this time. Mr. Majors, I'd like to turn the conference back over to you for any additional or closing remarks.

Mike Majors *- Torchmark Corporation - VP of IR*

Alright those are our comments, and we'll talk to you again next quarter