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Company Conference Presentation

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Call Participants

EXECUTIVES

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Christopher John Swift
Chairman & CEO

ANALYSTS

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Scott Frost

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Presentation

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Hartford Financial. Very pleased to have with us, Chairman and CEO, Chris Swift; along with CFO, Beth Bombara. Both Chris and Beth have been critical in leading The Hartford through a time of significant, significant change over the past 5 years and really helping to define what the company has become. It has been transformed into a much simpler company, which, from my standpoint, just makes my job a lot easier for analyzing this company. So thank you for that. I know that's why you did it.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

If you felt like it.

Christopher John Swift
Chairman & CEO

Yes.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I do appreciate it, and we all do. What I want to do is maybe just turn it over to Chris for you to give some opening thoughts and set the stage, and we'll dive into some of these questions.

Christopher John Swift
Chairman & CEO

Sure. Thank you, as always, for inviting us to be here. Always a pleasure to look out at your great city. All I'd like to say is just a little bit of a reprise from what we disclosed in our earnings call, Friday. We described the year and the fourth quarter as a continuation of an eventful 2017. If you look at all our major transactions, if you look at the significant weather impacts, particularly catastrophes, it was an eventful year. In spite of that, we delivered a little over $1 billion of core earnings, 11% increase, 19% increase on an EPS per share basis. And we're really pleased with the underlying performance. My probably biggest pleasure in talking about '17 comes from the dramatic improvement in Personal Lines. While we're not quite at target margins where we want to be in personal auto in particular, we're, nonetheless, pleased with the improving fundamentals there. A little bit of a cost on the top line, which we telegraphed we're going to start to return to more of a growth orientation heading into '18. And then lastly, the prospects for integrating Aetna, its benefit business with The Hartford's benefit business, creating what I think is the most balanced life and disability benefits player in the marketplace. So all our businesses have momentum continuing into 2018. Small Commercial continues to be a crown jewel of our enterprise. We have significant financial flexibility, Jay, going forward. And we talked about how we intend to use conceptually our excess capital that we generate over the next couple of years without providing any specifics as of this point in time. So that's a quick summary of '17 as we head into '18.

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Question and Answer

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I want to start on the auto insurance business because that's what surprised us the most. Question is were you surprised by how quickly that improved? And if you were surprised, what was the change? What happened to surprise you?

Christopher John Swift
Chairman & CEO

Oh, we surprised you on both sides. I think you were one of the first analysts to be really disappointed and surprised at just how bad it got, including some of the adverse development that we had in '16. Remember that surprise?

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I do.

Christopher John Swift
Chairman & CEO

Yes. We do, too. So I think, on the other hand, though, with the rate actions, the underwriting actions that we've taken, we've really pared back our agency in distribution. Still committed to an agency platform in Personal Lines. But we grew too fast, and we just needed to course correct, compounded with sort of the rise and spike in frequency and severity, just put pressure on us. So we knew it was fixable. We were pleased with the turnaround. So I'm not totally surprised. At 57, there's few things that could surprise me anymore, but the improvement was good to see.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. The only thing I'd add to that is we're obviously watching the trends very closely through '17. And in the fourth quarter, we did lower our estimate for the current year relative to what we were seeing from a cost perspective. So we still see trends elevated. We just don't see the same sort of rate of change, but we're watching it closely. Because just as it spiked up, the fact that it started to level off, we want to make sure we don't miss another inflection point if it were to change. So we're very thoughtful about how we set our loss picks at the beginning of the year. We watch the trends and then react to them.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

With the claims trends moderating a bit, people like me are always asking, why did that happen? Maybe these questions aren't answerable. Do you have any light you can shed on that?

Christopher John Swift
Chairman & CEO

You're right. It's difficult to pinpoint 1 or 2 answers. But the key point on frequencies, frequencies are down, still elevated from where they were 3 years ago, as Beth just described from an overall change side. But if frequencies are down, usually severities have a corresponding decrease also. And it could be safety. It could be less distracted driving. There's been more campaigns from an awareness side. I could tell you, our 4 kids are a little inconsistent in their driving patterns, but 2 of them do put their phone in the glove box now, which is a good behavior. So it could be just a variety of things. We've had maybe road conditions improved a little bit. But I think it's just hard for us to look at a data set over 1 year and say, "Okay, what's the root cause of any improvement in a 1-year time horizon?

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Jay Adam Cohen
BofA Merrill Lynch, Research Division

We want to know by quarter, too. Makes it even tougher. So transitioning from kind of shrinking, improving the margins more towards growth, how easy is that? Is that just flip a switch? Or does that take a bit longer to do?

Christopher John Swift
Chairman & CEO

No, it's not that easy. I mean, there's a lead time to, I'll call it, our advertising lead generation activities, which tends to be 2 to 4 months from a start to finish side. So we are elevating and increasing our marketing spend as we speak. But as I said in the call, there's a lot of good competition out there. Just because we want to grow again, it doesn't mean a lot of other competitors aren't in good position also. So rate adequacy in most states, we feel better about. There's probably one large state, California, being less rate adequate compared to other states. But we'll have to position our value proposition through an AARP member or through an agent, just like we had done before. So we have confidence in our ability to do that, but it's not a layup by any stretch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

You mentioned you're committed to the agency channel. So my question is why? This business is tiny for you now. You don't have scale in that business. Why are you sticking with that distribution for Personal Lines?

Christopher John Swift
Chairman & CEO

Yes. Two reasons. One, I mean, it's a channel that we know well. We've obviously have commercial business with a lot of the same agents. If you believe in the auto trends long term as we do, there will be more autonomous vehicles. Homeowners becomes a more -- an important product line. Homeowners is part of our larger strategy of being a bigger and broader, deeper risk player in property, real estate, infrastructure-related activities, construction, builders risk. So we'd like to continue to grow our homeowners capabilities specifically, and that's why we want to maintain it. And it's a distribution channel for AARP members, too. There's certain amount of AARP members that still want advice as opposed to interacting directly with our advice givers over the phone or through the Internet. So that's why we continue to support it because we think there's opportunities to grow particularly in homeowners long term.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I guess, at this point, there's just not much capital associated with it, anyway, where from an ROE standpoint, I'd assume it doesn't make much of a difference.

Christopher John Swift
Chairman & CEO

Well, I mean, it's a channel that we want to maximize the ROE, so we still have to improve it. And we hope it makes a difference in the long term.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. As far as leveraging your direct distribution capabilities, over the years, there's been various efforts to do that. But it's really still just AARP. Is this a hope at some point in the future you can sell to other groups or more broadly on a direct basis?

Christopher John Swift
Chairman & CEO

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Yes. We -- I would say, we run experiments and small activities in our direct capability outside of AARP for home and auto. So there's definitely learnings, and there's definitely things that we can continue to improve, risk selection even through the AARP channel that can impact the others. But you should not expect us to have an all-in launch of a nonaffinity group direct channel at this point.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. From a tax standpoint, one thing that was missed with all the discussion around taxes for you guys was how the change in the AMT affects you. Beth, if you could walk us through that, that might be more important than people suspect.

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. So we were very pleased with the outcome on tax reform. Obviously, we did take a charge because we had to write down our tax assets. But what you're pointing out as it relates to both our NOL and our AMT credits, because of the change, we'll be able to monetize both of those much quicker than we would have otherwise. And really with the repeal of AMT, we've been an AMT payer for many, many years. So you're utilizing NOL, but you're generating and paying AMT. So we have these credits building on our balance sheet. And now with tax reform, those will be refunded to us over time. So beginning in -- when we file our 2018 tax return in '19, we'll get 50% of those AMT credits back and we'll get all of them back by 2022. So for us, that was a little bit over $700 million of AMT credits that we have on our balance sheet at the end of 2017. So that's cash that will come to the holding company as it'll get refunded. And then on top of that, we still have NOLs to utilize. And again, when we look at our projections going forward, a little over $600 million in NOLs that will get monetized. And again, the way that works with our tax-sharing arrangement, it's just cash that will go to the holding company from the subsidiaries because they're not going to be paying tax. And so those cash flows end up actually at the holding company. So when we think about holding company resources over the next few years, there is that cash that will be there.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Should -- but this is -- it's not an additional. This is just happening faster than it normally would have?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

It's happening much faster, and we're not continuing to pay AMT. So for us, it was not just that we have these credits that would be refunded over time. But as we were utilizing our NOLs, we were generating more AMT credit. So pre tax reform, it was many years out before we really get the benefit of that.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Is it something you could quantify for 2018, the extra cash, if you will, that would go to the holding company because of this tax reform?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. So again, the AMT credit piece, we'll get the first refund of that when we file our tax return in 2019, so the cash won't be there in '18 as it relates to the AMT credit. And then again, the NOL will be a function of what our taxable income is, but we don't anticipate paying cash tax in 2018 because we'll utilize the NOL.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

So we should take what we assume your GAAP taxes are and assume that's really just cash that goes...

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Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. I mean, roughly speaking because there's -- it's a little more complicated than that, but yes.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

While we have you front and center, Beth, let's talk about capital. And Chris, obviously, you can comment as well. So you stopped the buyback following the Aetna deal. And you've been upfront saying it's always on the table, but we were going through a process. Talk about the process. What happens internally as you allocate capital? Who are the decision-makers? How are these decisions made? Maybe, Chris, you should start.

Christopher John Swift
Chairman & CEO

Those are trade secrets. We really can't talk about it that way. No, look, I think really what we're really waiting for is we need Talcott to close, right? So -- and I think the financing of the deal is pretty clear. You could look at how we described it in the past, how we're going to build up capital back at the Group Benefit company to get it to a targeted RBC ratio. You've seen what we've telegraphed on debt over the next couple of years. So really that it's going to be an evaluation of our organic growth needs into '19 and '20, how market conditions evolve, new classes of product we might launch in those areas, look at the dividend from a competitive side and an appropriate side and then determine if there are any actionable M&A opportunities that would accelerate our organic growth strategies that make both financial and, ultimately, strategic sense. So it's -- there's not a calculus per se, as I tried to describe on the call. But I mean, there are definite tenets that we want to be able to explore fully to create shareholder value for long term.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

As far as acquisitions -- potential acquisitions, one would assume the benefits business, you're kind of where you need to be to a great degree. So the assumption would be more likely to see it on the nonlife side. Are there any particular businesses you feel, which could benefit your businesses that could benefit from an acquisition?

Christopher John Swift
Chairman & CEO

Yes. We talk internally. We have 4 businesses, and we love them all. But each have different strengths, different needs and different opportunities, so you have to be tailored by business.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Well, they're your kids, right?

Christopher John Swift
Chairman & CEO

Yes, exactly. You've heard the analogy before. And look, I mean, we would allocate capital to all of them if there was a right opportunity from an M&A side. But I think our priority probably aligns in Commercial, Middle Market, Specialty, E&S. We did one little acquisition in the E&S space. It's working out, I think, wonderfully. So we would prioritize either the Commercial businesses. But if there's something interesting in the Personal Lines space that has an adjacency to what we do on a direct affinity-based opportunity, we would look at that also.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

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The last deal you did on the nonlife side was, I guess, Maxum. You said it went well. Can you put some numbers around that? Any -- I know it's not broken out. But relative to what you would expect it as far as returns go, where are you at this point?

Christopher John Swift
Chairman & CEO

I would say from a return side, a growth side, everything played out as planned. I mean, we didn't plan to have the severe cats that we did this year. So that's probably the only minor deviation from any expectations, just particularly on the property side, the flood side. But what we're most pleased about going forward is our announcement that we're going to integrate Maxum into our ICON platform, which is our front-end quoting platform for Small Commercial for E&S capabilities. Gone through -- continuing to go through a wholesaler. We've signed an exclusive arrangement with AmWINS for a period of time, where if an agent has one line of business with us in standard lines and then has an E&S capability, we could get it to AmWINS to present that quote first to Maxum. And if Maxum doesn't have a risk appetite for that, then place it with a third-party carrier and all contained in our administration capabilities and one bill for the customer. So we're greatly easing, I'll call it, the frictional cost on agents and placing hard-to-place Small Commercial business through our platform through AmWINS with one billing and one administration platform.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

So your system will take a risk from a retail agent. And automatically, if it doesn't fit the standard mode, it goes into AmWINS?

Christopher John Swift
Chairman & CEO

Our retail agent needs to have one line of business with us in standard markets: comp, BOP, property, auto. And if then they have an E&S business, we could route it through AmWINS to be placed in the market either with Maxum or with a third-party E&S player, administered and billed through The Hartford.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

If it goes to a different E&S carrier, not Maxum, do you guys make any money? Is there a fee that you charge for that?

Christopher John Swift
Chairman & CEO

The implicit fee is the service fee and the one line of business that we wouldn't have had or we would have expanded into with that retail agent.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. Let's -- oh, any questions out there? Yes, Scott.

Scott Frost

Sorry, just following up on the tax question. I think post-GE, you'll be the third largest Connecticut employer. Do you have any leverage over the state of Connecticut with respect to anything you could ask of them?

Christopher John Swift
Chairman & CEO

I mean, we have a good working relationship with the Governor. The Mayor -- had dinner with the Mayor last night, talking about economic growth and activity in The Hartford. We have been incented to apply for

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tax credits as we've built out certain aspect of our campus and refurbished it. There's nothing additional or unique that I feel like we need to ask for from the state or the city. And in fact, the opposite is the true. There's a number of our insurance competitors in the city that contributed $50 million to the city's financial health to revive it for the long term to create more economic growth and activity. So we've been actually a net giver as opposed to a net receiver at this point.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Scott lives in Connecticut, so he's just worried about his taxes probably. Sticking with the commercial business, which is we have folks like you up here, we do want to get your latest, greatest thinking on the pricing environment, what you're seeing out there and what you think could happen in 2018.

Christopher John Swift
Chairman & CEO

That is the $64,000 question, isn't it? We've provided some guidance in our call. And if Doug were here, he would say we're optimistic of prices increasing in general, but there's been a soft start to the year. And again, 1 month does not make a year, but the competition out there seems to be fierce. And what we would specifically say, I think everyone knows that comp is our largest product line. So when you look at it in totality, if comp is going to be flat to maybe slightly down, particularly due to mandated price reductions, that's going to be hard to have an effect on your overall book. That isn't going to be depressed if your largest line is just down a little bit. But we would also say that we continue to see high single-digit rate increases in commercial auto. You've seen what we've done over the last 5 quarters with personal auto, the rate increases being double digits. Now we expect that to get back into the mid-single-digit range in 2018. Getting back on the commercial side, really what we expect and are planning for is that mid-single-digit increases in property and liability, particularly liability. It needs some rate, we believe, as loss cost -- as price has not kept up with the loss cost over the last couple of years. But I would put this in the context of, look, why aren't we having a faster rate recovery after $135 billion of insured industry losses? I don't know. Obviously, there's a good number of competitors in Bermuda that are trying to diversify their model away from reinsurance. There's a number of good foreign competitors. There's alternative capital that has also recapitalized the industry even after the significant cat season. So I boil it down to there are still willing competitors to compete on price, capital is abundant and there isn't a significant push, tailwind to put in significant price increases. Everyone's just looking for sort of the ones and twos to keep up at a minimum with trend, I think, in '18 and '19.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Any questions from the audience? Let's shift over to the Aetna deal. Was there something about the deal where you as a team sort of said, "Wow." This is -- there was 1 or 2 things that were a real hook that you said, "this makes sense," excluding valuations.

Christopher John Swift
Chairman & CEO

Well, I would start by saying we've always talked about, tried to reinforce to our shareholders that benefits is a core strategic business for us, first and foremost. So we had looked at other benefit businesses that had been available in the marketplace and weren't successful, primarily due to just price constraints that we saw. So when this opportunity came about -- and we had talked to Aetna's leadership for a good number of years ahead of time to see if there was anything they wanted to do on a private basis. They chose the route they did, and we were pleased to win it. But as we went more through due diligence, I think we were really pleased with their claims system and some of the digital interfaces they created with their customers. And we, on The Hartford side, had put more of our investment dollars in benefits on the front end, on billing systems, on customer interfaces. And we knew we were staring at a relatively large $100-plus million investment to improve the claim system in benefits. So putting the 2 together, I think, was the best of both from their capabilities to our capabilities and then be able to create, in essence, the largest group life and disability player in the marketplace with scale to drive more efficiencies and

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ultimately to cross-sell voluntary and A&H products to a $20 million -- 20 million member customer base, we see growth opportunities there. So that's what I would...

Beth A. Bombara
Chief Financial Officer and Executive Vice President

And I agree. The only thing I would add is that since we closed on November 1 and the teams have been working, I think the excitement and opportunities have just increased as we really look at what those capabilities are. We've talked about before that we really have gone into saying we're going to take the best of the best of how the 2 operations work, so it's not just do it The Hartford way or do it the Aetna way. It's really trying to look at what is the best way to do it, and the team is very excited about that. And as Chris said, the capabilities that came with a claims system, but it's also even how their clients interact with that system and the capabilities that we can give to our clients that has the team really excited. So they're very focused on integration and so forth, but -- and we're very excited about it.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Does the deal allow you to reach a margin level that you couldn't have on your own? Or is this much more about top line growth with similar margins?

Christopher John Swift
Chairman & CEO

I think more of the latter. I think our margins are pretty strong. They had a -- they were part obviously of a medical organization and had some synergies between the medical product line and this. Obviously, we're a stand-alone benefit company. We're looking for additional opportunities to market disability and compensation -- workers' compensation together. So I think this is more about how we can grow voluntary and A&H products with being a more efficient company because we have a larger premium base to spread fix costs and investments over.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

So there is an opportunity for margin improvement as well?

Christopher John Swift
Chairman & CEO

Our margins are pretty strong, yes.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

So you're avoiding -- sort of a big investment in this claims system. If I ask you the question, what are the biggest investments you'll be making in 2018, throw in '19 as well, I guess, what would they be as far as the company goes?

Christopher John Swift
Chairman & CEO

Yes. I would -- I'll talk about it by business. I would say Small Commercial probably is getting the most time and attention and dollars from 2 perspectives: One, trying to develop an end-to-end digital business model. That's not an '18 initiative. We think we've made great advances over multiple years, particularly on front end in attracting customers and interacting with agents through some great automation. But if you think about service, if you think about audit premiums and how we could be more efficient in interacting with customers in a digital format there, that's what we think about. And then, obviously, the claims side, to create that end-to-end capabilities. I smile on some regards when I listen to the Lemonade management team talk about claims and accusing the industry of being deceitful in the claims process. That's not our review. But there are, I think, opportunities to greatly improve the customer experience with digital. So that would be a large body of work in Small. I would say in Middle Market,

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we're trying to think about how we create a more consistent platform with our 40, 50 offices across the country, how we use data and analytics in a much more robust way to cut down the interchange and data needs to underwrite as we think about it today. I think across the platform, we're rolling out a common administration system or I call it the inventory system of how you keep track of policies. That's a Guidewire product line. I would say we're probably 60% through that conversion, which again should greatly improve our efficiency, speed to market, customer experience from a billings side. And then lastly, I would say there is a big data and analytics exercise across the organization, particularly in Small and getting to fewer questions, but also in claims as it relates to health claims, workers' comp claims, disability claims and ultimately driving to better outcomes in those product lines with more insights on medical health care data.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I guess, these investments, a lot of us think about these investments as a big upfront investment and then the benefit comes, but these are probably more rolling investments over many, many years where the benefit will emerge over years as well.

Christopher John Swift
Chairman & CEO

Yes. I would describe it as -- look, at least in my view for The Hartford, the P&C and the benefits operations weren't allowed to invest all that significantly, except for Small Commercial historically. So some of it is just catching up from 40-year-old administration systems and tools, trying to create that digital environment that is more consumer centric, customer centric. So yes, I mean, there's a basic amount of R&D that you've got to do every year that will emerge over longer period of time. But I would say there's one big project -- that Guidewire project is probably a 6-year project start to finish. That is at the core of everything we're going to build off of going forward. And roughly, the math on it, if we spend -- and we have been consistently spending between $350 million and $400 million a year in IT project-related activities over the last 5 years. 50% of that is capitalized. 50% of it is expensed. So it's not like we're building a huge deferral of costs that need to be amortized in the future. And I would say -- and we don't talk about it because you've always said to us, Jay, "Just prove it to me." We are becoming a more efficient company. So we've had expense initiatives and programs going on over the last 2 years. So we're wringing out the cost to continue and to invest at the pace that we want.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

We've got time for one more question. Anyone in the audience want to grab that last question? I just had one more, I guess, for Beth. On the leverage, you've talked about publicly your goals. You never put a time frame around it. We want time frames. Is it not a good question to ask? Is it not that important a topic for you, the time frame you'll get there, and rating agencies are okay with it? Is that kind of how it works?

Beth A. Bombara
Chief Financial Officer and Executive Vice President

Yes. I mean, we've been on this path, and we've laid out some of the actions that we plan to take over the next 12 to 18 months that will continue to allow us to get in the range of that goal. It's -- we think it's very, very manageable and that will get us there. We've been able to take advantage of maturing debt to do a lot of this, which from our perspective just from a cost perspective has made sense to do, so -- just because of the way our debt is layered out as far as maturities. So we keep the rating agencies informed. They haven't been pressing us to make radical changes and comfortable with the pace that we're on.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

And I guess, that cash flow that really is in excess of your GAAP earnings gives you a bit more flexibility than you'd look at -- than I would look at just in looking at your income statement?

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Beth A. Bombara
Chief Financial Officer and Executive Vice President

Right, right, exactly.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

All right. That wraps it up. Thanks, everyone. Thank you, guys, for doing this.

Christopher John Swift
Chairman & CEO
Thank you, Jay, for inviting us.

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