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Table of Contents

Call Participants 3

Presentation 4

Question and Answer 5

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Call Participants

EXECUTIVES

Beth Costello
Executive VP & CFO

Christopher Jerome Swift
Chairman & CEO

ANALYSTS

Jay Adam Cohen
BofA Merrill Lynch, Research Division

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Presentation

Christopher Jerome Swift
Chairman & CEO

[Audio Gap] So thank you for just for the opportunity. I thought I'd just touch upon a couple of things. 2019 was an excellent year for The Hartford both strategically and financially and the results speak for themselves. But at a high level, we generated $2.1 billion of core earnings, an ROE of 13.6%, and we're able to grow book value per share, about 11% for the second consecutive year. Strategically, I think we've proven we have the ability to acquire and integrate operations, companies into our platform that help us expand our underwriting capabilities, expand our product sets and grow our distribution channels and capabilities. So really at The Hartford, we have been focused and we'll continue to focus on execution and organic growth. We talked about for Navigators, the integration is proceeding well. We're about 9 months into it. And I think we have our arms around it as far as what we have and the capabilities that we acquired. We're pleased with it, but we're really focused on improving the underwriting performance of that business unit. We're looking at how we cross-sell within our larger platform. We think we're bringing to Navigators the enhanced claims capabilities with our fast claims operations, and then really leveraging all The Hartford capabilities. And when I say that, I specifically mean data and analytics and our deeper actuarial capabilities. So things are on track.

In our earnings call in the fourth quarter, we did reaffirm our view that we can create $200 million of incremental core earnings. And what we did was we shortened that by a year. When we closed the deal, we talked about generating that over a 4- to 5-year period of time. Now we think we could generate that over a 3- to 4-year period of time. And as I said, we have our arms around navigators, its operations, the changes that we've done over this past year, give us great confidence going forward that we'll be able to expand margins. We also talked about expanding navigators margins in that 5% to 6% range on an overall combined ratio. And that, again, is really driven primarily by underwriting action, pricing actions, eliminating limits, policy limits, looking at terms and conditions differently, and quite honestly, exiting businesses, particularly in London that just weren't profitable.

So if I then changed to the commercial lines, we provided our guidance for an underlying combined ratio in that 92% to 94% range. That is an improvement over this year, primarily, again, driven by the 5 to 6 points of Navigators sub-improvement and I mentioned where that's coming from. And then also, we see improvement in our core small commercial, middle and large commercial segments in spite of some margin compression, slight margin compression in workers' comp. And that's just reality. That's just reality. And I'm being honest and transparent as we always are.

If I look at group benefits, group benefits had an outstanding year with $539 million of operating earnings, core earnings, a margin of 8.9%. And largely, what we're foreshadowing is that, that we're at the late stages of finalizing the integration of the Aetna book, and we're pivoting towards growth. Growth in new products, new services that complement our existing core capabilities and ultimately focusing on a better customer experience, particularly the employer experience.

As it relates to capital management, I think we continue to be thoughtful in managing excess capital that's generated beyond what we need to fund growth in our operations. We announced our $1 billion buyback program a year ago. We expect to buy back about 800 million of shares this year in 2020, and we raised the dividend 8%. So as I sit here, Jay, I think we ended 2019 with significant confidence and momentum as we head into 2020, about improving our operations, particularly margins and creating shareholder value for that.
So that's what I would say.

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Question and Answer

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Any opening comments from you, just about how the balance sheet shaped up relative to what you expected at the end of the year.

Beth Costello
Executive VP & CFO

Yes. I think when you look at the things that we've done over the years to get the balance sheet, I think, in a very good position, and we've talked for a while about our goals relative to leverage ratios and so forth and see ourselves really within reach of those goals as we look to pay down, obviously maturing debt this March. So very pleased with the profile there. As Chris commented on, we're pleased to be able to increase the dividend again this year. And so I think it positions us very well going into 2020.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Just to follow-up something. Chris, you said about the Navigators. You talked about achieving your goals 1 year earlier. So that begs the question, what changed relative to your original expectations?

Christopher Jerome Swift
Chairman & CEO

Sure. Well, we laid the path out to the $200 million as far as improved underwriting results, expense synergies and enhanced net investment income. All 3 of those are still the components, but we didn't anticipate this level of rate increase. We talked about it in the fourth quarter. I mean, basically, the Navigators Group is plus 15% and closer to 18%. And we see that continuing into the second half of '20. So as those rates earn in, you roll forward a couple of years of continued rate increase. We think we do have our arms around loss cost trends for Navigators. It's just -- it's going to -- we're going to hit our goals a year sooner than we anticipated.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I assume you probably thought initially, those prices might be up single-digit?

Christopher Jerome Swift
Chairman & CEO

Yes. We, in essence, had a view of, I wouldn't say exactly single digits, but in that higher range of single digits just given the needed improvement where ROEs were, but we're basically double the rate increase from our original expectations. In spite of interest rates coming down, and this really wasn't an expense play for us, this was an expanded capability in maximizing our distribution play.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Let's talk about, I guess, the commercial lines market. You seem to express some conviction that this pricing momentum would continue into this year, maybe even into next year. As you look at the world, what gives you that level of confidence?

Christopher Jerome Swift
Chairman & CEO

Well, the straight answer is, I don't think, as an industry broadly defined, we've really kept up with loss cost trends over the last 5 or 6 years. And if you look at where we are today in certain lines of business

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with our combined ratios, it's going to take 18 to 24 months of continued rate increases, rate on rate increases, I think, to hit targeted returns in commercial auto, liability and property. You couple that with a low interest rate environment, lower for longer with tenure today, 160, 155. I think as an industry, we need to continue to be disciplined and focused on rate and underwriting to make up for that loss in NII that inevitably is going to happen.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

The question that I get a lot is, yes, prices are going up, but there's a reason. Claims are going up as well, not across the board but in many lines. As you look into 2020 and '21, is your assumption that the loss environment continues to get worse from here? Or get better? What's your underlying assumption?

Christopher Jerome Swift
Chairman & CEO

We believe it's stable. But again, it's making up for sort of the accumulation of years of not keeping up with trends. I think we've been pretty clear that we feel good about where we have trend peg today in that 5% range in aggregate for our portfolio. And we just need to continue to execute above that to be able to expand margins from here. So -- but I would say, again, at least for our book of business, we don't see anything dramatically shifting. We've talked about sort of our litigation rates. Our representation rates have been very stable. We're not experiencing a major shift in any of our liabilities. We've seen over the years, the last 5 years, the need to make adjustments in loss picks for certain liability lines, primarily commercial auto and general liability. We've done that. So Jay, for us in our book, we just need to keep up with that trend that we pegged for liability lines in that 5% range, primary maybe a little less. You get into umbrella and excess, it could be a little bit higher. You blend it all together. And as an industry, we just need to catch up from where we were.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Is it fair to say that the backdrop is a fairly rational industry? In other words, as you take this action, would you expect your new business to suffer notably or your renewal retention to be impacted?

Christopher Jerome Swift
Chairman & CEO

What I would say is the trade between rate and retention, you always need rate ahead of retention because if you have an unprofitable account or unprofitable segment, you just need to fix it. And if it leaves you, it's unfortunate from a customer side, but that's -- you need to write it in your book. So I would say, generally, our distribution partners understand the environment. We've been working hard with them, particularly the last 6 to 9 months to educate the reason for the rate, the trend environment. And I think we have an alignment with our distribution partners about what are the actions that we need into '20 and then also heading into '21. The best example I can give you maybe is just tangible, is that we work really hard on our commercial order book over the last 6 years. It's about a $600 million book of business to us. We put about 50 points of aggregate rate into the book over that period of time and has still produced 102 combined ratio today. So when I talk about the next 18 to 24 months to get that line to targeted rate increases, we're going to need 10 to 12 points of rate this year; 10 to 12 points of rate in '21, to even get close to earning an adequate return on risk-adjusted capital.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

You could argue you guys have been maybe a little ahead of the curve there. So arguably, others would have to at least see that kind of increase, if not more.

Christopher Jerome Swift
Chairman & CEO

I'm not going to disagree.

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Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay. That's fair enough. Let's turn to workers' comp. I guess, it was last year or the year before you had this bit of a speed bump, I think it was in the third quarter. We've talked -- I think the market made too much out of it...

Christopher Jerome Swift
Chairman & CEO

Second quarter.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Was it second quarter?

Christopher Jerome Swift
Chairman & CEO

Yes, I think it was the first half of the year.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay. What are you seeing as far as claims trends there now? And for us to actually see prices going up in workers' comp, I'm assuming there would have to be some sort of change in the claims trend.

Christopher Jerome Swift
Chairman & CEO

Yes. So you are right. We did -- basically, the first half of the year signaled that the frequency of claims, not severity. The frequency of claims in certain segments of our book was increasing. And if you remember at that time, we talked about sort of the demand surge that we suspected occurred with tax reform and hiring and getting maybe more inexperienced workers into certain job classifications that posed just more injuries early on. And that still is what largely happened in our book of business. So if you look at segments like retail, restaurants, I'll call it, high demand, maybe high turnover businesses, there was a little bit of surge hiring that just was inexperienced in certain classes, including manufacturing. I think that largely settled down in the second half of the year. And so as we sit here today, the trend really over the last 6 quarters except for those blips in the first 2 quarters of '18 has been frequencies have gone back to normal and have been slightly negative. And severity, particularly on medical, is better than our long-term assumptions that we generate planned for in that 4.5%, 5% range. So I think the line is performing well. We still make good margins and returns, but with the continued rate rollback pressure due to good experience, those margins, as we alluded to and guided to, are going to be under some slight pressure heading into '20.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

What's interesting is those factors that you cited when the frequency picked up, arguably are still around and in place. Yet it seems like the frequency settled back down again. The impossible question is, why do you think that happened? I know there's no answer, but I am sure you guys have thought about it.

Christopher Jerome Swift
Chairman & CEO

I call it the demand surge, right? So when you needed workers, there was a demand surge, primarily rated, I believe, to tax reform and some of the stimulus. And then what happens is people get trained, as they get more experience, as safety always continues to improve, it reverted back to the long-term mean.

Jay Adam Cohen

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BofA Merrill Lynch, Research Division

Let's talk about small commercial. You're obviously a leader in that area, but you're not standing still. You continue to make investments there. Can you talk about some of the more recent investments you've made and how they could drive growth going forward in that platform?

Christopher Jerome Swift
Chairman & CEO

Sure. Yes, we're clearly, really proud of what we've done with small commercial over an extended period of time, right? And it's been about 30 years since we launched that segment of the business. And it's one that we've constantly invested in for innovation for customer experience. I think there's 2 examples that I can give you just quickly, Jay, without sounding like a commercial, unless you want me to sound like a commercial.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Go right ahead. You got a platform, might as well. We're not going to charge it for you.

Christopher Jerome Swift
Chairman & CEO

Thank you. As we rolled out what we call next-gen Spectrum, which is basically our BOP policy, our business owners policy that combines property and liability insurance. We've had a BOP out there for a long, long time that is used by many different classes of business in the industry. But this 1 was basically a modular design. So if you think of Amazon in your shopping cart, we're able to present to agents that are quoting our BOPs, a more modular approach of sort of what is a baseline policy, baseline from a liability side. And then all the additional coverages and features that you can add, whether it be cyber-enhanced protection and liability. Industry-specific recommendations for like restaurants or dentist office, so we really customized it so that depending on what type of customer you were, we're able to present to you optional coverages, price points for those optional coverages that protect your business more holistically on a more transparent basis, and clearly, with more speed, so that you know sort of your running total of what your spend for your policy is. So we think it will revolutionize the BOP business. And we weren't going to be able to do that until we basically invested in some core platform capabilities of how we administer policies, how do we quote. So those all investments started 4 or 5 years ago on a baseline basis that allowed us to innovate today with our next-gen spectrum.

The other thing that I would just say and I know everyone in this room knows it, but the power of data and analytics is real and our ability to cut down questions from lets say 50 years ago down to something less than 10, to be able to pre-fill data that makes underwriters and agents jobs easier, to be able to use imagery and underwriting, just the advancements in data and analytics that's embedded into the small commercial underwriting process is pretty impressive.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Just interesting, you mentioned Amazon. People are so used to buying goods that way, especially younger people, whether it's the phone or the computer, but that whole process of buying something with a card. And so, I guess, you're tapping into that. And I think certainly, as these younger people come up in the industry that's a natural thing for them.

Christopher Jerome Swift
Chairman & CEO

Sure. It really is. And the way we really present it, and if you want, you can go online and see it, is it's sort of the base, sort of the good, the better, the best, and then you could see the optional coverages that are attached to each of those different characterizations of good, better and best.

Jay Adam Cohen

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BofA Merrill Lynch, Research Division

There's something that, I guess, you haven't been impacted too much by, but you'd hear about it in the industry, is this whole concept of social inflation, expect to some of your businesses. Give us your thoughts on what do you think is causing that? Is it just more aggressive creative lawyers? Is there a backdrop politically or socially that's changing it?

Christopher Jerome Swift
Chairman & CEO

Sure. Well, like you said, and I said it a couple of times in our earnings call, I mean, it's a phenomenon that's affecting all aspects of the insurance business, East Coast, West Coast, Central, and its effects vary, obviously, based on your business mix. And what I was trying to describe was a primary liability to a rider that might have certain impacts. Umbrella excess riders might have more as you get more severity into those types of conditions and events, but what we are also trying to say is that I think we've been ahead of the curve, and we've been adjusting and reacting to social inflation over the last 5 years in various aspects of our book. The root cause, look, I'm not a sociologist. Does that sound good?

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes. You are not.

Christopher Jerome Swift
Chairman & CEO

I'm not really. I am an accountant. I just think we're in a litigious environment. I think maybe plaintiffs bars doing a more effective job and arguing for larger settlements. Maybe juries are more sympathetic to injuries and outcomes. Whatever it is -- it is -- and others have talked about it, so I'm stealing some of their language, it's a tax on society that we all pay in one way, shape or another. So how we fight it? We do it every day with our claims and law professionals and trying to say what's a reasonable settlement. I always say, we're in the business of paying claims those that are legitimate, covered by our contractual terms and languages, and that's fair. That's not excessive or punitive. And that's our philosophy that we approach for our shareholders and our policyholders.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I wanted to shift away from Commercial Lines. Before I do that, are there any questions out there on Hartford's Commercial Lines business before I make that shift? If you have a question, raise your hand, we'll get you a mic. I covered a lot of ground. You guys cover a lot of ground. And that was pretty good for an accountant, by the way.

Christopher Jerome Swift
Chairman & CEO

I resemble that.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Beth, let's shift to you. You had kind of alluded to before, in your opening comments about getting the leverage ratio down to your goal. Walk us through, I guess, the next 2 years, capital generation, what debt you're retiring? And kind of when do you think you can get to those margin levels or the leverage levels that you expect?

Beth Costello
Executive VP & CFO

Yes. So we did, I think, lay out pretty clearly in our earnings release, our thoughts on capital generation for 2020 that what we're expecting as far as dividends from our operating companies. And so again, our

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P&C company targeting dividends about $850 million to $900 million; group benefits $300 million to $350 million and then mutual funds, $100 million to $125 million. We do still have some more tax attributes on our balance sheet that we're monetizing. And so we expect a little over $500 million of cash receipts to the holding company as we both get refunds of our AMT credits as well as just continue to use our net operating losses. So very healthy cash flows to the holding company as we look at 2020.

As I mentioned, we do have some debt maturing in March, and we do plan to pay that down, not refinance it. So that's $500 million of debt. And so when we put that into the mix, it puts us in a really nice place relative to our leverage ratios. And then from a holding company cash requirement, it's really just interest and dividends. All of our operating expenses are allocated to our subsidiaries, and interest and dividends are a little bit over $700 million. So kind of gives you a sense of just sort of what the cash flow generation is. As Chris said, we do have $800 million of share buybacks that we'd be doing in 2020 to complete our $1 billion authorization. And then as we look beyond that, again, as our operating companies continue to improve as far as earnings, we take that into consideration as far as dividends in the future. And so I think there'd be some room for those to increase slightly. And we just raised our dividend. Again, we've been on a path of doing that year-over-year. So we continue to evaluate it, if that made sense to do in the future. And then that kind of gives you a picture of just the excess cash flow that we have at the holding company to decide what the best use of that would be.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

You've done 2 decent-sized deals, acquisitions over the past several years. And I'd say you executed on them well so far. But some hiccups with Navigators, but you're obviously achieving your goals quicker than you thought.

Christopher Jerome Swift
Chairman & CEO

I quibble with the hiccup, but this is your stage.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Oh, you had to go...

Beth Costello
Executive VP & CFO

Well, fair enough.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay.

Christopher Jerome Swift
Chairman & CEO

Because that was all part of the planned purchase and sort of opening balance sheet and reinsurance and all the adjustments, but we are eyes wide open on and getting our arms around day 1.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

So -- but you've executed on both pretty well, quite well, I would say. It always raises the question. You're not going to close your eyes to future acquisitions. When you think about the ability to acquire businesses, someone comes to you tomorrow with the perfect deal, what does that look like to you, realistically?

Christopher Jerome Swift
Chairman & CEO

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Sure. Well, again, the context of our acquisitions were things that we've needed to do from a platform side to expand our capabilities and to basically serve more customer needs. That was the primary genesis behind our acquisitions, whether it be the scale business that we achieved with Aetna or really some of the specialties and the liabilities, the specialty orientation, we picked up with Navigators. I thought both were strategically important and financially will work out very well for shareholders. So the bar is high going forward, principally because I think we have everything we need as a platform, as an organization. We just like to grow it organically, make it bigger, have larger scale, have more shelf space in our agents office. So I'm trying to describe that there's not a burning desire of a need to do any additional acquisitions. But like you said, I mean, we're aware. We'll listen, but the bar to execute is very high because it just really needs to be very, very accretive compared to where we are today, but if something where to come along in the small commercial space or the middle market space that would be a nice complementary bolt-on that would give us additional scale benefits particularly in small -- I think we have the most efficient small commercial operation so we could leverage that great operating strength, and with the middle market, clearly, our goal is to be a bigger and more relevant player in that marketplace, and we're committed to doing it organically, but if there's something that accelerates that, we'll consider it.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. Any questions on capital or M&A on this topic, no one wants to challenge what he said? Fair enough. Let's talk about a business that probably doesn't get enough attention because it's been a great business, and that's the benefits business. It feels like your 2020 guidance is really conservative, given how great these results have been. What are we missing here?

Christopher Jerome Swift
Chairman & CEO

Well, yes. I mean, it's a $5.5 billion business. We're the second largest writer behind MetLife. I think is right around the corner here. So yes, we're really proud of what we've built organically, how we've improved that business. I'm always reminded, when I joined The Hartford in 2010. In 2011, that business earned about $65 million, $75 million of earnings. So it's at a pretty good turnaround, and the acquisition obviously helps. So yes, all the guidance really implies is an 8.9% margin, it's probably unsustainable. We experienced, obviously, very favorable severity -- excuse me, frequency and severity of getting people back to work in recovery.

Our approach to pricing and reserving, so assume sort of a 5-year averaging. And that's what the guidance reflects. So you're right. If we -- if the economy continues to perform, that people don't go out on disability, meaning lower incidence continues, we have a chance to outperform, but the way we price products, given we're making 3-year rate guarantees or 4, in some cases, way we reserve and way we assume earnings would emerge is more on a 5-year average basis of those incidents and recoveries, and that's what we guided to.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it.

Beth Costello
Executive VP & CFO

I think the only thing I'd add is what another component of the outperformance was, the performance of the investment portfolio. So our limited partnership portfolio performed very strongly across our businesses but in group benefits as well. We have a -- we, again, take a long-term view when we plan. So that's also a component of that decrease.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

I think we all hope that's going to continue.

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Beth Costello
Executive VP & CFO

Yes.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

On this business, you sort of suggested in Europe, any comments Chris pivoting towards growth. We got a little bit of time left. Talk about the sources of that growth, where does that come from?

Christopher Jerome Swift
Chairman & CEO

Sure. I think there's 2 main sources. Our core product capabilities, group life, group disability, both long-term and short term, our scale businesses. Where we're not at scale is our voluntary businesses, and voluntary in our binocular remains critical illness, hospital indemnity, AD&D, accidental death, business travel accident, you get into the A&H side of things. So I think there's an opportunity with our customer base of over 20 million customers, our distribution relationships to really enhance growth in our voluntary and A&H space, and that's what we're going to do. Beyond that, we're thinking about, I'll call it, wellness in general and technology and services and how we might augment some of our core capabilities, but that -- those are things on the drawing board, but we are thinking just how is this whole health care wellness benefits space going to emerge. So those are probably the 3 primary areas. 2 short term, voluntary and A&H, where we have products on the street today, and 1 a little bit longer term, where we're innovating on offerings and services.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. My last question in the time we have left. I was interested to hear on your call when you were talking on your fourth quarter call. You mentioned a number of positive I'll call them ESG-type attributes of the company. We generally don't hear that from insurance companies. So my question is, why did you bring that up? Are you getting feedback from shareholders, investors, employees, to suggest this is a bigger issue?

Christopher Jerome Swift
Chairman & CEO

I think from an investor side, and you could point to people in this room and their firms and some of the stances that people have taken on broad ESG issues, yes, it is becoming more and more important for investors to understand companies and their strategies and their logics behind ESG. I think we've been a leader in this area for a good decade. So this isn't anything new to some of the things that we've been working on as an organization. And we define it more from a sustainability perspective and I'll call it 4 quadrants, one governance and ethics. Second quadrant would be diversity and pay equity. Third quadrant would be communities and giving back, and the fourth quadrant would be environmental, EG, your carbon footprint. So we've been working on these things for well over a decade. We've gone public with goals, last year, about this time, where I put out a sustainability goal report in those dimensions. So yes, I do think it's becoming more relevant, more top of mind because you need a multidimensional focus, I think, for all stakeholders to create value over a long period of time. And obviously, we're a shareholder-driven organization. We got to deliver to shareholders first, but I believe there's ways of balancing that with the other dimensions of creating a good work environment, a good community environment for the long term.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

That was great. You brought it up. I'm not getting a ton of questions on it, but I know in our department, in the equities business, in general, it has become a really big issue, and it's great that you're kind of leading that and making sure your view of this is out there. That's great. We are really bumping up against

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the end of the session. Why don't we call it quits here. Chris, Beth, thank you very much for joining us here.

Beth Costello
Executive VP & CFO

Thank you.

Christopher Jerome Swift
Chairman & CEO
Thank you.

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