

HORACE MANN EDUCATORS CORP /DE/

Form 10-Q

November 08, 2007

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2007

OR

TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 1-10890

HORACE MANN EDUCATORS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of

incorporation or organization)

1 Horace Mann Plaza, Springfield, Illinois 62715-0001

(Address of principal executive offices, including Zip Code)

Registrant's Telephone Number, Including Area Code: 217-789-2500

37-0911756
(I.R.S. Employer

Identification No.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark the registrant's filer status, as such terms are defined in Rule 12b-2 of the Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Act. Yes No

As of October 31, 2007, 43,342,534 shares of Common Stock, par value \$0.001 per share, were outstanding, net of 17,503,371 shares of treasury stock.

Table of Contents

HORACE MANN EDUCATORS CORPORATION

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2007

INDEX

| | Page |
|------------------------------------------------------------------------------------------------------|-------------|
| PART I - FINANCIAL INFORMATION | |
| Item 1. Financial Statements | |
| <u>Report of Independent Registered Public Accounting Firm</u> | 1 |
| <u>Consolidated Balance Sheets</u> | 2 |
| <u>Consolidated Statements of Operations and Comprehensive Income</u> | 3 |
| <u>Consolidated Statements of Changes in Shareholders' Equity</u> | 4 |
| <u>Consolidated Statements of Cash Flows</u> | 5 |
| <u>Notes to Consolidated Financial Statements</u> | |
| <u>Note 1 - Basis of Presentation</u> | 6 |
| <u>Note 2 - Debt</u> | 7 |
| <u>Note 3 - Investments</u> | 8 |
| <u>Note 4 - Share Repurchase Program and Treasury Shares Held</u> | 10 |
| <u>Note 5 - Income Taxes</u> | 10 |
| <u>Note 6 - Pension Plans and Other Postretirement Benefits</u> | 11 |
| <u>Note 7 - Reinsurance</u> | 13 |
| <u>Note 8 - Segment Information</u> | 14 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 15 |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 42 |
| Item 4. <u>Controls and Procedures</u> | 42 |
| PART II - <u>OTHER INFORMATION</u> | |
| Item 1A. <u>Risk Factors</u> | 43 |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u> | 43 |
| Item 5. <u>Other Information</u> | 43 |
| Item 6. <u>Exhibits</u> | 43 |
| <u>SIGNATURES</u> | 44 |

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Horace Mann Educators Corporation:

We have reviewed the accompanying consolidated balance sheet of Horace Mann Educators Corporation and subsidiaries (the Company) as of September 30, 2007, the related consolidated statements of operations and comprehensive income for the three-month and nine-month periods ended September 30, 2007 and 2006, and the related consolidated statements of changes in shareholders' equity and cash flows for the nine-month periods ended September 30, 2007 and 2006. These consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2006, and the related consolidated statements of operations and comprehensive income, changes in shareholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated February 28, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2006, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it was derived.

/s/ KPMG LLP

KPMG LLP

Chicago, Illinois

November 8, 2007

Table of Contents**HORACE MANN EDUCATORS CORPORATION****CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands)

| | September 30, 2007 (Unaudited) | December 31, 2006 |
|-----------------------------------------------------------------------------------------------------------|--------------------------------------|----------------------|
| ASSETS | | |
| Investments | | |
| Fixed maturities, available for sale, at fair value | | |
| Fixed maturities (amortized cost 2007, \$3,797,028; 2006, \$3,511,034) | \$ 3,763,926 | \$ 3,530,658 |
| Fixed maturity securities on loan (amortized cost 2007, \$72,960; 2006, \$291,144) | 72,222 | 289,524 |
| Total fixed maturities | 3,836,148 | 3,820,182 |
| Short-term and other investments | 254,571 | 182,312 |
| Short-term investments, loaned securities collateral | 77,583 | 299,722 |
| Total investments | 4,168,302 | 4,302,216 |
| Cash | 8,293 | 13,438 |
| Accrued investment income and premiums receivable | 105,006 | 107,590 |
| Deferred policy acquisition costs | 263,778 | 249,377 |
| Goodwill | 47,396 | 47,396 |
| Value of acquired insurance in force | 6,768 | 10,523 |
| Other assets | 85,431 | 104,533 |
| Separate Account (variable annuity) assets | 1,610,342 | 1,494,614 |
| Total assets | \$ 6,295,316 | \$ 6,329,687 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Policy liabilities | | |
| Fixed annuity contract liabilities | \$ 2,000,535 | \$ 1,944,675 |
| Interest-sensitive life contract liabilities | 658,199 | 641,252 |
| Unpaid claims and claim expenses | 324,851 | 326,661 |
| Future policy benefits | 187,794 | 185,747 |
| Unearned premiums | 206,369 | 203,017 |
| Total policy liabilities | 3,377,748 | 3,301,352 |
| Other policyholder funds | 140,208 | 142,832 |
| Liability for securities lending agreements | 77,642 | 298,494 |
| Other liabilities | 208,993 | 203,332 |
| Short-term debt | | |
| Long-term debt | 199,468 | 231,982 |
| Separate Account (variable annuity) liabilities | 1,610,342 | 1,494,614 |
| Total liabilities | 5,614,401 | 5,672,606 |
| Preferred stock, \$0.001 par value, authorized 1,000,000 shares; none issued | | |
| Common stock, \$0.001 par value, authorized 75,000,000 shares; issued, 2007, 60,798,330; 2006, 60,594,626 | 61 | 61 |
| Additional paid-in capital | 352,397 | 347,873 |
| Retained earnings | 685,084 | 634,110 |
| Accumulated other comprehensive income (loss), net of taxes: | | |

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| | | |
|---------------------------------------------------------------------------|----------------|----------------|
| Net unrealized gains and losses on fixed maturities and equity securities | (20,594) | 11,070 |
| Net funded status of pension and other postretirement benefit obligations | (3,456) | (3,456) |
| Treasury stock, at cost, 17,503,371 shares | (332,577) | (332,577) |
| Total shareholders' equity | 680,915 | 657,081 |
| Total liabilities and shareholders' equity | \$ 6,295,316 | \$ 6,329,687 |

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

Table of Contents

HORACE MANN EDUCATORS CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands, except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------------------------------------------------------|-------------------------------------|------------------|------------------------------------|------------------|
| | 2007 | 2006 | 2007 | 2006 |
| Revenues | | | | |
| Insurance premiums and contract charges earned | \$ 163,329 | \$ 162,759 | \$ 487,996 | \$ 487,314 |
| Net investment income | 56,054 | 53,152 | 166,330 | 154,804 |
| Net realized investment gains (losses) | (461) | 794 | 2,105 | 5,282 |
| Total revenues | 218,922 | 216,705 | 656,431 | 647,400 |
| Benefits, losses and expenses | | | | |
| Benefits, claims and settlement expenses | 108,608 | 102,177 | 306,959 | 292,925 |
| Interest credited | 32,135 | 30,964 | 94,979 | 91,087 |
| Policy acquisition expenses amortized | 18,418 | 18,094 | 55,683 | 54,719 |
| Operating expenses | 29,030 | 32,954 | 92,215 | 95,273 |
| Amortization of intangible assets | 1,267 | 1,287 | 4,030 | 4,195 |
| Interest expense | 3,401 | 3,672 | 10,632 | 9,448 |
| Total benefits, losses and expenses | 192,859 | 189,148 | 564,498 | 547,647 |
| Income before income taxes | 26,063 | 27,557 | 91,933 | 99,753 |
| Income tax expense | 7,741 | 8,250 | 27,177 | 29,700 |
| Net income | \$ 18,322 | \$ 19,307 | \$ 64,756 | \$ 70,053 |
| Net income per share | | | | |
| Basic | \$ 0.42 | \$ 0.45 | \$ 1.50 | \$ 1.63 |
| Diluted | \$ 0.41 | \$ 0.43 | \$ 1.45 | \$ 1.55 |
| Weighted average number of shares and equivalent shares (in thousands) | | | | |
| Basic | 43,288 | 43,006 | 43,210 | 42,997 |
| Diluted | 44,268 | 45,002 | 44,840 | 46,023 |
| Comprehensive income | | | | |
| Net income | \$ 18,322 | \$ 19,307 | \$ 64,756 | \$ 70,053 |
| Other comprehensive income (loss), net of taxes: | | | | |
| Change in net unrealized gains and losses on fixed maturities and equity securities | 14,077 | 62,650 | (31,664) | (21,408) |
| Change in net funded status of pension and other postretirement benefit obligations | | | | |
| Other comprehensive income (loss) | 14,077 | 62,650 | (31,664) | (21,408) |
| Total | \$ 32,399 | \$ 81,957 | \$ 33,092 | \$ 48,645 |

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

Table of Contents**HORACE MANN EDUCATORS CORPORATION****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)**

(Dollars in thousands, except per share data)

| | Nine Months Ended September 30, | |
|------------------------------------------------------------------------------------------|------------------------------------|------------|
| | 2007 | 2006 |
| Common stock | | |
| Beginning balance | \$ 61 | \$ 60 |
| Options exercised, 2007, 183,227 shares; 2006, 54,050 shares | | 1 |
| Conversion of Director Stock Plan units, 2007, 18,362 shares; 2006, 761 shares | | |
| Conversion of restricted stock units, 2007, 2,115 shares; 2006, 0 shares | | |
| Ending balance | 61 | 61 |
| Additional paid-in capital | | |
| Beginning balance | 347,873 | 345,251 |
| Options exercised and conversion of Director Stock Plan units and restricted stock units | 3,815 | 885 |
| Share-based compensation expense | 709 | |
| Ending balance | 352,397 | 346,136 |
| Retained earnings | | |
| Beginning balance | 634,110 | 553,712 |
| Net income | 64,756 | 70,053 |
| Cash dividends, \$0.315 per share | (13,782) | (13,736) |
| Ending balance | 685,084 | 610,029 |
| Accumulated other comprehensive income (loss), net of taxes: | | |
| Beginning balance | 7,614 | 14,145 |
| Change in net unrealized gains and losses on fixed maturities and equity securities | (31,664) | (21,408) |
| Change in net funded status of pension and other postretirement benefit obligations | | |
| Ending balance | (24,050) | (7,263) |
| Treasury stock, at cost | | |
| Beginning and ending balance, 2007 and 2006, 17,503,371 shares | (332,577) | (332,577) |
| Shareholders' equity at end of period | \$ 680,915 | \$ 616,386 |

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

Table of Contents**HORACE MANN EDUCATORS CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(Dollars in thousands)

| | Nine Months Ended September 30, | |
|------------------------------------------------------------|--------------------------------------------|------------------|
| | 2007 | 2006 |
| Cash flows - operating activities | | |
| Premiums collected | \$ 501,120 | \$ 497,323 |
| Policyholder benefits paid | (329,141) | (320,315) |
| Policy acquisition and other operating expenses paid | (157,478) | (162,237) |
| Federal income taxes paid | (11,260) | (12,633) |
| Investment income collected | 164,410 | 155,657 |
| Interest expense paid | (7,157) | (4,210) |
| Contribution to defined benefit pension plan trust fund | | (6,450) |
| Other | 3,745 | 4,921 |
| Net cash provided by operating activities | 164,239 | 152,056 |
| Cash flows - investing activities | | |
| Fixed maturities | | |
| Purchases | (891,894) | (735,128) |
| Sales | 436,453 | 395,115 |
| Maturities | 397,298 | 202,109 |
| Net cash used in short-term and other investments | (73,464) | (59,525) |
| Net cash used in investing activities | (131,607) | (197,429) |
| Cash flows - financing activities | | |
| Dividends paid to shareholders | (13,782) | (13,736) |
| Exercise of stock options | 3,427 | 866 |
| Proceeds from issuance of Senior Notes due 2016 | | 123,485 |
| Repurchase of Senior Convertible Notes | (32,563) | (82,846) |
| Annuity contracts, variable and fixed | | |
| Deposits | 258,292 | 241,122 |
| Benefits and withdrawals | (147,997) | (110,456) |
| Net transfer to Separate Account (variable annuity) assets | (107,563) | (87,731) |
| Life policy accounts | | |
| Deposits | 850 | 1,154 |
| Withdrawals and surrenders | (4,878) | (5,316) |
| Change in bank overdrafts | 6,437 | (21,169) |
| Net cash (used in) provided by financing activities | (37,777) | 45,373 |
| Net decrease in cash | (5,145) | |
| Cash at beginning of period | 13,438 | |
| Cash at end of period | \$ 8,293 | \$ |

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

Table of Contents

HORACE MANN EDUCATORS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2007 and 2006

(Dollars in thousands, except per share data)

Note 1 - Basis of Presentation

The accompanying unaudited consolidated financial statements of Horace Mann Educators Corporation (HMEC ; and together with its subsidiaries, the Company or Horace Mann) have been prepared in accordance with United States (U.S.) generally accepted accounting principles (GAAP) and with the rules and regulations of the Securities and Exchange Commission (SEC), specifically Regulation S-X and the instructions to Form 10-Q. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. The Company believes that these consolidated financial statements contain all adjustments (consisting of normal recurring accruals) which are, in the opinion of management, necessary to present fairly the Company s consolidated financial position as of September 30, 2007, the consolidated results of operations and comprehensive income for the three and nine months ended September 30, 2007 and 2006, and the consolidated changes in shareholders equity and cash flows for the nine months ended September 30, 2007 and 2006. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The subsidiaries of HMEC market and underwrite tax-qualified retirement annuities and private passenger automobile, homeowners and life insurance products, primarily to educators and other employees of public schools and their families. The Company s principal operating subsidiaries are Horace Mann Life Insurance Company, Horace Mann Insurance Company, Teachers Insurance Company, Horace Mann Property & Casualty Insurance Company and Horace Mann Lloyds.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

The results of operations for the three and nine months ended September 30, 2007 are not necessarily indicative of the results to be expected for the full year.

The Company has reclassified the presentation of certain prior period information to conform with the 2007 presentation.

Table of Contents**Note 1 - Basis of Presentation-(Continued)***Adoption of SOP 05-1*

Effective January 1, 2007, the Company adopted American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts and did not utilize the alternative application guidance outlined in paragraphs 18 and 19 of SOP 05-1.

SOP 05-1 provides guidance on accounting for deferred policy acquisition costs (DAC) on internal replacements of insurance and investment contracts other than those specifically described in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments . SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement or rider to a contract, or by the election of a feature or coverage within a contract. Modifications that result in a replacement contract that is substantially unchanged from the replaced contract are accounted for as a continuation of the replaced contract. When modifications represent a substantial change compared to the replaced contract, the transaction is accounted for as an extinguishment of the replaced contract, and unamortized DAC and unearned revenue liabilities from the replaced contract are written off. For the nine months ended September 30, 2007, internal replacements of traditional non-interest-sensitive life insurance contracts which represented substantial changes compared to the replaced contracts resulted in \$169 of additional DAC amortization for the period.

Note 2 - Debt

Indebtedness outstanding was as follows:

| | September 30, 2007 | December 31, 2006 |
|---------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
| Short-term debt: | | |
| Bank Credit Facility | \$ | \$ |
| Long-term debt: | | |
| 1.425% Senior Convertible Notes, due May 14, 2032. Aggregate principal amount of \$68,553 less unaccrued discount of \$35,990 (3.0% imputed rate) | | 32,563 |
| 6.05% Senior Notes, due June 15, 2015. Aggregate principal amount of \$75,000 less unaccrued discount of \$205 and \$226 (6.1% imputed rate) | 74,795 | 74,774 |
| 6.85% Senior Notes, due April 15, 2016. Aggregate principal amount of \$125,000 less unaccrued discount of \$327 and \$355 (6.9% imputed rate) | 124,673 | 124,645 |
| Total | \$ 199,468 | \$ 231,982 |

The Bank Credit Facility, 1.425% Senior Convertible Notes due 2032 (Senior Convertible Notes), 6.05% Senior Notes due 2015 (Senior Notes due 2015) and 6.85% Senior Notes due 2016 (Senior Notes due 2016) are described in Notes to Consolidated Financial Statements Note 4 Debt of the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

Table of Contents**Note 2 - Debt-(Continued)**

On May 14, 2007, pursuant to provisions of the indenture, HMEC redeemed its remaining outstanding Senior Convertible Notes (\$68,553 aggregate principal amount; \$32,563 carrying value) at \$475.00 per \$1,000.00 principal amount. The \$32,563 aggregate cost was funded with a portion of the remaining cash proceeds from HMEC's April 2006 issuance of 6.85% Senior Notes Due 2016. None of the Senior Convertible Notes were converted into shares of HMEC's common stock. No early termination penalties were incurred as a result of this redemption.

The \$231,947 aggregate principal amount of Senior Convertible Notes which HMEC previously held in brokerage accounts and the \$68,553 aggregate principal amount of Senior Convertible Notes redeemed on May 14, 2007 have been canceled.

Note 3 - Investments*Fixed Maturity Securities*

The following table presents the composition and value of the Company's fixed maturity securities portfolio by rating category. The Company has classified the entire fixed maturity securities portfolio as available for sale, which is carried at fair value.

| Rating of Fixed Maturity Securities (1) | Percent of Fair Value | | September 30, 2007 | |
|--------------------------------------------|-----------------------|----------------------|---------------------|---------------------|
| | September 30, 2007 | December 31, 2006 | Fair Value (2) | Amortized Cost |
| AAA | 45.2% | 44.9% | \$ 1,734,781 | \$ 1,746,055 |
| AA | 11.3 | 8.5 | 434,314 | 441,916 |
| A | 17.9 | 19.6 | 686,612 | 698,882 |
| BBB | 20.2 | 21.5 | 775,391 | 775,137 |
| BB | 1.8 | 1.4 | 71,511 | 71,797 |
| B | 3.4 | 3.9 | 130,195 | 132,283 |
| CCC or lower | 0.1 | 0.1 | 1,951 | 2,007 |
| Not rated (3) | 0.1 | 0.1 | 1,393 | 1,911 |
| Total | 100.0% | 100.0% | \$ 3,836,148 | \$ 3,869,988 |

- (1) Ratings are as assigned primarily by Standard & Poor's Corporation (S&P) when available, with remaining ratings as assigned on an equivalent basis by Moody's Investors Service, Inc. (Moody's). Ratings for publicly traded securities are determined when the securities are acquired and are updated monthly to reflect any changes in ratings.
- (2) Fair values are based on quoted market prices, when available. Fair values for private placements and certain other securities that are infrequently traded are estimated by the Company with the assistance of its investment advisors utilizing recognized valuation methodology, including cash flow modeling.
- (3) This category includes \$691 (fair value) of private placement securities not rated by either S&P or Moody's. The National Association of Insurance Commissioners (NAIC) has rated 95.1% of these private placement securities as investment grade. The remaining \$702 (fair value) of securities in this category were obtained in partial settlement of a default that occurred in 2002 and are not rated by S&P, Moody's or the NAIC.

Table of Contents**Note 3 - Investments-(Continued)**

The following table presents the distribution of the Company's fixed maturity securities portfolio by estimated expected maturity. Estimated expected maturities differ from contractual maturities, reflecting assumptions regarding borrowers' utilization of the right to call or prepay obligations with or without call or prepayment penalties. Estimated expected maturities consider broker dealer survey values and are verified for consistency with the interest rate and economic environments.

| | Percent of Fair Value | | September 30, 2007 | |
|-------------------------------------|-----------------------|-------------------|--------------------|----------------|
| | September 30, 2007 | December 31, 2006 | Fair Value | Amortized Cost |
| Due in 1 year or less | 7.1% | 8.2% | \$ 270,872 | \$ 273,261 |
| Due after 1 year through 5 years | 28.8 | 28.0 | 1,104,180 | 1,113,920 |
| Due after 5 years through 10 years | 34.4 | 36.1 | 1,321,058 | 1,332,712 |
| Due after 10 years through 20 years | 9.4 | 9.2 | 362,677 | 365,877 |
| Due after 20 years | 20.3 | 18.5 | 777,361 | 784,218 |
| Total | 100.0% | 100.0% | \$ 3,836,148 | \$ 3,869,988 |

The average option adjusted duration for the Company's fixed maturity securities was 5.6 years at September 30, 2007 and 5.4 years at December 31, 2006.

In the three months ended September 30, 2007, the Company recorded impairment charges of \$285 from the paper sector of its fixed maturity securities portfolio, and a portion of these securities were subsequently sold in October 2007. In the three months ended June 30, 2007, the Company recorded impairment charges of \$2,319 from the home builder sector of its fixed maturity securities portfolio, and these securities were subsequently sold in July 2007. There were no other impairment charges recorded in 2007. At September 30, 2007 and December 31, 2006, the fair value and gross unrealized losses of fixed maturity securities in an unrealized loss position were as follows:

| | 12 months or less | | More than 12 months | | Total | |
|------------------------------------------------------------|-------------------|-------------------------|---------------------|-------------------------|--------------|-------------------------|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| As of September 30, 2007 | | | | | | |
| U.S. government and federally sponsored agency obligations | | | | | | |
| Mortgage-backed securities | \$ 263,522 | \$ 2,407 | \$ 453,194 | \$ 13,868 | \$ 716,716 | \$ 16,275 |
| Other | 71,008 | 60 | 70,081 | 514 | 141,089 | 574 |
| Municipal bonds | 155,026 | 1,903 | 80,107 | 1,526 | 235,133 | 3,429 |
| Foreign government bonds | | | 7,126 | 194 | 7,126 | 194 |
| Corporate bonds | 537,964 | 17,809 | 693,186 | 23,588 | 1,231,150 | 41,397 |
| Other mortgage-backed securities | 95,848 | 9,084 | 70,294 | 979 | 166,142 | 10,063 |
| Totals | \$ 1,123,368 | \$ 31,263 | \$ 1,373,988 | \$ 40,669 | \$ 2,497,356 | \$ 71,932 |

As of December 31, 2006

| | | | | | | |
|------------------------------------------------------------|------------|----------|--------------|-----------|--------------|-----------|
| U.S. government and federally sponsored agency obligations | | | | | | |
| Mortgage-backed securities | \$ 40,617 | \$ 281 | \$ 508,887 | \$ 12,208 | \$ 549,504 | \$ 12,489 |
| Other | 76,575 | 41 | 139,848 | 1,884 | 216,423 | 1,925 |
| Municipal bonds | 41,612 | 174 | 102,341 | 1,709 | 143,953 | 1,883 |
| Foreign government bonds | | | 9,025 | 206 | 9,025 | 206 |
| Corporate bonds | 330,826 | 4,696 | 697,987 | 20,732 | 1,028,813 | 25,428 |
| Other mortgage-backed securities | 28,134 | 93 | 100,443 | 1,759 | 128,577 | 1,852 |
| Totals | \$ 517,764 | \$ 5,285 | \$ 1,558,531 | \$ 38,498 | \$ 2,076,295 | \$ 43,783 |

Table of Contents

Note 3 - Investments-(Continued)

The Company's investment portfolio includes no derivative financial instruments (futures, forwards, swaps, option contracts or other financial instruments with similar characteristics).

Securities Lending

The Company loans fixed income securities to third parties, primarily major brokerage firms. As of September 30, 2007 and December 31, 2006, fixed maturities with a fair value of \$72,222 and \$289,524, respectively, were on loan, and as of September 30, 2007 short-term investments of \$2,993 were on loan. Loans of securities are required at all times to be secured by collateral from borrowers at least equal to 100% of the fair value of the securities loaned. The Company maintains effective control over the loaned securities and therefore reports them as Fixed Maturity Securities and Short-term Investments, as appropriate, in the Consolidated Balance Sheets. Securities lending collateral is classified as short-term investments with a corresponding liability in the Company's Consolidated Balance Sheets.

Note 4 - Share Repurchase Program and Treasury Shares Held (Common Stock)

As previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, \$96,343 remained authorized for future repurchases of Horace Mann Educators Corporation's Common Stock, par value \$0.001, under the May 1999 authorization by the Company's Board of Directors (the Board). The Company's last repurchase of its common shares was in July 2000. On September 12, 2007, the Board authorized a new share repurchase program allowing repurchases up to \$50,000 and ended the May 1999 authorization. The new share repurchase program authorizes the repurchase of common shares in open market or privately negotiated transactions, from time to time, depending on market conditions. As of September 30, 2007, no shares were repurchased under the new program.

At September 30, 2007, the Company held 17,503,371 shares in treasury.

Note 5 - Income Taxes

Effective January 1, 2007, the Company adopted FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No 109. FIN 48 provides recognition of tax benefits from tax return positions only if it is more likely than not the position will be sustainable, upon examination, on its technical merits and any relevant administrative practices or precedents. As a result, the Company now applies a more-likely-than-not recognition threshold for all tax uncertainties.

As of January 1, 2007, the Company had \$3,914 of unrecognized tax benefits. The amount which would affect the effective tax rate is \$3,897 and differs from the gross unrecognized tax benefit liability due to the impact of federal and state benefits.

The Company does not anticipate any significant changes to its total unrecognized tax benefits within the next 12 months. Tax years 2002 through 2006 remain subject to examination by all major taxing authorities. The Company is currently under examination by the Internal Revenue Service for tax years 2002, 2004 and 2005.

Table of Contents**Note 5 - Income Taxes-(Continued)**

The Company classifies all income tax-related interest and penalties as income tax expense. As of January 1, 2007, the Company had accrued \$569 in liabilities for tax-related interest and penalties on its Consolidated Balance Sheet.

Note 6 - Pension Plans and Other Postretirement Benefits

The Company has the following retirement plans: a defined contribution plan; a 401(k) plan; a defined benefit plan for employees hired on or before December 31, 1998; and certain employees participate in a supplemental defined contribution plan or a supplemental defined benefit plan or both. Additional information regarding the Company's retirement plans is contained in Notes to Consolidated Financial Statements Note 9 Pension Plans and Other Postretirement Benefits of the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

The following table summarizes the components of net periodic pension cost recognized for the defined benefit plan and the supplemental defined benefit plans for the three and nine months ended September 30, 2007 and 2006.

| | Defined Benefit Plan | | | |
|----------------------------------------------------|-----------------------------|----------------------|--------------------------|----------------------|
| | Three Months Ended | | Nine Months Ended | |
| | September 30, | September 30, | September 30, | September 30, |
| | 2007 | 2006 | 2007 | 2006 |
| Components of net periodic pension expense: | | | | |
| Service cost | \$ | \$ | \$ | \$ |
| Interest cost | 164 | 436 | 883 | 1,594 |
| Expected return on plan assets | (171) | (414) | (922) | (1,512) |
| Recognized net actuarial loss | 104 | 265 | 563 | 967 |
| Settlement loss | 77 | 288 | 415 | 1,050 |
| Net periodic pension expense | \$ 174 | \$ 575 | \$ 939 | \$ 2,099 |

| | Supplemental Defined Benefit Plans | | | |
|----------------------------------------------------|-------------------------------------------|----------------------|--------------------------|----------------------|
| | Three Months Ended | | Nine Months Ended | |
| | September 30, | September 30, | September 30, | September 30, |
| | 2007 | 2006 | 2007 | 2006 |
| Components of net periodic pension expense: | | | | |
| Service cost | \$ (11) | \$ (7) | \$ (34) | \$ (21) |
| Interest cost | 244 | 227 | 733 | 683 |
| Expected return on plan assets | | | | |
| Recognized net actuarial loss | 226 | 154 | 680 | 460 |
| Settlement loss | | | | |
| Net periodic pension expense | \$ 459 | \$ 374 | \$ 1,379 | \$ 1,122 |

Table of Contents**Note 6 - Pension Plans and Other Postretirement Benefits-(Continued)**

Consistent with disclosure in Notes to Consolidated Financial Statements Note 9 Pension Plans and Other Postretirement Benefits of the Company's Annual Report on Form 10-K for the year ended December 31, 2006, the Company expects to contribute \$1,140 to the supplemental defined benefit plans in 2007, of which \$842 was contributed during the nine months ended September 30, 2007. At the time of the Company's Annual Report on Form 10-K, the Company anticipated contributing \$250 to the defined benefit plan and has subsequently determined that no contribution will be made in 2007.

In addition to providing pension benefits, the Company also provides certain health care and life insurance benefits to retired employees, who meet the Plan's eligibility requirements, and their eligible dependents. As described in Notes to Consolidated Financial Statements Note 9 Pension Plans and Other Postretirement Benefits, effective January 1, 2007, the Company eliminated the previous health care benefits for retirees 65 years of age and over and established a Health Reimbursement Account (HRA) for each eligible participant. Also, the new plan does not provide life insurance benefits to individuals who retired in 1994 or later. As a result of the changes in the plan for other postretirement benefits, the Company anticipates a reduction in its expenses of approximately \$4,500 in 2007 and \$2,300 in 2008.

The following table summarizes the components of the net periodic benefit cost (gain) for postretirement benefits other than pension for the three and nine months ended September 30, 2007 and 2006.

| | Three Months Ended September 30, 2007 | | Nine Months Ended September 30, 2006 | |
|------------------------------------------------|------------------------------------------------------|----------------|-----------------------------------------------------|----------------|
| Components of net periodic cost (gain): | | | | |
| Service cost | \$ 12 | \$ 11 | \$ 37 | \$ 25 |
| Interest cost | 359 | 353 | 1,076 | 645 |
| Amortization of prior service cost | (1,163) | (1,244) | (3,489) | (1,362) |
| Recognized net actuarial gain | (328) | (524) | (984) | (446) |
| Net periodic benefit gain | \$ (1,120) | \$ (1,404) | \$ (3,360) | \$ (1,138) |

Consistent with disclosure in Notes to Consolidated Financial Statements Note 9 Pension Plans and Other Postretirement Benefits of the Company's Annual Report on Form 10-K for the year ended December 31, 2006, the Company expects to contribute \$1,637 to the postretirement benefit plans other than pensions in 2007, of which \$996 was contributed during the nine months ended September 30, 2007.

Table of Contents**Note 7 - Reinsurance**

The Company recognizes the cost of reinsurance premiums over the contract periods for such premiums in proportion to the insurance protection provided. Amounts recoverable from reinsurers for unpaid claims and claim settlement expenses, including estimated amounts for unsettled claims, claims incurred but not reported and policy benefits, are estimated in a manner consistent with the insurance liability associated with the policy. The effects of reinsurance on premiums written and contract deposits; premiums and contract charges earned; and benefits, claims and settlement expenses were as follows:

| | Gross | | | |
|----------------------------------------------|---------------|--------------|----------------|------------|
| | Amount | Ceded | Assumed | Net |
| Three months ended September 30, 2007 | | | | |
| Premiums written and contract deposits | \$ 262,974 | \$ 9,768 | \$ 1,216 | \$ 254,422 |
| Premiums and contract charges earned | 171,576 | 9,626 | 1,379 | 163,329 |
| Benefits, claims and settlement expenses | 109,540 | 1,958 | 1,026 | 108,608 |
| Three months ended September 30, 2006 | | | | |
| Premiums written and contract deposits | \$ 259,691 | \$ 9,428 | \$ 1,975 | \$ 252,238 |
| Premiums and contract charges earned | 170,412 | 9,439 | 1,786 | 162,759 |
| Benefits, claims and settlement expenses | 105,762 | 4,235 | 650 | 102,177 |
| Nine months ended September 30, 2007 | | | | |
| Premiums written and contract deposits | \$ 760,588 | \$ 28,791 | \$ 3,702 | \$ 735,499 |
| Premiums and contract charges earned | 513,407 | 29,673 | 4,262 | 487,996 |
| Benefits, claims and settlement expenses | 311,998 | 6,820 | 1,781 | 306,959 |
| Nine months ended September 30, 2006 | | | | |
| Premiums written and contract deposits | \$ 747,000 | \$ 28,688 | \$ 5,558 | \$ 723,870 |
| Premiums and contract charges earned | 510,787 | 29,248 | 5,775 | 487,314 |
| Benefits, claims and settlement expenses | 316,968 | 25,977 | 1,934 | 292,925 |

Table of Contents**Note 8 - Segment Information**

The Company conducts and manages its business through four segments. The three operating segments, representing the major lines of insurance business, are: property and casualty insurance, principally personal lines automobile and homeowners products; annuity products, principally individual, tax-qualified fixed and variable deposits; and life insurance. The Company does not allocate the impact of corporate level transactions to the insurance segments, consistent with the basis for management's evaluation of the results of those segments, but classifies those items in the fourth segment, corporate and other. In addition to ongoing transactions such as debt service, realized investment gains and losses and certain public company expenses, within the past five years such items have included debt retirement costs/gains and restructuring charges. Summarized financial information for these segments is as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------------------------------------------------------------------|-------------------------------------|-------------------|------------------------------------|-------------------|
| | 2007 | 2006 | 2007 | 2006 |
| Insurance premiums and contract charges earned | | | | |
| Property and casualty | \$ 133,469 | \$ 133,679 | \$ 399,240 | \$ 400,835 |
| Annuity | 5,486 | 4,953 | 16,369 | 14,593 |
| Life | 24,374 | 24,127 | 72,387 | 71,886 |
| Total | \$ 163,329 | \$ 162,759 | \$ 487,996 | \$ 487,314 |
| Net investment income | | | | |
| Property and casualty | \$ 9,350 | \$ 8,879 | \$ 27,806 | \$ 25,806 |
| Annuity | 32,525 | 30,395 | 96,066 | 89,078 |
| Life | 14,357 | 13,592 | 42,421 | 39,688 |
| Corporate and other | 96 | 565 | 863 | 1,071 |
| Intersegment eliminations | (274) | (279) | (826) | (839) |
| Total | \$ 56,054 | \$ 53,152 | \$ 166,330 | \$ 154,804 |
| Net income (loss) | | | | |
| Property and casualty | \$ 10,319 | \$ 14,453 | \$ 45,070 | \$ 53,277 |
| Annuity | 5,253 | 3,340 | 13,717 | 9,857 |
| Life | 5,490 | 3,945 | 12,723 | 10,996 |
| Corporate and other | (2,740) | (2,431) | (6,754) | (4,077) |
| Total | \$ 18,322 | \$ 19,307 | \$ 64,756 | \$ 70,053 |
| Amortization of intangible assets, pretax (included in segment net income) | | | | |
| Value of acquired insurance in force | | | | |
| Annuity | \$ 932 | \$ 938 | \$ 3,017 | \$ 3,138 |
| Life | 335 | 349 | 1,013 | 1,057 |
| Total | \$ 1,267 | \$ 1,287 | \$ 4,030 | \$ 4,195 |

| | September 30, 2007 | December 31, 2006 |
|---------------------------|-----------------------|----------------------|
| Assets | | |
| Property and casualty | \$ 930,710 | \$ 903,015 |
| Annuity | 4,113,517 | 4,094,491 |
| Life | 1,184,685 | 1,232,722 |
| Corporate and other | 103,182 | 126,166 |
| Intersegment eliminations | (36,778) | (26,707) |

| | | |
|-------|--------------|--------------|
| Total | \$ 6,295,316 | \$ 6,329,687 |
|-------|--------------|--------------|

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

(Dollars in millions, except per share data)

Forward-looking Information

Statements made in the following discussion that state the Company's or management's intentions, hopes, beliefs, expectations or predictions of future events or the Company's future financial performance are forward-looking statements and involve known and unknown risks, uncertainties and other factors. Horace Mann is not under any obligation to (and expressly disclaims any such obligation to) update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. It is important to note that the Company's actual results could differ materially from those projected in forward-looking statements due to, among other risks and uncertainties inherent in the Company's business, the following important factors:

Changes in the composition of the Company's assets and liabilities which may result from occurrences such as acquisitions, divestitures, impairment in asset values or changes in estimates of insurance reserves.

Fluctuations in the fair value of securities in the Company's investment portfolio and the related after-tax effect on the Company's shareholders' equity and total capital through either realized or unrealized investment losses. In addition, the impact of fluctuations in the financial markets on the Company's defined benefit pension plan assets and the related after-tax effect on the Company's operating expenses, shareholders' equity and total capital.

The impact of fluctuations in the financial markets on the Company's variable annuity fee revenues, valuations of deferred policy acquisition costs and value of acquired insurance in force, and the level of guaranteed minimum death benefit reserves.

The impact of fluctuations in the capital markets on the Company's ability to refinance outstanding indebtedness or repurchase shares of the Company's common stock.

Defaults on interest or dividend payments in the Company's investment portfolio due to credit issues and the resulting impact on investment income.

Prevailing interest rate levels, including the impact of interest rates on (i) unrealized gains and losses in the Company's investment portfolio and the related after-tax effect on the Company's shareholders' equity and total capital, (ii) the book yield of the Company's investment portfolio, (iii) the Company's ability to maintain appropriate interest rate spreads over the fixed rates guaranteed in the Company's life and annuity products and (iv) valuations of deferred policy acquisition costs and value of acquired insurance in force.

The cyclicity of the insurance industry and the related effects of changes in price competition and industry-wide underwriting results.

The frequency and severity of catastrophes such as hurricanes, earthquakes, storms and wildfires and the ability of the Company to provide accurate estimates of ultimate catastrophe costs in its consolidated financial statements in light of such factors as: the proximity of the catastrophe occurrence date to the date of the consolidated financial statements; potential inflation of property repair costs in the affected area; the occurrence of multiple catastrophes in a geographic area over a relatively short period of time; the outcome of litigation which may be filed against the Company by policyholders, state attorneys general and other parties relative to loss coverage disputes and loss settlement payments; and the ability of state insurance facilities to assess participating insurers when financial deficits occur.

Table of Contents

The Company's risk exposure to catastrophe-prone areas. Based on 2006 property and casualty direct earned premiums, the Company's ten largest states represented 57% of the segment total. Included in this top ten group are certain states which are considered more prone to catastrophe occurrences: Florida, California, North Carolina, Texas, Louisiana and South Carolina.

The potential near-term, adverse impact of underwriting actions to mitigate the Company's risk exposure to catastrophe-prone areas on premium, policy and earnings growth.

The ability of the Company to maintain a favorable catastrophe reinsurance program considering both availability and cost; and the collectibility of reinsurance receivables.

Adverse development of property and casualty loss and loss adjustment expense reserve experience and its impact on estimated claims and claim settlement expenses for losses occurring in prior years.

Adverse changes in business persistency, policyholder mortality and morbidity rates, interest spreads and market appreciation and the resulting impact on both estimated reserves and the valuations of deferred policy acquisition costs and value of acquired insurance in force.

Changes in insurance regulations, including (i) those affecting the ability of the Company's insurance subsidiaries to distribute cash to the holding company and (ii) those impacting the Company's ability to profitably write property and casualty insurance policies in one or more states.

Changes in federal income tax laws and changes resulting from federal tax audits affecting corporate tax rates or taxable income.

Changes in federal and state laws and regulations, which affect the relative tax and other advantages of the Company's life and annuity products to customers, including, but not limited to, changes in IRS regulations governing Section 403(b) plans.

The resolution of legal proceedings and related matters including the potential adverse impact on the Company's reputation and charges against the Company's earnings resulting from legal defense costs, a settlement agreement and/or an adverse finding or findings against the Company from the proceedings.

The Company's ability to maintain favorable claims-paying ability, financial strength and debt ratings.

The Company's ability to profitably expand its property and casualty business in highly competitive environments.

The competitive impact of the new Section 403(b) tax-qualified annuity regulations, including 1) their potential to lead plan sponsors to restrict the number of providers and 2) the possible entry into the 403(b) market of larger competitors experienced in 401(k) plans.

The Company's ability to develop and expand its agency operations, including its agent force and their licensed producers and support staff, as well as the Company's ability to maintain and secure sponsorships by local, state and national education associations.

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The Company's dated and complex information systems, which are more prone to error than advanced technology systems.

Disruptions of the general business climate, investments, capital markets and consumer attitudes caused by pandemics or geopolitical acts such as terrorism, war or other similar events.

Table of Contents

Executive Summary

Horace Mann Educators Corporation (HMEC ; and together with its subsidiaries, the Company or Horace Mann) is an insurance holding company. Through its subsidiaries, HMEC markets and underwrites personal lines of property and casualty and life insurance and retirement annuities in the U.S. The Company markets its products primarily to educators and other employees of public schools and their families.

For the three months ended September 30, 2007, the Company's net income of \$18.4 million decreased \$1.0 million compared to the prior year, including a \$0.8 million decrease in after tax realized investment gains. Third quarter 2007 property and casualty segment net income was \$4.1 million less than prior year, adversely affected by increased current accident year, non-catastrophe loss costs, particularly in the homeowners line, higher catastrophe losses and a lower level of favorable prior years' reserve development. Net income for the annuity and life segments exceeded prior year in the current quarter by \$1.8 million and \$1.5 million, respectively.

For the nine months ended September 30, 2007, the Company's net income decreased \$5.3 million compared to the prior year, including a \$2.0 million reduction in after tax realized investment gains. Consistent with management's expectations and industry experience, the year-to-date increase in property and casualty average loss costs per policy exceeded the increase in average premium per policy for the current accident period, which adversely impacted the combined ratio and net income. Compared to the first nine months of 2006, results in the first nine months of 2007 were also negatively impacted by a lower level of favorable development of prior years' property and casualty non-catastrophe reserves as well as the increased cost of the Company's catastrophe reinsurance program. Net income in the first nine months of 2007 benefited from a decrease in catastrophe costs compared to the prior year. Including all of these factors, the property and casualty combined ratio was 91.8% for the first nine months of 2007 compared to 88.3% for 2006. Annuity segment net income increased compared to the first nine months of 2006, driven by increases in the interest margin and contract charges earned. Life segment net income increased compared to a year earlier, reflecting growth in investment income and favorable mortality experience.

Premiums written and contract deposits increased 1% and 2% compared to the three and nine months ended September 30, 2006, respectively. As described in Results of Operations Insurance Premiums and Contract Charges , the third quarter 2007 expiration of an educator excess professional liability policy represented an \$8.6 million decrease compared to the prior year. Also, for the first nine months of 2007, the additional costs associated with the Company's property and casualty catastrophe reinsurance program represented a \$1.1 million decrease to current period premiums. Property and casualty premiums written reflected a slight decrease as a result of these two unfavorable items and a decrease in average automobile premium per policy partially offset by growth in average homeowners premium per policy and growth in policies in force for both automobile and homeowners. Including the effect of recent initiatives, new automobile sales units increased 2% in the current period compared to the first nine months of 2006. This sales growth, along with continued improvements in policy retention, resulted in increases in voluntary automobile policies in force compared to both December 31, 2006 and September 30, 2006. The automobile policies in force growth was driven primarily by an increase in educator policies. Annuity contract deposits for the three and nine months ended September 30, 2007 increased 10% and 7%, respectively, each compared to a year earlier, and life segment insurance premiums and contract deposits decreased 2% and 1% compared to the three and nine months ended September 30, 2006, respectively.

Table of Contents

Critical Accounting Policies

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires the Company s management to make estimates and assumptions based on information available at the time the consolidated financial statements are prepared. These estimates and assumptions affect the reported amounts of the Company s consolidated assets, liabilities, shareholders equity and net income. Certain accounting estimates are particularly sensitive because of their significance to the Company s consolidated financial statements and because of the possibility that subsequent events and available information may differ markedly from management s judgements at the time the consolidated financial statements were prepared. Management has discussed with the Audit Committee the quality, not just the acceptability, of the Company s accounting principles as applied in its financial reporting. The discussions generally included such matters as the consistency of the Company s accounting policies and their application, and the clarity and completeness of the Company s consolidated financial statements, which include related disclosures. For the Company, the areas most subject to significant management judgements include: liabilities for property and casualty claims and claim settlement expenses, liabilities for future policy benefits, deferred policy acquisition costs, value of acquired insurance in force for annuity and interest-sensitive life products, valuation of investments and valuation of assets and liabilities related to the defined benefit pension plan.

Liabilities for Property and Casualty Claims and Claim Settlement Expenses

Underwriting results of the property and casualty segment are significantly influenced by estimates of the Company s ultimate liability for insured events. There is a high degree of uncertainty inherent in the estimates of ultimate losses underlying the liability for unpaid claims and claim settlement expenses. This inherent uncertainty is particularly significant for liability-related exposures due to the extended period, often many years, that transpires between a loss event, receipt of related claims data from policyholders and ultimate settlement of the claim. Reserves for property and casualty claims include provisions for payments to be made on reported claims (case reserves), claims incurred but not yet reported (IBNR) and associated settlement expenses (together loss reserves). The process by which these reserves are established requires reliance upon estimates based on known facts and on interpretations of circumstances, including the Company s experience with similar cases and historical trends involving claim payments and related patterns, pending levels of unpaid claims and product mix, as well as other factors including court decisions, economic conditions and public attitudes.

Reserves are reestimated quarterly. Changes to reserves are recorded in the period in which development factor changes result in reserve reestimates. Detailed discussion of the process utilized to estimate loss reserves, risk factors considered and the impact of adjustments recorded during recent years is included in Notes to Consolidated Financial Statements Note 3 Property and Casualty Unpaid Claims and Claim Expenses of the Company s Annual Report on Form 10-K for the year ended December 31, 2006. Due to the nature of the Company s personal lines business, the Company has no exposure to claims for toxic waste cleanup, other environmental remediation or asbestos-related illnesses other than claims under homeowners insurance policies for environmentally related items such as mold.

Table of Contents

Based on the Company's products and coverages, historical experience, and modeling of various actuarial methodologies used to develop reserve estimates, the Company estimates that the potential variability of the property and casualty loss reserves, excluding the unprecedented hurricane losses experienced in 2005 and 2004, within a reasonable probability of other possible outcomes, may be approximately plus or minus 6%, or plus or minus approximately \$12 million in net income. Although this evaluation reflects the most likely outcomes, it is possible the final outcome may fall below or above these estimates.

There are a number of assumptions involved in the determination of the Company's property and casualty loss reserves. Among the key factors affecting recorded loss reserves for both long-tail and short-tail related coverages, claim severity and claim frequency are of particular significance. Management estimates that a 2% change in claim severity or claim frequency for the most recent 36-month period is a reasonably likely scenario based on recent experience and would result in a change in the estimated loss reserves of between \$6.0 million and \$10.0 million for long-tail liability related exposures (automobile liability coverages) and between \$3.0 million and \$4.0 million for short-tail liability related exposures (homeowners and automobile physical damage coverages). Actual results may change, depending on the magnitude and direction of the deviation.

The Company's loss and loss adjustment expense actuarial analysis is discussed with management. As part of this discussion, the indicated point estimate of the IBNR loss reserve by line of business (coverage) is reviewed. The Company actuaries also discuss any indicated changes to the underlying assumptions used to calculate the indicated point estimate. Review of the variance between the indicated reserves from these changes in assumptions and the previously carried reserves takes place. After discussion of these analyses and all relevant risk factors, management determines whether the reserve balances require adjustment. The Company's best estimate of loss reserves may change depending on a revision in the underlying assumptions.

The Company's liabilities for property and casualty unpaid claims and claim settlement expenses were as follows:

| | September 30, 2007 | | | December 31, 2006 | | |
|----------------------|--------------------|---------------|-----------|-------------------|---------------|-----------|
| | Case Reserves | IBNR Reserves | Total (1) | Case Reserves | IBNR Reserves | Total (1) |
| Automobile liability | \$ 78.3 | \$ 140.2 | \$ 218.5 | \$ 80.9 | \$ 140.2 | \$ 221.1 |
| Automobile other | 5.1 | 1.7 | 6.8 | 5.7 | 2.3 | 8.0 |
| Homeowners | 12.5 | 39.8 | 52.3 | 11.3 | 41.7 | 53.0 |
| All other | 4.0 | 33.6 | 37.6 | 3.7 | 32.0 | 35.7 |