HORACE MANN EDUCATORS CORP /DE/
Form 10-Q
November 09, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

[x] QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended **September 30, 2011**

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	37-0911756
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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 _X_ No ___

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes _X_ 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	X
Non-accelerated filer	Smaller reporting company	

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

As of October 28, 2011, 39,930,140 shares of Common Stock, par value $0.001 per share, were outstanding, net of 21,873,322 shares of treasury stock.

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HORACE MANN EDUCATORS CORPORATION

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2011

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Horace Mann Educators Corporation:

We have reviewed the consolidated balance sheet of Horace Mann Educators Corporation and subsidiaries (the Company) as of September 30, 2011, the related consolidated statements of operations and comprehensive income for the three-month and nine-month periods ended September 30, 2011 and 2010, and the related consolidated statements of changes in shareholders equity and cash flows for the nine-month periods ended September 30, 2011 and 2010. 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, 2010, and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders equity, and cash flows for the year then ended (not presented herein); and in our report dated February 28, 2011, 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, 2010, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it was derived.

Note 1 of the Company s audited consolidated financial statements as of December 31, 2010, and for the year then ended, discloses that the Company changed its method of accounting for other-than-temporary impairments of debt securities due to the adoption of FASB Staff Position No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (included in FASB ASC Topic 320, *Investments-Debt and Equity Securities*), as of April 1, 2009. Our auditors report on those consolidated financial statements dated February 28, 2011, includes an explanatory paragraph referring to the matter in Note 1 of those consolidated financial statements.

/s/ KPMG LLP

KPMG LLP

Chicago, Illinois

November 9, 2011

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HORACE MANN EDUCATORS CORPORATION

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

	September 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost 2011, $4,882,036; 2010, $4,533,233)	$ 5,307,034	$ 4,715,537
Equity securities, available for sale, at fair value (cost 2011, $19,906; 2010, $20,765)	23,061	24,056
Short-term and other investments	249,802	334,030
Total investments	5,579,897	5,073,623
Cash	40,757	5,928
Deferred policy acquisition costs	260,589	272,825
Goodwill	47,396	47,396
Other assets	234,994	230,113
Separate Account (variable annuity) assets	1,173,065	1,375,656
Total assets	$ 7,336,698	$ 7,005,541
LIABILITIES AND SHAREHOLDERS EQUITY		
Policy liabilities		
Fixed annuity contract liabilities	$ 2,857,966	$ 2,614,380
Interest-sensitive life contract liabilities	738,206	725,286
Unpaid claims and claim expenses	310,085	315,436
Future policy benefits	207,559	202,341
Unearned premiums	212,484	211,290
Total policy liabilities	4,326,300	4,068,733
Other policyholder funds	102,354	112,739
Other liabilities	441,729	330,727
Short-term debt	38,000	38,000
Long-term debt	199,728	199,679
Separate Account (variable annuity) liabilities	1,173,065	1,375,656
Total liabilities	6,281,176	6,125,534
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, 2011, 61,792,029; 2010, 61,469,148	62	61
Additional paid-in capital	372,924	367,448
Retained earnings	847,197	823,579
Accumulated other comprehensive income (loss) net of taxes:		
Net unrealized gains and losses on fixed maturities and equity securities	257,164	109,737
Net funded status of pension and other postretirement benefit obligations	(13,155)	(13,155)
Treasury stock, at cost, 2011, 21,873,322 shares; 2010, 21,813,196 shares	(408,670)	(407,663)

Total shareholders equity	1,055,522	880,007
Total liabilities and shareholders equity	$ 7,336,698	$ 7,005,541

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

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HORACE MANN EDUCATORS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Revenues				
Insurance premiums and contract charges earned	$ 167,035	$ 168,062	$ 500,066	$ 502,845
Net investment income	71,550	68,290	213,708	203,273
Net realized investment gains	21,121	12,062	32,674	25,305
Other income	1,127	1,616	4,209	5,294
Total revenues	260,833	250,030	750,657	736,717
Benefits, losses and expenses				
Benefits, claims and settlement expenses	124,412	124,864	398,822	356,162
Interest credited	39,288	37,076	114,987	108,854
Policy acquisition expenses amortized	27,922	20,189	71,712	66,080
Operating expenses	33,898	36,075	102,556	104,265
Interest expense	3,474	3,496	10,428	10,449
Total benefits, losses and expenses	228,994	221,700	698,505	645,810
Income before income taxes	31,839	28,330	52,152	90,907
Income tax expense	8,711	8,164	14,900	25,157
Net income	$ 23,128	$ 20,166	$ 37,252	$ 65,750
Net income per share				
Basic	$ 0.58	$ 0.51	$ 0.93	$ 1.67
Diluted	$ 0.56	$ 0.49	$ 0.90	$ 1.61
Weighted average number of shares and equivalent shares (in thousands)				
Basic	39,919	39,411	39,854	39,294
Diluted	41,451	41,115	41,455	40,947
Net realized investment gains (losses)				
Total other-than-temporary impairment losses on securities	$ -	$ (4,345)	$ -	$ (6,196)
Portion of losses recognized in other comprehensive income	-	-	-	459
Net other-than-temporary impairment losses on securities recognized in earnings	-	(4,345)	-	(5,737)
Realized gains	21,121	16,407	32,674	31,042
Total	$ 21,121	$ 12,062	$ 32,674	$ 25,305

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

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HORACE MANN EDUCATORS CORPORATION

CONSOLIDATED STATEMENTS OF

COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Comprehensive income				
Net income	$ 23,128	$ 20,166	$ 37,252	$ 65,750
Other comprehensive income, net of taxes:				
Change in net unrealized gains and losses on fixed maturities and equity securities	104,267	82,325	147,427	193,338
Change in net funded status of pension and other postretirement benefit obligations	-	-	-	-
Other comprehensive income	104,267	82,325	147,427	193,338
Total	$ 127,395	$ 102,491	$ 184,679	$ 259,088

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

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HORACE MANN EDUCATORS CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

(Dollars in thousands, except per share data)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Common stock, $0.001 par value		
Beginning balance	$ 61	$ 61
Options exercised, 2011, 136,290 shares; 2010, 51,850 shares	1	-
Conversion of common stock units, 2011, 15,715 shares; 2010, 160,876 shares	-	-
Conversion of restricted stock units, 2011, 170,876 shares; 2010, 46,584 shares	-	-
Ending balance	62	61
Additional paid-in capital		
Beginning balance	367,448	358,081
Options exercised and conversion of common stock units and restricted stock units	4,247	3,889
Share-based compensation expense	1,229	1,158
Ending balance	372,924	363,128
Retained earnings		
Beginning balance	823,579	758,343
Cumulative effect of adoption of accounting principle, net of taxes	-	(1,338)
Net income	37,252	65,750
Cash dividends, 2011, $0.33 per share; 2010, $0.24 per share	(13,634)	(9,785)
Ending balance	847,197	812,970
Accumulated other comprehensive income (loss), net of taxes		
Beginning balance	96,582	10,723
Cumulative effect of adoption of accounting principle, net of taxes	-	1,338
Change in net unrealized gains and losses on fixed maturities and equity securities	147,427	193,338
Change in net funded status of pension and other postretirement benefit obligations	-	-
Ending balance	244,009	205,399
Treasury stock, at cost		
Beginning balance, 2011 and 2010, 21,813,196 shares	(407,663)	(407,663)
Acquisition of shares, 2011, 60,126 shares; 2010, 0 shares	(1,007)	-
Ending balance, 2011, 21,873,322 shares; 2010, 21,813,196 shares	(408,670)	(407,663)
Shareholders equity at end of period	$ 1,055,522	$ 973,895

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

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HORACE MANN EDUCATORS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)

	Nine Months Ended September 30,	
	2011	**2010**
Cash flows - operating activities		
Premiums collected	$ 498,747	$ 503,033
Policyholder benefits paid	(425,327)	(364,579)
Policy acquisition and other operating expenses paid	(181,593)	(176,166)
Federal income taxes paid	(4,130)	(20,163)
Investment income collected	203,352	196,582
Interest expense paid	(6,897)	(6,914)
Contribution to defined benefit pension plan trust	(5,774)	(1,307)
Other	(2,328)	(1,622)
Net cash provided by operating activities	76,050	128,864
Cash flows - investing activities		
Fixed maturities		
Purchases	(1,016,995)	(1,151,950)
Sales	457,411	533,894
Maturities, paydowns, calls and redemptions	285,491	278,820
Net cash provided by short-term and other investments	85,178	133,287
Net cash used in investing activities	(188,915)	(205,949)
Cash flows - financing activities		
Dividends paid to shareholders	(13,634)	(9,785)
Exercise of stock options	2,127	854
Annuity contracts, variable and fixed		
Deposits	318,872	288,691
Benefits, withdrawals and net transfers to Separate Account (variable annuity) assets	(161,576)	(177,900)
Life policy accounts		
Deposits	1,553	1,404
Withdrawals and surrenders	(4,066)	(3,844)
Change in bank overdrafts	4,418	10,891
Net cash provided by financing activities	147,694	110,311
Net increase in cash	34,829	33,226
Cash at beginning of period	5,928	7,848
Cash at end of period	$ 40,757	$ 41,074

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

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HORACE MANN EDUCATORS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2011 and 2010

(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 which are normally included in annual financial statements prepared in accordance with GAAP but are not required for interim reporting purposes have been 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, 2011, the consolidated results of operations and comprehensive income for the three and nine months ended September 30, 2011 and 2010, and the consolidated changes in shareholders equity and cash flows for the nine months ended September 30, 2011 and 2010. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect (1) the reported amounts of assets and liabilities, (2) disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and (3) 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 K-12 teachers, administrators and other employees of public schools and their families. HMEC 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.

The Company has evaluated subsequent events through the date these consolidated financial statements were issued.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes to consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

The results of operations for the three and nine months ended September 30, 2011 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 2011 presentation.

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Note 1 - Basis of Presentation-(Continued)

Adopted Accounting Standards

Investments Held Through Separate Accounts

Effective January 1, 2011, the Company adopted accounting guidance to address how investments held through the separate accounts of an insurance entity affect the consolidation analysis. The guidance clarifies that an insurance entity should not consider any separate account interests in an investment held for the benefit of policyholders to be the insurer s interest and those interests should not be combined with an insurer s general account interests when making a consolidation assessment. The adoption of this accounting guidance did not have an effect on the results of operations or financial position of the Company.

Accounting Standards Not Yet Adopted, Retrospective Application

Costs Associated with Acquiring or Renewing Insurance Contracts

In October 2010, the Financial Accounting Standard Board (FASB) issued accounting guidance to address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The guidance will allow an insurance entity to capitalize only incremental and certain direct costs related to the successful acquisition of new or renewal insurance contracts. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011 and provides for either prospective or retrospective application. As of the time of this Quarterly Report on Form 10-Q, management continues to assess the impact that the adoption of this accounting guidance will have on the results of operations and financial position of the Company. While management has completed a significant amount of analysis regarding deferrable costs under the new guidance, a considerable amount of work still needs to be completed, especially related to the Annuity and Life segments. As of the time of this Quarterly Report on Form 10-Q, management s preliminary results indicate an impact on reported shareholders equity excluding unrealized investment gains and losses of less than 5%. However, completion of the Company s final analysis could result in a larger impact on shareholders equity. Management currently anticipates electing retrospective application of the new guidance effective January 1, 2012 resulting in a downward adjustment to the deferred policy acquisition costs asset with a corresponding adjustment to beginning retained earnings. On a forward-looking basis, management currently anticipates the net impact of lower expense deferrals and lower amortization on net income to be minimal.

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Note 2 - Investments

Maturities/Sales of Fixed Maturity Securities

The following table presents the distribution of the Company s fixed maturity securities (fixed maturities) 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. For structured securities, including mortgage-backed securities and other asset-backed securities, estimated expected maturities consider broker dealer survey prepayment assumptions and are verified for consistency with the interest rate and economic environments.

	Percent of Total Fair Value		September 30, 2011	
	September 30, 2011	December 31, 2010	Fair Value	Amortized Cost
Due in 1 year or less	3.8%	3.3%	$ 200,883	$ 184,796
Due after 1 year through 5 years	19.1	20.5	1,011,904	930,869
Due after 5 years through 10 years	32.7	29.5	1,737,247	1,598,125
Due after 10 years through 20 years	22.4	22.7	1,187,932	1,092,800
Due after 20 years	22.0	24.0	1,169,068	1,075,446
Total	100.0%	100.0%	$ 5,307,034	$ 4,882,036

The average option-adjusted duration for the Company s fixed maturity securities was 6.5 years at September 30, 2011 and 6.9 years at December 31, 2010.

Proceeds received from sales of fixed maturities, determined using the specific identification method, and gross gains and gross losses realized as a result of those sales for each period were:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Proceeds received	$ 246,127	$ 171,300	$ 457,411	$ 533,894
Gross gains realized	19,272	14,544	28,954	31,324
Gross losses realized	(9)	(416)	(92)	(5,491)

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Note 2 - Investments-(Continued)

Unrealized Gains and Losses on Fixed Maturities and Equity Securities

The amortized cost or cost, unrealized investment gains and losses, fair values and other-than-temporary impairment (OTTI) included in accumulated other comprehensive income (loss) (AOCI) of all fixed maturities and equity securities in the portfolio as of September 30, 2011 and December 31, 2010 were as follows:

	Amortized Cost/Cost	Unrealized Gains	Unrealized Losses	Fair Value	OTTI in AOCI (2)
September 30, 2011					
Fixed maturity securities					
U.S. government and federally sponsored agency obligations (1)					
Mortgage-backed securities	$ 445,263	$ 55,346	$ 10	$ 500,599	$ -
Other	558,144	44,003	15	602,132	-
Municipal bonds	1,155,900	106,002	1,062	1,260,840	-
Foreign government bonds	44,542	4,122	-	48,664	-
Corporate bonds	1,924,036	195,866	23,703	2,096,199	-
Other mortgage-backed securities	754,151	59,526	15,077	798,600	2,094
Totals	$ 4,882,036	$ 464,865	$ 39,867	$ 5,307,034	$ 2,094
Equity securities	$ 19,906	$ 3,747	$ 592	$ 23,061	$ -
December 31, 2010					
Fixed maturity securities					
U.S. government and federally sponsored agency obligations (1)					
Mortgage-backed securities	$ 442,969	$ 26,255	$ 1,180	$ 468,044	$ -
Other	512,692	6,227	21,465	497,454	-
Municipal bonds	1,080,324	27,782	19,399	1,088,707	-
Foreign government bonds	42,982	2,554	-	45,536	-
Corporate bonds	1,790,159	152,866	10,437	1,932,588	-
Other mortgage-backed securities	664,107	34,746	15,645	683,208	1,401
Totals	$ 4,533,233	$ 250,430	$ 68,126	$ 4,715,537	$ 1,401
Equity securities	$ 20,765	$ 3,747	$ 456	$ 24,056	$ -

(1) Fair value includes securities issued by Federal National Mortgage Association (FNMA) of $548,472 and $431,635; Federal Home Loan Mortgage Corporation (FHLMC) of $357,466 and $310,751; and Government National Mortgage Association (GNMA) of $40,108 and $45,454 as of September 30, 2011 and December 31, 2010, respectively.

(2) Represents the amount of other-than-temporary impairment losses in AOCI which, beginning April 1, 2009, was not included in earnings under current accounting guidance. Amounts also include unrealized gains and losses on impaired securities relating to changes in the fair value of such securities subsequent to the impairment measurement date.

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Note 2 - Investments-(Continued)

Net unrealized gains and losses are computed as the difference between fair value and amortized cost for fixed maturities or cost for equity securities. The following table reconciles the net unrealized investment gains and losses, net of tax, included in accumulated other comprehensive income (loss), before the impact of deferred policy acquisition costs:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net unrealized investment gains (losses) on fixed maturity securities, net of tax				
Beginning of period	$ 163,967	$ 144,514	$ 118,498	$ 24,599
Change in unrealized investment gains and losses	125,937	94,655	178,913	221,980
Reclassification of net realized investment (gains) losses to net income	(13,655)	(7,542)	(21,162)	(14,952)
End of period	$ 276,249	$ 231,627	$ 276,249	$ 231,627
Net unrealized investment gains (losses) on equity securities, net of tax				
Beginning of period	$ 2,885	$ 276	$ 2,139	$ (1,189)
Change in unrealized investment gains and losses	(761)	2,421	(12)	3,946
Reclassification of net realized investment (gains) losses to net income	(73)	(11)	(76)	(71)
End of period	$ 2,051	$ 2,686	$ 2,051	$ 2,686

Credit Losses

The following table summarizes the cumulative amounts related to the Company s credit loss component of the other-than-temporary impairment losses on fixed maturity securities held as of September 30, 2011 and 2010 that the Company did not intend to sell as of those dates, and it was not more likely than not that the Company would be required to sell the securities before the anticipated recovery of the amortized cost bases, for which the non-credit portions of the other-than-temporary impairment losses were recognized in other comprehensive income:

	Nine Months Ended September 30,	
	2011	2010
Cumulative credit loss (1)		
Beginning of period	$ 4,518	$ 2,875
New credit losses	-	647
Losses related to securities sold or paid down during the period	(561)	-
End of period	$ 3,957	$ 3,522

(1) The cumulative credit loss amounts exclude other-than-temporary impairment losses on securities held as of the periods indicated that the Company intended to sell or it was more likely than not that the Company would be required to sell the security before the recovery of the amortized cost basis. The current definition, reporting and disclosure of credit loss was effective as of April 1, 2009.

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Note 2 - Investments-(Continued)

Fixed Maturities and Equity Securities

At September 30, 2011, the gross unrealized loss in the fixed maturity and equity securities portfolio was $40,459 (300 positions, the fair value of which represented 11.2% of total fixed maturity and equity securities fair value). The following table presents the fair value and gross unrealized losses of fixed maturity securities and equity securities in an unrealized loss position at September 30, 2011 and December 31, 2010. The Company views the decrease in value of all of the securities with unrealized losses at September 30, 2011 -- which was driven largely by spread widening and changes in interest rates from the date of acquisition -- as temporary. For fixed maturity securities, management does not have the intent to sell the securities and it is not more likely than not the Company will be required to sell the securities before the anticipated recovery of the amortized cost bases. In addition, management expects to recover the entire cost basis of the fixed maturity securities. For equity securities, the Company has the ability and intent to hold the securities for the recovery of cost and recovery of cost is expected within a reasonable period of time. Therefore, no impairment of these securities was recorded at September 30, 2011.

	12 Months or Less		More than 12 Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
September 30, 2011						
Fixed maturity securities						
U.S. government and federally sponsored agency obligations						
Mortgage-backed securities	$ 60	$ -	$ 1,618	$ 10	$ 1,678	$ 10
Other	2,852	15	-	-	2,852	15
Municipal bonds	38,119	349	35,967	713	74,086	1,062
Foreign government bonds	-	-	-	-	-	-
Corporate bonds	374,350	17,983	23,719	5,720	398,069	23,703
Other mortgage-backed securities	76,118	2,261	38,545	12,816	114,663	15,077
Totals	$ 491,499	$ 20,608	$ 99,849	$ 19,259	$ 591,348	$ 39,867
Equity securities (1)	$ -	$ -	$ 5,410	$ 592	$ 5,410	$ 592
December 31, 2010						
Fixed maturity securities						
U.S. government and federally sponsored agency obligations						
Mortgage-backed securities	$ 27,111	$ 1,179	$ 1,907	$ 1	$ 29,018	$ 1,180
Other	312,750	21,465	-	-	312,750	21,465
Municipal bonds	416,216	14,520	34,825	4,879	451,041	19,399
Foreign government bonds	-	-	-	-	-	-
Corporate bonds	179,339	4,587	45,789	5,850	225,128	10,437
Other mortgage-backed securities	117,602	2,932	68,921	12,713	186,523	15,645
Totals	$ 1,053,018	$ 44,683	$ 151,442	$ 23,443	$ 1,204,460	$ 68,126

Equity securities (1)	$	938	$	49	$	5,822	$	407	$	6,760	$	456

(1) Includes primarily nonredeemable (perpetual) preferred stocks and also common stocks.

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

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Note 3 - Fair Value of Financial Instruments

The following table presents the Company s fair value hierarchy for those assets and liabilities measured at fair value on a recurring and nonrecurring basis as of September 30, 2011 and December 31, 2010. At September 30, 2011, Level 3 invested assets comprised approximately 1.3% of the Company s total investment portfolio fair value.

	Carrying Amount	Fair Value	Fair Value Measurements at Reporting Date Using (1) Level 1	Level 2	Level 3
September 30, 2011					
Financial Assets					
Investments					
Fixed maturities					
U.S. government and federally sponsored agency obligations					
Mortgage-backed securities	$ 500,599	$ 500,599	$ -	$ 500,599	$ -
Other	602,132	602,132	73,783	528,349	-
Municipal bonds	1,260,840	1,260,840	-	1,260,840	-
Foreign government bonds	48,664	48,664	-	48,664	-
Corporate bonds	2,096,199	2,096,199	25,957	2,002,732	67,510
Other mortgage-backed securities	798,600	798,600	-	795,909	2,691
Totals	5,307,034	5,307,034	99,740	5,137,093	70,201
Equity securities	23,061	23,061	9,278	13,399	384
Short-term investments	123,167	123,167	120,627	2,540	-
Other investments (2)	126,635	130,641	-	-	-
Total investments	5,579,897	5,583,903	229,645	5,153,032	70,585
Separate Account (variable annuity) assets	1,173,065	1,173,065	-	1,173,065	-
Financial Liabilities					
Fixed annuity contract liabilities	2,857,966	2,565,570			
Policyholder account balances on interest-sensitive life contracts	79,432	74,750			
Other policyholder funds	102,354	102,354			
Short-term debt	38,000	38,000			
Long-term debt	199,728	215,180			
December 31, 2010					
Financial Assets					
Investments					
Fixed maturities					
U.S. government and federally sponsored agency obligations					
Mortgage-backed securities	$ 468,044	$ 468,044	$ -	$ 468,044	$ -
Other	497,454	497,454	114,931	382,523	-
Municipal bonds	1,088,707	1,088,707	-	1,088,707	-
Foreign government bonds	45,536	45,536	-	45,536	-
Corporate bonds	1,932,588	1,932,588	32,087	1,855,257	45,244
Other mortgage-backed securities	683,208	683,208	-	682,263	945
Totals	4,715,537	4,715,537	147,018	4,522,330	46,189
Equity securities	24,056	24,056	9,866	13,794	396
Short-term investments	211,998	211,998	204,950	7,048	-
Other investments (2)	122,032	125,790	-	-	-
Total investments	5,073,623	5,077,381	361,834	4,543,172	46,585

Separate Account (variable annuity) assets	1,375,656	1,375,656	-	1,375,656	-
Financial Liabilities					
Fixed annuity contract liabilities	2,614,380	2,346,971			
Policyholder account balances on interest-sensitive life contracts	79,710	75,011			
Other policyholder funds	112,739	112,739			
Short-term debt	38,000	38,000			
Long-term debt	199,679	214,971			

(1) This information is not required for financial and nonfinancial assets and liabilities not recognized at fair value in the Consolidated Balance Sheets.

(2) Fair value of Other investments includes investments, primarily policy loans, for which inputs to fair value measurements are not required. Inputs to fair value measurements are provided only for those investments carried at fair value.

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Note 3 - Fair Value of Financial Instruments-(Continued)

The Company did not have any transfers between Levels 1 and 2 during the nine months ended September 30, 2011. The following tables present reconciliations for the three and nine months ended September 30, 2011 and 2010 for all Level 3 assets measured at fair value on a recurring basis.

	Corporate Bonds	Other Mortgage-Backed Securities	Total Fixed Maturities	Equity Securities	Total
Financial Assets					
Beginning balance, July 1, 2011	$ 49,285	$ 824	$ 50,109	$ 384	$ 50,493
Transfers in (out) of Level 3 (1)	15,098	1,921	17,019	-	17,019
Total gains or losses					
Net realized gains (losses) included in net income	-	-	-	-	-
Net unrealized gains (losses) included in other comprehensive income	3,388	6	3,394	-	3,394
Purchases	-	-	-	-	-
Issuances	-	-	-	-	-
Sales	-	-	-	-	-
Settlements	-	-	-	-	-
Paydowns and maturities	(261)	(60)	(321)	-	(321)
Ending balance, September 30, 2011	$ 67,510	$ 2,691	$ 70,201	$ 384	$ 70,585
Beginning balance, January 1, 2011	$ 45,244	$ 945	$ 46,189	$ 396	$ 46,585
Transfers in (out) of Level 3 (1)	18,762	1,921	20,683	-	20,683
Total gains or losses					
Net realized gains (losses) included in net income	-	-	-	-	-
Net unrealized gains (losses) included in other comprehensive income	4,233	20	4,253	(12)	4,241
Purchases	-	-	-	-	-
Issuances	-	-	-	-	-
Sales	-	-	-	-	-
Settlements	-	-	-	-	-
Paydowns and maturities	(729)	(195)	(924)	-	(924)
Ending balance, September 30, 2011	$ 67,510	$ 2,691	$ 70,201	$ 384	$ 70,585

(1) Transfers into and out of Level 3 during the periods ended September 30, 2011 were attributable to changes in the availability of observable market information for individual fixed maturity securities. The Company s policy is to recognize transfers in and transfers out as of the ending date of the reporting period.

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Note 3 - Fair Value of Financial Instruments-(Continued)

	Corporate Bonds	Other Mortgage-Backed Securities	Total Fixed Maturities	Equity Securities	Total
Financial Assets					
Beginning balance, July 1, 2010	$ 12,917	$ 7,513	$ 20,430	$ 539	$ 20,969
Transfers in (out) of Level 3 (1)	18,829	24,915	43,744	-	43,744
Total gains or losses					
Net realized gains (losses) included in net income	-	-	-	-	-
Net unrealized gains (losses) included in other comprehensive income	509	223	732	-	732
Purchases	-	-	-	-	-
Issuances	-	-	-	-	-
Sales	-	-	-	-	-
Settlements	-	-	-	-	-
Paydowns and maturities	(153)	(377)	(530)	-	(530)
Ending balance, September 30, 2010	$ 32,102	$ 32,274	$ 64,376	$ 539	$ 64,915
Beginning balance, January 1, 2010	$ 2,439	$ 7,860	$ 10,299	$ 539	$ 10,838
Transfers in (out) of Level 3 (1)	28,982	24,525	53,507	-	53,507
Total gains or losses					
Net realized gains (losses) included in net income	-	-	-	-	-
Net unrealized gains (losses) included in other comprehensive income	1,004	526	1,530	-	1,530
Purchases	-	-	-	-	-
Issuances	-	-	-	-	-
Sales	-	-	-	-	-
Settlements	-	-	-	-	-
Paydowns and maturities	(323)	(637)	(960)	-	(960)
Ending balance, September 30, 2010	$ 32,102	$ 32,274	$ 64,376	$ 539	$ 64,915

(1) Transfers into and out of Level 3 during the periods ended September 30, 2010 were attributable to changes in the availability of observable market information for individual fixed maturity securities. The Company s policy is to recognize transfers in and transfers out as of the ending date of the reporting period.

At September 30, 2011 and 2010, there were no realized gains or losses, due to the change in unrealized gains or losses, included in earnings that were attributable to Level 3 assets still held.

Note 4 - Debt

Indebtedness outstanding was as follows:

	September 30, 2011	December 31, 2010
Short-term debt:		
Bank Credit Facility	$ 38,000	$ 38,000
Long-term debt:		
6.05% Senior Notes, due June 15, 2015. Aggregate principal amount of $75,000 less unaccrued discount of $98 and $118 (6.1% imputed rate)	74,902	74,882
6.85% Senior Notes, due April 15, 2016. Aggregate principal amount of $125,000 less unaccrued discount of $174 and $203 (6.9% imputed rate)	124,826	124,797
Total	$ 237,728	$ 237,679

The Bank Credit Facility, 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 5 -- Debt of the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

Credit Agreement with Financial Institutions (Bank Credit Facility)

On May 31, 2005, HMEC entered into a Bank Credit Agreement by and between HMEC, certain financial institutions named therein and Bank of America, N.A., as administrative agent, that was amended and restated effective December 19, 2006 (the Previous Bank Credit Agreement). The Previous Bank Credit Agreement, which provided for unsecured borrowings of up to $125,000, was terminated on October 7, 2011 following HMEC s entry into the Current Bank Credit Facility and repayment of the $38,000 balance outstanding, as described below.

On October 7, 2011, HMEC entered into a new Bank Credit Agreement (the Current Bank Credit Facility) that replaces the Previous Bank Credit Agreement, described above, which was scheduled to expire on December 19, 2011. The Current Bank Credit Facility is by and between HMEC, certain financial institutions named therein and JPMorgan Chase Bank, N.A., as administrative agent, provides for unsecured borrowings of up to $150,000 and expires on October 6, 2015.

On October 7, 2011, there was no change to HMEC s short-term debt balance. HMEC borrowed $38,000 under the Current Bank Credit Facility and used the proceeds to repay the $38,000 balance outstanding under the Previous Bank Credit Agreement.

Under the Current Bank Credit Facility, interest accrues at varying spreads relative to prime or eurodollar base rates and is payable monthly or quarterly depending on the applicable base rate (eurodollar base rate plus 1.25%, or 1.63%, as of October 7, 2011). The unused portion of the Current Bank Credit Facility is subject to a variable commitment fee, which was 0.15% on an annual basis at October 7, 2011.

The Current Bank Credit Facility contains financial covenants, as defined in the agreement, as follows: (1) debt to capital ratio not to exceed 35%, (2) minimum net worth and (3) insurance subsidiaries risk based capital percentages of not less than 300%.

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Note 5 - 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.

Defined Benefit Plan and Supplemental Defined Benefit Plans

The following tables summarize 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, 2011 and 2010.

	Defined Benefit Plan			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Components of net periodic pension (income) expense:				
Service cost:				
Benefit accrual	$ -	$ -	$ -	$ -
Other expenses	63	62	188	187
Interest cost	424	470	1,268	1,408
Expected return on plan assets	(610)	(597)	(1,820)	(1,791)
Settlement (gain) loss	1,098	(155)	1,098	619
Amortization of:				
Prior service cost	-	-	-	-
Actuarial loss	478	261	1,366	784
Net periodic pension expense	$ 1,453	$ 41	$ 2,100	$ 1,207

	Supplemental Defined Benefit Plans			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Components of net periodic pension (income) expense:				
Service cost:				
Benefit accrual	$ -	$ -	$ -	$ -
Other expenses	-	-	-	-
Interest cost	201	85	598	631
Expected return on plan assets	-	-	-	-
Settlement loss	-	-	-	-
Amortization of:				
Prior service cost	31	31	94	93
Actuarial loss	194	62	523	185
Net periodic pension expense	$ 426	$ 178	$ 1,215	$ 909

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Note 5 - Pension Plans and Other Postretirement Benefits-(Continued)

There is a minimum funding requirement of approximately $900 for the Company s defined benefit plan in 2011. At the time of the Company s Annual Report on Form 10-K for the year ended December 31, 2010, the Company expected to contribute approximately $5,200 to the defined benefit plan and approximately $1,300 to the supplemental retirement plans in 2011. As of the time of this Quarterly Report on Form 10-Q, the Company expects to contribute $5,926 to the defined benefit pension plan, of which $5,774 was contributed during the nine months ended September 30, 2011. As of the time of this Quarterly Report on Form 10-Q, in 2011 the Company expects to contribute $1,355 to the supplemental retirement plans, of which $1,015 was contributed during the nine months ended September 30, 2011. For the full year, the Company expects amortization of net losses of $1,821 and $698 for the defined benefit plan and the supplemental retirement plans, respectively, and expects amortization of prior service cost of $124 for the supplemental retirement plans to be included in net periodic pension expense to 2011.

Postretirement Benefits Other Than Pensions

In addition to providing pension benefits, the Company also provides certain health care and life insurance benefits to eligible employees. Effective January 1, 2007, the Company eliminated the previous group health insurance benefits for retirees 65 years of age and over, including elimination of pharmacy benefits for Medicare eligible retirees, and established a Health Reimbursement Account (HRA) for each eligible participant. Funding of HRA accounts was $153 and $258 for the nine months ended September 30, 2011 and 2010, respectively.

The following table summarizes the components of the net periodic benefit for postretirement benefits other than pensions for the three and nine months ended September 30, 2011 and 2010.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Components of net periodic benefit:				
Service cost	$ -	$ -	$ -	$ -
Interest cost	32	43	91	128
Amortization of prior service cost	-	-	-	-
Amortization of prior gains	(101)	(130)	(376)	(390)
Net periodic benefit	$ (69)	$ (87)	$ (285)	$ (262)

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, 2010, for the full year the Company expects to contribute approximately $600 to the postretirement benefit plans other than pensions in 2011, of which $343 was contributed during the nine months ended September 30, 2011. In addition, the Company expects amortization of prior gains of $501 to be included in the net periodic benefit for the year ended December 31, 2011.

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Note 6 - 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 yet 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 to Other Companies	Assumed from Other Companies	Net Amount
Three months ended September 30, 2011				
Premiums written and contract deposits	$ 305,476	$ 7,484	$ 918	$ 298,910
Premiums and contract charges earned	173,537	7,480	978	167,035
Benefits, claims and settlement expenses	127,524	4,278	1,166	124,412
Three months ended September 30, 2010				
Premiums written and contract deposits	$ 296,544	$ 8,200	$ 972	$ 289,316
Premiums and contract charges earned	175,228	8,211	1,045	168,062
Benefits, claims and settlement expenses	124,524	768	1,108	124,864
Nine months ended September 30, 2011				
Premiums written and contract deposits	$ 823,557	$ 23,698	$ 2,477	$ 802,336
Premiums and contract charges earned	522,207	24,702	2,561	500,066
Benefits, claims and settlement expenses	413,909	17,478	2,391	398,822
Nine months ended September 30, 2010				
Premiums written and contract deposits	$ 804,713	$ 25,424	$ 3,499	$ 782,788
Premiums and contract charges earned	525,729	26,399	3,515	502,845
Benefits, claims and settlement expenses	359,405	6,319	3,076	356,162

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Note 7 - 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 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 also have included debt retirement costs/gains. Summarized financial information for these segments is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Insurance premiums and contract charges earned				
Property and casualty	$ 136,636	$ 139,326	$ 410,456	$ 415,825
Annuity	4,936	4,160	14,443	12,986
Life	25,463	24,576	75,167	74,034
Total	$ 167,035	$ 168,062	$ 500,066	$ 502,845
Net investment income				
Property and casualty	$ 8,927	$ 9,178	$ 27,402	$ 27,093
Annuity	45,582	42,150	135,029	125,197
Life	17,294	17,213	52,040	51,757
Corporate and other	(1)	7	(2)	5
Intersegment eliminations	(252)	(258)	(761)	(779)
Total	$ 71,550	$ 68,290	$ 213,708	$ 203,273
Net income (loss)				
Property and casualty	$ 1,735	$ 1,430	$ (11,598)	$ 20,969
Annuity	4,355	8,547	20,517	22,690
Life	3,555	5,678	13,464	15,766
Corporate and other	13,483	4,511	14,869	6,325
Total	$ 23,128	$ 20,166	$ 37,252	$ 65,750

	September 30, 2011	December 31, 2010
Assets		
Property and casualty	$ 993,212	$ 954,201
Annuity	4,766,353	4,556,317
Life	1,485,860	1,393,169
Corporate and other	120,431	130,191
Intersegment eliminations	(29,158)	(28,337)
Total	$ 7,336,698	$ 7,005,541

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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 are not historical in nature are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995 and are subject to 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:

- The impact that a prolonged economic recession may have on the Company s investment portfolio; volume of new business for automobile, homeowners, annuity and life products; policy renewal rates; and additional annuity contract deposit receipts.
- 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, as well as the potential impact on the ability of the Company s insurance subsidiaries to distribute cash to the holding company and/or need for the holding company to make capital contributions to the insurance subsidiaries. In addition, the impact of fluctuations in the financial market 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.
- Prevailing interest rate levels, including the impact of interest rates on (1) 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, (2) the book yield of the Company s investment portfolio, (3) the Company s ability to maintain appropriate interest rate spreads over the fixed rates guaranteed in the Company s life and annuity products and (4) amortization of deferred policy acquisition costs.
- The impact of fluctuations in the financial market on the Company s variable annuity fee revenues, amortization of deferred policy acquisition costs, and the level of guaranteed minimum death benefit reserves.
- Defaults on interest or dividend payments in the Company s investment portfolio due to credit issues and the resulting impact on investment income.
- 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.

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The Company s risk exposure to catastrophe-prone areas. Based on full year 2010 property and casualty direct earned premiums, the Company s ten largest states represented 58% of the segment total. Included in this top ten group are certain states which are considered more prone to catastrophe occurrences: California, Florida, North Carolina, Texas, Louisiana, South Carolina and Georgia.

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 expenses for losses occurring in prior years.

Climate change, to the extent it produces rising temperatures and changes in weather patterns, which could impact the frequency and/or severity of weather events and wildfires, the affordability and availability of catastrophe reinsurance coverage, and the Company s ability to make homeowners insurance available to its customers.

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

Adverse results from the assessment of the Company s goodwill asset requiring write off of the impaired portion.

The Company s ability to maintain favorable claims-paying ability ratings.

The Company s ability to maintain favorable financial strength and debt ratings.

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.

The Company s ability to (1) develop and expand its marketing operations, including agents and other points of distribution, and (2) maintain and obtain sponsorships by and/or marketing agreements with local, state and national education associations, as well as various school administrator, principal and business official associations.

The competitive impact of Section 403(b) tax-qualified annuity regulations, including (1) their potential to lead plan sponsors to further restrict the number of providers and (2) the possible increased competition within the 403(b) market from larger companies experienced in 401(k) plans.

The effects of economic forces and other issues affecting the educator market including, but not limited to, federal, state and local budget deficits and cut-backs and adverse changes in state and local tax revenues. The effects of these forces include, among others, teacher layoffs and early retirements, as well as individual concerns regarding employment and economic uncertainty.

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

Changes in insurance regulations, including (1) those affecting the ability of the Company s insurance subsidiaries to distribute cash to the holding company and (2) those impacting the Company s ability to profitably write property and casualty insurance policies in one or more states.

Changes in federal and state tax laws, including changes in elements of taxation or rates of taxation which could be in response to budget pressures related to general economic conditions or other factors, and changes resulting from tax audits affecting corporate tax rates.

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.
Changes in federal and state laws and regulations, which affect the relative tax advantage of certain investments or which affect the ability of debt issuers to declare bankruptcy or restructure debt.
The cyclicality of the insurance industry and the related effects of changes in price competition and industry-wide underwriting results.
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 dated and complex information systems, which are difficult to upgrade and 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.

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 insurance, retirement annuities and life insurance in the U.S. The Company markets its products primarily to K-12 teachers, administrators and other employees of public schools and their families.

For the three months ended September 30, 2011, the Company reported net income of $23.2 million, which represented an increase of $3.1 million, or 15%, compared to the prior year. After-tax net realized investment gains increased by $6.0 million between periods. Annuity segment net income decreased $4.2 million, or 49%, compared to the third quarter of 2010, primarily due to the negative impact on the current quarter from the evaluation of deferred policy acquisition costs which was largely driven by the change in financial market performance, partially offset by improvements in the interest margin. Life segment net income decreased $2.0 million, or 36%, compared to a year earlier, primarily due to higher mortality costs. For the property and casualty segment, net income increased $0.2 million, or 13%, compared to a year earlier, due to improvements in property non-catastrophe loss experience including a reduction in sinkhole claims, which were partially offset by an increase in the automobile current accident year loss ratio and a smaller benefit in the current period from favorable prior years reserve development. While only somewhat greater than the third quarter 2010 level, catastrophe losses had a negative impact on the comparison to prior year.

For the nine months ended September 30, 2011, the Company s net income of $37.3 million represented a decrease of $28.4 million, or 43%, compared to the prior year primarily due to the increase in property and casualty catastrophe losses. After-tax net realized investment gains increased by $4.8 million between periods. For the property and casualty segment, the net loss of $11.6 million reflected a decrease of $32.6 million, compared to net income for the first nine months of 2010, primarily due to the increase in catastrophe costs but also reflecting a smaller benefit in the current period from favorable prior years reserve development. Catastrophe costs increased $26.5 million after tax compared to the prior year. Favorable prior years property and casualty reserve development was $5.8 million after tax

lower than the same period a year ago. For the nine months, current period incurred sinkhole claims in Florida were less than the prior year by approximately $6 million after tax. Excluding catastrophe losses, compared to a year earlier current accident year results for the property line improved while automobile current accident year losses increased. Including all factors, the property and casualty combined ratio was 111.4% for the first nine months of 2011 compared to 100.8% for the same period in 2010. Annuity segment net income decreased $2.2 million, or 10%, compared to the first nine months of 2010, reflecting the negative impacts from the evaluation of deferred policy acquisition costs and a non-recurring tax benefit recorded in the prior year, partially offset by improvements in the interest margin. Compared to the first nine months of 2010, life segment net income decreased $2.2 million, or 14%, including higher mortality costs in the current period.

Premiums written and contract deposits increased 3% and 2% compared to the third quarter and first nine months of 2010, respectively, driven by the increase in annuity deposit receipts. Building on increased levels of receipts in 2010, annuity deposits received increased 10% compared to the first nine months of 2010, driven by a 29% increase in single deposit and rollover receipts in the current year. Property and casualty segment premiums written decreased 2% compared to the prior year-to-date, with approximately 1 percentage point of the decrease related to the Company s Florida homeowners non-renewal program. Total new automobile sales units and true new auto sales units for the current period were 6% and 7% less, respectively, than in the first nine months of 2010. The premium impact from increases in average premium per policy for both homeowners and automobile in the current year was more than offset by the reduced level of automobile and homeowners policies in force. Life segment insurance premiums and contract deposits decreased 1% compared to the first nine months of the prior year.

The Company s book value per share was $26.44 at September 30, 2011, an increase of 7% compared to 12 months earlier, reflecting net income for the trailing 12 months and the improvement in unrealized investment gains and losses due to lower yields on U.S. Treasury securities somewhat offset by widening spreads, the combination of which caused an increase in values for the Company s holdings of U.S. government and agency securities, municipal bonds and agency mortgage-backed securities. In addition, the Company has reduced the holdings in its commercial mortgage-backed securities portfolio compared to a year ago.

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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 judgments 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 judgments include: fair value measurements, other-than-temporary impairment of investments, goodwill, deferred policy acquisition costs for annuity and interest-sensitive life products, liabilities for property and casualty claims and claim expenses, liabilities for future policy benefits, deferred taxes and valuation of assets and liabilities related to the defined benefit pension plan.

Fair Value Measurements

The fair value of a financial instrument is the estimated amount at which the instrument could be exchanged in an orderly transaction between knowledgeable, unrelated and willing parties. The valuation of fixed maturity securities and equity securities is more subjective when markets are less liquid due to the lack of market based inputs, which may increase the potential that the estimated fair value of an investment is not reflective of the price at which an actual transaction would occur.

Valuation of Fixed Maturity and Equity Securities

For fixed maturity securities, each month the Company receives prices from its investment managers and custodian bank. Fair values for the Company s fixed maturity securities are based primarily on prices provided by its investment managers and sometimes by its custodian bank. The prices from the custodian bank are compared to prices from the investment managers. Differences in prices between the sources that the Company considers significant are researched and the Company utilizes the price that it considers most representative of an exit price. Both the investment managers and the custodian bank use a variety of independent, nationally recognized pricing sources to determine market valuations. Each designate specific pricing services or indexes for each sector of the market based upon the provider s expertise. Typical inputs used by these pricing sources include, but are not limited to, reported trades, benchmark yield curves, benchmarking of like securities, sector groupings, matrix pricing, issuer spreads, bids, offers, and/or estimated cash flows and prepayment speeds.

When the pricing sources cannot provide fair value determinations, the Company obtains non-binding price quotes from broker-dealers. The broker-dealers valuation methodology is sometimes matrix-based, using indicative evaluation measures and adjustments for specific security characteristics and market sentiment. The market inputs utilized in the evaluation measures and adjustments include: benchmark yield curves, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. The extent of the use of each market input depends on the market sector and the market conditions. Depending on the security, the priority of the use of inputs may change or some market inputs may not be relevant. For some securities, additional inputs may be necessary.

The Company analyzes price and market valuations received to verify reasonableness, to understand the key assumptions used and their sources, to conclude the prices obtained are appropriate, and to determine an appropriate fair value hierarchy level based upon trading activity and the observability of market inputs. Based on this evaluation and investment class analysis, each security is classified into Level 1, 2 or 3. The Company has in place certain control processes to determine the reasonableness of the financial asset fair values. These processes are designed to ensure the values received are accurately recorded and that the data inputs and valuation techniques utilized are appropriate, consistently applied, and that the assumptions are reasonable and consistent with the objective of determining fair value. For example, on a continuing basis, the Company assesses the reasonableness of individual security values received from pricing sources that vary from certain thresholds. Historically, the control processes have not resulted in adjustments to the valuations provided by pricing sources. The Company s fixed maturity securities portfolio is primarily publicly traded, which allows for a high percentage of the portfolio to be priced through pricing services. Approximately 91% of the portfolio, based on fair value, was priced through pricing services or index priced as of September 30, 2011. The remainder of the portfolio was priced by broker-dealers or pricing models. When non-binding broker-dealer quotes could be corroborated by comparison to other vendor quotes, pricing models or analysis, the securities were generally classified as Level 2. There were no significant changes to the valuation process during the first nine months of 2011.

Fair values of equity securities have been determined by the Company from observable market quotations, when available. When a public quotation is not available, equity securities are valued by using non-binding broker quotes or through the use of pricing models or analysis that is based on market information regarding interest rates, credit spreads and liquidity. The underlying source data for calculating the matrix of credit spreads relative to the U.S. Treasury curve are nationally recognized indices. These inputs are based on assumptions deemed appropriate given the circumstances and are believed to be consistent with what other market participants would use when pricing such securities. There were no significant changes to the valuation process in the first nine months of 2011.

At September 30, 2011, Level 3 invested assets comprised approximately 1.3% of the Company s total investment portfolio fair value. Invested assets are classified as Level 3 when fair value is determined based on unobservable inputs that are supported by little or no market activity and those inputs are significant to the fair value. For additional detail, see Notes to Consolidated Financial Statements -- Note 3 -- Fair Value of Financial Instruments .

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Other-than-temporary Impairment of Investments

The Company s methodology of assessing other-than-temporary impairments is based on security-specific facts and circumstances as of the date of the reporting period. Based on these facts, if the Company has the intent to sell the fixed maturity security, or if it is more likely than not the Company will be required to sell the fixed maturity security before the anticipated recovery of the amortized cost basis or if management does not expect to recover the entire cost basis of the fixed maturity security, an other-than-temporary impairment is considered to have occurred. For equity securities, if the Company does not have the ability and intent to hold the security for the recovery of cost or if recovery of cost is not expected within a reasonable period of time, an other-than-temporary impairment is considered to have occurred. Additionally, if events become known that call into question whether the security issuer has the ability to honor its contractual commitments, such security holding will be evaluated to determine whether or not such security has suffered an other-than-temporary decline in value.

The Company reviews the fair value of all investments in its portfolio on a monthly basis to assess whether an other-than-temporary decline in value has occurred. These reviews, in conjunction with the Company s investment managers monthly credit reports and relevant factors such as (1) the financial condition and near-term prospects of the issuer, (2) the length of time and extent to which the fair value has been less than amortized cost for fixed maturity securities or cost for equity securities, (3) for fixed maturity securities, the Company s intent to sell a security or whether it is more likely than not the Company will be required to sell the security before the anticipated recovery in the amortized cost basis; and for equity securities, the Company s ability and intent to hold the security for the recovery of cost or if recovery of cost is not expected within a reasonable period of time, (4) the stock price trend of the issuer, (5) the market leadership position of the issuer, (6) the debt ratings of the issuer, and (7) the cash flows and liquidity of the issuer or the underlying cash flows for asset-backed securities, are all considered in the impairment assessment. A write-down of an investment is recorded when a decline in the fair value of that investment is deemed to be other-than-temporary, with a realized investment loss charged to income for the period for all equity securities and for the credit-related loss portion associated with impaired fixed maturity securities. The amount of the total other-than-temporary impairment related to non-credit factors for fixed maturity securities is recognized in other comprehensive income, net of applicable taxes, unless the Company has the intent to sell the security or if it is more likely than not the Company will be required to sell the security before the anticipated recovery of the amortized cost basis.

With respect to fixed income securities involving securitized financial assets -- primarily asset-backed and commercial mortgage-backed securities in the Company s portfolio -- a significant portion of the fair values is determined by observable inputs. In addition, the securitized financial asset securities underlying collateral cash flows are stress tested to determine if there has been any adverse change in the expected cash flows.

A decline in fair value below amortized cost is not assumed to be other-than-temporary for fixed maturity investments with unrealized losses due to spread widening, market illiquidity or changes in interest rates where there exists a reasonable expectation based on the Company s consideration of all objective information available that the Company will recover the entire cost basis of the security and the Company does not have the intent to sell the investment before maturity or a market recovery is realized and it is more likely than not the Company will not be required to sell the investment. An other-than-temporary impairment loss will be recognized based upon all relevant facts and circumstances for each investment, as appropriate.

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Goodwill

Goodwill represents the excess of the amounts paid to acquire a business over the fair value of its net assets at the date of acquisition. Goodwill is not amortized, but is tested for impairment at least annually or more frequently if events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. A reporting unit is defined as an operating segment or one level below an operating segment. The Company s reporting units, for which goodwill has been allocated, are equivalent to the Company s operating segments.

The goodwill impairment test, as defined in the accounting guidance, follows a two-step process. In the first step, the fair value of a reporting unit is compared to its carrying value. If the carrying value of a reporting unit exceeds its fair value, the second step of the impairment test is performed for purposes of confirming and measuring the impairment. In the second step, the fair value of the reporting unit is allocated to all of the assets and liabilities of the reporting unit to determine an implied goodwill value. If the carrying amount of the reporting unit goodwill exceeds the implied goodwill value, an impairment loss would be recognized in an amount equal to that excess, and the charge could have a material adverse effect on the Company s results of operations and financial position.

The Company completed its annual goodwill assessment for the individual reporting units as of December 31, 2010. The first step of the Company s analysis indicated that fair value exceeded carrying value for each reporting unit. Management s determination of the fair value of each reporting unit incorporated multiple inputs including discounted cash flow calculations, the level of the Company s own share price and assumptions that market participants would make in valuing each reporting unit. Fair value estimates were based primarily on an in-depth analysis of historical experience, projected future cash flows and relevant discount rates, which considered market participant inputs and the relative risk associated with the projected cash flows. Other assumptions included levels of economic capital, future business growth, earnings projections and assets under management for each reporting unit. Estimates of fair value are subject to assumptions that are sensitive to change and represent the Company s reasonable expectations regarding future developments. The Company also considered other valuation techniques such as peer company price-to-earnings and price-to-book multiples.

As part of the Company s December 31, 2010 goodwill analysis, the Company compared the fair value of the aggregated reporting units to the market capitalization of the Company. The difference between the aggregated fair value of the reporting units and the market capitalization of the Company was attributed to transaction premium. The amount of the transaction premium was determined to be reasonable based on insurance industry and Company-specific facts and circumstances.

Subsequent goodwill assessments could result in impairment due to the impact of a volatile financial market on earnings, discount rate assumptions, liquidity and market capitalization. Management believes the Company s continued depressed market capitalization is largely the result of current global financial market conditions and is similar to companies within the annuity and life insurance sector. There were no events or material changes in circumstances during the nine months ended September 30, 2011 that indicated that a material change in the fair value of the Company s reporting units had occurred.

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Deferred Policy Acquisition Costs for Annuity and Interest-sensitive Life Products

Policy acquisition costs, consisting of commissions, policy issuance and other costs, which vary with and are primarily related to the production of business, are capitalized and amortized on a basis consistent with the type of insurance coverage. For all investment (annuity) contracts, acquisition costs are amortized over 20 years in proportion to estimated gross profits. Capitalized acquisition costs for interest-sensitive life contracts are also amortized over 20 years in proportion to estimated gross profits.

The most significant assumptions that are involved in the estimation of annuity gross profits include interest rate spreads, future financial market performance, business surrender/lapse rates, expenses and the impact of realized investment gains and losses. For the variable deposit portion of the annuity segment, the Company amortizes policy acquisition costs utilizing a future financial market performance assumption of a 10% reversion to the mean approach with a 200 basis point corridor around the mean during the reversion period, representing a cap and a floor on the Company s long-term assumption. The Company s practice with regard to returns on Separate Accounts assumes that long-term appreciation in the financial market is not changed by short-term market fluctuations, but is only changed when sustained interim deviations are experienced. The Company monitors these fluctuations and only changes the assumption when its long-term expectation changes. The effect of an increase/(decrease) by 100 basis points in the assumed future rate of return is reasonably likely to result in a decrease/(increase) in the deferred policy acquisition costs amortization expense of approximately $1 million. At September 30, 2011, the ratio of capitalized annuity policy acquisition costs to the total annuity accumulated cash value was approximately 4%.

In the event actual experience differs significantly from assumptions or assumptions are significantly revised, the Company may be required to record a material charge or credit to amortization expense for the period in which the adjustment is made. As noted above, there are key assumptions involved in the evaluation of capitalized policy acquisition costs. In terms of the sensitivity of this amortization to two of the more significant assumptions, assuming all other assumptions are met, (1) a 10 basis point deviation in the annual targeted interest rate spread assumption would currently impact amortization between $0.15 million and $0.25 million and (2) a 1% deviation from the targeted financial market performance for the underlying mutual funds of the Company s variable annuities would currently impact amortization between $0.20 million and $0.30 million. These results may change depending on the magnitude and direction of the deviations but represent a range of reasonably likely experience for the noted assumptions. Detailed discussion of the impact of adjustments to the amortization of capitalized acquisition costs is included in Results of Operations -- Policy Acquisition Expenses Amortized .

Liabilities for Property and Casualty Claims and Claim 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

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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. The Company calculates and records a single best estimate of the reserve (which is equal to the actuarial point estimate) as of each balance sheet date.

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 4 -- Property and Casualty Unpaid Claims and Claim Expenses of the Company s Annual Report on Form 10-K for the year ended December 31, 2010. 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.

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 within a reasonable probability of other possible outcomes may be approximately plus or minus 6%, which equates to plus or minus approximately $11 million of net income based on net reserves as of September 30, 2011. 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 $5.0 million for short-tail liability related exposures (homeowners and automobile physical damage coverages). Actual results may differ, 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.

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

	September 30, 2011			December 31, 2010		
	Case Reserves	IBNR Reserves	Total (1)	Case Reserves	IBNR Reserves	Total (1)
Automobile liability	$ 67.9	$ 125.1	$ 193.0	$ 71.4	$ 129.0	$ 200.4
Automobile other	3.6	1.4	5.0	5.4	2.1	7.5
Homeowners	11.2	67.3	78.5	9.2	62.5	71.7
All other	1.6	17.2	18.8	4.0	18.0	22.0
Total	$ 84.3	$ 211.0	$ 295.3	$ 90.0	$ 211.6	$ 301.6

(1) These amounts are gross, before reduction for ceded reinsurance reserves.

The facts and circumstances leading to the Company s reestimate of reserves relate to revisions of the development factors used to predict how losses are likely to develop from the end of a reporting period until all claims have been paid. Reestimates occur because actual loss amounts are different than those predicted by the estimated development factors used in prior reserve estimates. At September 30, 2011, the impact of a reserve reestimation resulting in a 1% increase in net reserves would be a decrease of approximately $2 million in net income. A reserve reestimation resulting in a 1% decrease in net reserves would increase net income by approximately $2 million.

Favorable prior years reserve reestimates increased net income for the nine months ended September 30, 2011 by approximately $3.7 million, primarily the result of favorable frequency and severity trends in voluntary automobile losses for accident years 2009 and prior, as well as favorable development of homeowners loss reserves for accident years 2010 and prior. The lower than expected claims emergence and resultant lower expected loss ratios caused the Company to lower its reserve estimate at September 30, 2011.

Information regarding the Company s property and casualty claims and claims expense reserve development table as of December 31, 2010 is located in Business -- Property and Casualty Segment -- Property and Casualty Reserves of the Company s Annual Report on Form 10-K for the year ended December 31, 2010. Information regarding property and casualty reserve reestimates for each of the years in the three year period ended December 31, 2010 is located in Management s Discussion and Analysis of Financial Condition and Results of Operations -- Results of Operations for the Three Years Ended December 31, 2010 -- Benefits, Claims and Settlement Expenses of the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

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Liabilities for Future Policy Benefits

Liabilities for future benefits on life and annuity policies are established in amounts adequate to meet the estimated future obligations on policies in force. Liabilities for future policy benefits on certain life insurance policies are computed using the net level premium method and are based on assumptions as to future investment yield, mortality and withdrawals. Mortality and withdrawal assumptions for all policies have been based on actuarial tables which are consistent with the Company s own experience. In the event actual experience is worse than the assumptions, additional reserves may be required. This would result in a charge to income for the period in which the increase in reserves occurred. Liabilities for future benefits on annuity contracts and certain long-duration life insurance contracts are carried at accumulated policyholder values without reduction for potential surrender or withdrawal charges.

Deferred Taxes

Deferred tax assets and liabilities represent the tax effect of the differences between the financial statement carrying value of existing assets and liabilities and their respective tax bases. The Company evaluates deferred tax assets periodically to determine if they are realizable. Factors in the determination include the performance of the business including the ability to generate capital gains from a variety of sources and tax planning strategies. If, based on available information, it is more likely than not that the deferred income tax asset will not be realized, then a valuation allowance must be established with a corresponding charge to net income. Charges to establish a valuation allowance could have a material adverse effect on the Company s results of operations and financial position.

Valuation of Assets and Liabilities Related to the Defined Benefit Pension Plan

Effective April 1, 2002, participants stopped accruing benefits under the defined benefit pension plan but continue to retain the benefits they had accrued to that date.

The Company s cost estimates for its defined benefit pension plan are determined annually based on assumptions which include the discount rate, expected return on plan assets, anticipated retirement rate and estimated lump sum distributions. A discount rate of 4.58% was used by the Company for estimating accumulated benefits under the plan at December 31, 2010, which was based on the average yield for long-term, high grade securities having maturities generally consistent with the defined benefit pension payout period. To set its discount rate, the Company looks to leading indicators, including the Citigroup Pension Discount Curve. The expected annual return on plan assets assumed by the Company at December 31, 2010 was 7.5%. The assumption for the long-term rate of return on plan assets was determined by considering actual investment experience during the lifetime of the plan, balanced with reasonable expectations of future growth considering the various classes of assets and percentage allocation for each asset class. Management believes that it has adopted reasonable assumptions for investment returns, discount rates and other key factors used in the estimation of pension costs and asset values.

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To the extent that actual experience differs from the Company s assumptions, subsequent adjustments may be required, with the effects of those adjustments charged or credited to income and/or shareholders equity for the period in which the adjustments are made. Generally, a change of 50 basis points in the discount rate would inversely impact pension expense and accumulated other comprehensive income (AOCI) by approximately $0.1 million and $1.0 million, respectively. In addition, for every $1 million increase (decrease) in the value of pension plan assets, there is a comparable pretax increase (decrease) in AOCI.

Results of Operations

Insurance Premiums and Contract Charges

Insurance Premiums Written and Contract Deposits

(Includes annuity and life contract deposits)

	Nine Months Ended September 30,		Change From Prior Year	
	2011	2010	Percent	Amount
Property & casualty				
Automobile and property (voluntary)	$ 409.9	$ 419.0	-2.2%	$ (9.1)
Involuntary and other property & casualty	2.3	3.1	-25.8%	(0.8)
Total property & casualty	412.2	422.1	-2.3%	(9.9)
Annuity deposits	318.9	288.7	10.5%	30.2
Life	71.2	72.0	-1.1%	(0.8)
Total	$ 802.3	$ 782.8	2.5%	$ 19.5

Insurance Premiums and Contract Charges Earned

(Excludes annuity and life contract deposits)

	Nine Months Ended September 30,		Change From Prior Year	
	2011	2010	Percent	Amount
Property & casualty				
Automobile and property (voluntary)	$ 409.1	$ 413.7	-1.1%	$ (4.6)
Involuntary and other property & casualty	1.4	2.1	-33.3%	(0.7)
Total property & casualty	410.5	415.8	-1.3%	(5.3)
Annuity	14.4	13.0	10.8%	1.4
Life	75.2	74.0	1.6%	1.2
Total	$ 500.1	$ 502.8	-0.5%	$ (2.7)

For the three and nine months ended September 30, 2011, the Company s premiums written and contract deposits increased $9.6 million, or 3.3%, and $19.5 million, or 2.5%, respectively, compared to the same periods in the prior

year, both driven by the increase in annuity single premium and rollover deposit receipts. The Company s premiums and contract charges earned decreased $0.9 million, or 0.5%, and $2.7 million, or 0.5%, compared to the three and nine months ended September 30, 2010, respectively, primarily reflecting growth in annuity contract charges earned and the increasing favorable impact on earned premium of the automobile and property rate actions taken in 2010 which were more than offset by a reduced level of property and casualty policies in force in the current periods. Voluntary property and casualty business represents policies sold through the Company s marketing organization and issued under the Company s underwriting guidelines. Involuntary property and casualty business consists of allocations of business from state mandatory insurance facilities and assigned risk business.

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Total voluntary automobile and homeowners premium written decreased 2.2%, or $9.1 million, in the first nine months of 2011, with approximately 1 percentage point of the decrease related to the Company s Florida homeowners non-renewal program which is described below. Automobile and homeowners average written premium per policy each increased compared to the prior year, with the impact more than offset by a reduced level of policies in force in the current period. For the Company s automobile and homeowners business, rate changes effective during the first nine months of 2011 averaged 2% and 9%, respectively, compared to 7% and 10%, respectively, during the same period in 2010. At September 30, 2011, there were 489,000 voluntary automobile and 240,000 homeowners policies in force, for a total of 729,000 policies, compared to a total of 760,000 policies at December 31, 2010 and 772,000 policies at September 30, 2010. Management believes that the Company s rate and risk mitigation actions have had a negative impact, in some locations, on its policy retention rates and its sales levels.

Based on policies in force, the voluntary automobile 6-month retention rate for new and renewal policies was 90.7% at September 30, 2011 compared to 91.4% at September 30, 2010. The property 12-month new and renewal policy retention rate was 85.2% at September 30, 2011 compared to 88.0% at September 30, 2010, with the change including the impact of the Company s risk mitigation actions described below.

Voluntary automobile premium written decreased 3.1% ($8.6 million) compared to the first nine months of 2010. In the first nine months of 2011, the average written and earned premium per policy each increased 3%, more than offset by the decline in policies in force. Voluntary automobile policies in force at September 30, 2011 decreased 19,000 compared to December 31, 2010 and 27,000 compared to September 30, 2010. Both educator and non-educator policies decreased in each of these comparisons. The number of educator policies represented approximately 82% and 81% of the voluntary automobile policies in force at September 30, 2011 and 2010, respectively.

Voluntary homeowners premium written decreased 0.4% ($0.5 million) compared to the first nine months of 2010, net of catastrophe reinsurance premiums ceded that were less than the prior year. The average written and earned premium per policy increased 5% and 6%, respectively, in the first nine months of 2011 compared to a year earlier. Homeowners policies in force at September 30, 2011 decreased 12,000 compared to December 31, 2010 and 16,000 compared to September 30, 2010. The number of educator policies represented approximately 77% and 76% of the homeowners policies in force at September 30, 2011 and 2010, respectively. Growth in the number of educator policies that had been consistent sequentially for several years was offset somewhat beginning in the third quarter of 2010 by expected reductions due to the Company s risk mitigation programs, including actions in catastrophe-prone coastal areas, involving policies of both educators and non-educators. The Company continues to evaluate and implement actions to further mitigate its risk exposure in hurricane-prone areas, as well as other areas of the country. Such actions could include, but are not limited to, non-renewal of homeowners policies, restricted agent geographic placement, limitations on agent new business sales, further tightening of underwriting standards and increased utilization of third-party vendor products.

As an example, in early 2010 the Company began a program to address homeowners profitability and hurricane exposure issues in Florida. On January 1, 2010, the Company ceased writing new homeowner (including home, condo, renters and dwelling fire) policies in that state and initiated a program to non-renew about 9,600 policies, over half of the Company s Florida book of property business, starting with August 2010 policy effective dates.

By mid-August 2011, the non-renewal program had been completed, including approximately 3,600 policies terminated at the customers request -- a favorable result that progressed ahead of management s expected timing. In total, the Company s September 30, 2011 policy count for Florida homeowners business of less than 6,000 decreased by approximately 11,000 compared to December 31, 2009. Throughout the non-renewal program period, the Company s agents worked closely with customers to find coverage with third-party companies that underwrite property risks in Florida. While this program likely will continue to impact the overall policy in force count and premiums in the short-term, it is expected to reduce risk exposure concentration, reduce overall catastrophe reinsurance costs and improve homeowners underwriting results.

For the nine months ended September 30, 2011, total annuity deposits received increased 10.5% driven by the 28.7% increase in single premium and rollover deposit receipts, which more than offset the 6.9% decrease in scheduled annuity deposit receipts. In the first nine months of 2011, new deposits to variable accounts decreased 1.0%, or $0.8 million, and new deposits to fixed accounts increased 15.0%, or $31.0 million, compared to the prior year. In addition to external contractholder deposits, annuity new deposits include contributions and transfers by the Company s employees in the Company s 401(k) group annuity contract.

Total annuity accumulated cash value of $4.1 billion at September 30, 2011 increased 5.2% compared to a year earlier, as the increase from new deposits received and favorable retention more than offset unfavorable financial market performance over the 12 months. Cash value retentions for variable and fixed annuity options were 92.5% and 94.7%, respectively, for the 12 month period ended September 30, 2011. At September 30, 2011, the number of annuity contracts outstanding of 182,000 increased 1.1%, or 2,000 contracts, compared to December 31, 2010 and increased 2.2%, or 4,000 contracts, compared to September 30, 2010.

Variable annuity accumulated balances at September 30, 2011 reflected a decrease of 7.5% compared to September 30, 2010, including the unfavorable impact of financial market performance over the 12 months, particularly the performance in the third quarter of 2011. Annuity segment contract charges earned increased 10.8%, or $1.4 million, compared to the first nine months of 2010, primarily reflecting the growth in average variable annuity account values.

Life segment premiums and contract deposits decreased $0.8 million, or 1.1%, compared to the first nine months of 2010. The ordinary life insurance in force lapse ratio was 4.8% for the 12 months ended September 30, 2011 compared to 5.0% for the 12 months ended September 30, 2010.

Sales

For the Company, as well as other personal lines property and casualty companies, new business levels have been adversely impacted by the economy and the overall lower level of automobile and home sales compared to a few years ago. For the first nine months of 2011, total new automobile sales units were 5.6% less than the same period in the prior year, while true new automobile sales were 6.6% less than in the prior year. In the third quarter of 2011, true new auto sales units increased 7.1% compared to a year earlier, although total new auto sales units were comparable to the prior year. New homeowners sales units decreased 10.1% compared to the first nine months of 2010. Management believes that automobile and homeowners sales levels also have been negatively impacted by the Company s rate actions.

In addition, the year-to-date sales decreases in both lines of business were exacerbated by the Company s underwriting actions in Florida which were initiated in 2010.

Driven by increases in single premium and rollover deposits, total annuity sales increased 22.3% for the nine months ended September 30, 2011. Single premium and rollover deposits for Horace Mann annuity products increased 28.7% compared to the same period in 2010. In addition, the Company s new scheduled deposit business (measured on an annualized basis at the time of sale, compared to the reporting of new contract deposits which are recorded when cash is received) increased 21.1% compared to the first nine months of 2010, including growth of 23.6% for the three months ended September 30, 2011. In the first nine months of 2011, sales of third-party vendor annuity products, a relatively minor component of total annuity sales, decreased 23.5% compared to the first nine months of 2010. Sales of Horace Mann products by the Independent Agent distribution channel, included in the information above, increased 31.7% compared to the prior year, a comparison also impacted by current period growth in single premium and rollover deposits. The Company s annuity sales levels in recent years have been impacted both positively and negatively as K-12 educators respond to uncertainties regarding employment prospects during the economic recession. In situations where educator retirements increase, opportunities arise for single premium and rollover deposit business. For employed educators, uncertainty about their futures creates challenges for new sales of scheduled deposit business.

New sales of life insurance products have been adversely impacted by current economic conditions industry wide. The Company s introduction of new educator-focused portfolios of term and whole life products in the third quarters of 2009, 2010 and 2011 have helped to moderate the impact on the sales of proprietary life products. The current year-to-date increase in total life sales of 6.5% included a 7.1% increase in sales of third-party vendor products and a 5.8% increase in sales of proprietary life products.

Combining all lines of business, the Company s total new business sales increased 15.5% compared to the first nine months of 2010. Total sales for Horace Mann s Exclusive Agencies and Employee Agents for the first nine months of 2011 increased 12.1% compared to the prior year.

Distribution System

At September 30, 2011, there was a combined total of 735 Exclusive Agencies and Employee Agents, compared to 741 at December 31, 2010 and 701 at September 30, 2010. At September 30, 2011, there were 519 Horace Mann Exclusive Agencies -- more than half of which were formed by new appointments -- increasing 132 compared to September 30, 2010. The Company s Exclusive Agent opportunity was launched on January 1, 2009. At September 30, 2011, in addition to the Exclusive Agencies, there were 216 Employee Agents. See additional description in Business -- Corporate Strategy and Marketing -- Dedicated Agency Force of the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

As mentioned above, the Company utilizes a nationwide network of Independent Agents who comprise a supplemental distribution channel for the Company s 403(b) tax-qualified annuity products. The Independent Agent distribution channel included 950 authorized agents at September 30, 2011. During the first nine months of 2011, this channel generated $57.2 million in annualized new annuity sales for the Company compared to $43.4 million for the first nine months of 2010, primarily reflecting increases in single and rollover deposit business.

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Net Investment Income

For the three months ended September 30, 2011, pretax investment income of $71.5 million increased 4.7%, or $3.2 million, (4.3%, or $2.0 million, after tax) compared to the prior year. Pretax investment income of $213.7 million for the nine months ended September 30, 2011 increased 5.1%, or $10.4 million, (4.8%, or $6.6 million, after tax) compared to the prior year. The increase primarily reflected growth in the size of the average investment portfolio on an amortized cost basis. Average invested assets increased 8.0% over the 12 months ended September 30, 2011. The average pretax yield on the investment portfolio was 5.68% (3.84% after tax) for the first nine months of 2011, compared to a pretax yield of 5.83% (3.95% after tax) a year earlier.

Net Realized Investment Gains and Losses

For the three months ended September 30, 2011, net realized investment gains (pretax) were $21.2 million compared to net realized investment gains of $12.1 million in the same period in the prior year. For the nine months, net realized investment gains (pretax) were $32.7 million in 2011 compared to net realized investment gains of $25.3 million in the prior year. The net gains and losses in all periods were realized from ongoing investment portfolio management activity and, when determined, the recording of impairment write-down charges.

For the nine months ended September 30, 2011, the Company s net realized investment gains of $32.7 million included $33.3 million of gross gains realized on security sales and calls partially offset by $0.6 million of realized losses on securities that were disposed of during the nine months. There were no other-than-temporary impairment write-downs on securities in the current period. Gains realized on security disposals during the first nine months of 2011 included $0.3 million related to securities on which the Company had previously recognized other-than-temporary impairment write-downs.

For the nine months ended September 30, 2010, pretax net realized investment gains of $25.3 million included $5.7 million of credit-related impairment write-downs and $5.5 million of gross losses on securities that were disposed of during the period, which were more than offset by $36.5 million of gross realized gains on other security disposals.

The Company, from time to time, sells securities subsequent to the balance sheet date that were considered temporarily impaired at the balance sheet date. Such sales are generally due to events occurring subsequent to the balance sheet date that result in a change in the Company s intent to sell an invested asset.

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Fixed Maturity Securities and Equity Securities Portfolios

The table below presents the Company s fixed maturity securities and equity securities portfolios as of September 30, 2011 by major asset class, including the ten largest sectors of the Company s corporate bond holdings (based on fair value) and the sectors of the equity securities holdings. Compared to December 31, 2010, yields on U.S. Treasury securities decreased significantly while credit spreads widened notably across virtually all asset classes, with the Company s municipal bond portfolio showing the most significant improvement in net unrealized gains.

Fixed Maturity Securities	**Number of Issuers**	**Fair Value**	**Amortized Cost or Cost**	**Pretax Unrealized Gain**
Corporate bonds				
Banking and Finance	59	$ 385.9	$ 374.8	$ 11.1
Utilities	45	268.0	230.4	37.6
Energy	50	230.9	208.4	22.5
Insurance	25	136.4	120.1	16.3
Health Care	31	97.4	86.9	10.5
Metal and Mining	15	95.7	91.2	4.5
Broadcasting and Media	18	91.4	82.9	8.5
Transportation	20	84.3	79.7	4.6
Natural Gas	15	83.5	74.6	8.9
Telecommunications	22	77.2	70.0	7.2
All Other Corporates (1)	171	545.5	504.9	40.6
Total corporate bonds	471	2,096.2	1,923.9	172.3
Mortgage-backed securities				
U.S. government and federally sponsored agencies	334	500.6	445.3	55.3
Commercial	93	332.2	306.8	25.4
Other	14	14.3	13.6	0.7
Municipal bonds	386	1,260.8	1,155.9	104.9
Government bonds				
U.S.	8	602.1	558.1	44.0
Foreign	7	48.7	44.6	4.1
Collateralized debt obligations (2)	25	40.0	38.1	1.9
Asset-backed securities	99	412.1	395.7	16.4
Total fixed maturity securities	1,437	$ 5,307.0	$ 4,882.0	$ 425.0
Equity Securities				
Non-redeemable preferred stocks				
Banking and Finance	5	$ 8.7	$ 7.3	$ 1.4
Real Estate	2	5.7	4.9	0.8
Utilities	3	5.2	4.9	0.3
Insurance	3	2.8	2.7	0.1
U.S. federally sponsored agencies	2	0.2	*	0.2
Common stocks				
Technology	1	0.4	-	0.4
Cable and other	4	0.1	0.1	*
Total equity securities	20	$ 23.1	$ 19.9	$ 3.2
Total	1,457	$ 5,330.1	$ 4,901.9	$ 428.2

* Less than $0.1 million.

(1) The All Other Corporates category contains 19 additional industry classifications. Real estate, technology, retail, consumer products, miscellaneous and automobiles represented $326.3 million of fair value at September 30, 2011, with the remaining 13 classifications each representing less than $43 million.

(2) Based on fair value, 80.2% of the collateralized debt obligation securities were rated investment grade by Standard and Poor s Corporation (S&P) and/or Moody s Investors Service, Inc. (Moody s) at September 30, 2011.

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At September 30, 2011, the Company s diversified fixed maturity securities portfolio consisted of 1,698 investment positions, issued by 1,437 entities, and totaled approximately $5.3 billion in fair value. This portfolio was 95.1% investment grade, based on fair value, with an average quality rating of A+. The Company s investment guidelines generally limit single corporate issuer concentrations to 0.5% of invested assets for AA or AAA rated securities, 0.35% of invested assets for A or BBB rated securities, and 0.2% of invested assets for non-investment grade securities.

The following table presents the composition and value of the Company s fixed maturity securities and equity securities portfolios by rating category. At September 30, 2011, 95.0% of these combined portfolios were investment grade, with an overall average quality rating of A+. The Company has classified the entire fixed maturity securities and equity securities portfolios as available for sale, which are carried at fair value.

Rating of Fixed Maturity Securities and Equity Securities(1)

(Dollars in millions)

	Percent of Portfolio Fair Value		September 30, 2011	
	December 31, 2010	**September 30, 2011**	**Fair Value**	**Amortized Cost or Cost**
Fixed maturity securities				
AAA (2)	28.2%	5.1%	$ 271.2	$ 252.0
AA (2)	17.9	39.8	2,115.5	1,917.2
A	23.2	24.5	1,298.5	1,176.3
BBB	25.4	25.7	1,362.0	1,263.3
BB	2.9	2.6	140.5	151.3
B	2.3	2.0	104.5	106.4
CCC or lower	0.1	0.3	14.7	15.4
Not rated (3)	-	-	0.1	0.1
Total fixed maturity securities	100.0%	100.0%	$ 5,307.0	$ 4,882.0
Equity securities				
AAA	-	-	-	-
AA	-	-	-	-
A	17.0%	17.3%	$ 4.0	$ 4.5
BBB	55.6	50.6	11.7	10.5
BB	24.9	29.0	6.7	4.8
B	-	-	-	-
CCC or lower	0.4	0.9	0.2	*
Not rated (4)	2.1	2.2	0.5	0.1
Total equity securities	100.0%	100.0%	$ 23.1	$ 19.9
Total			$ 5,330.1	$ 4,901.9

* Less than $0.1 million.

(1)

Ratings are as assigned primarily by S&P when available, with remaining ratings as assigned on an equivalent basis by Moody s. Ratings for publicly traded securities are determined when the securities are acquired and are updated monthly to reflect any changes in ratings.

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(2) During the three months ended September 30, 2011, S&P and Moody s concluded on their respective evaluations of ratings for debt issued by the U.S. government. On August 2, 2011, Moody s affirmed its Aaa rating, with an outlook of negative. On August 5, 2011, S&P reduced its AAA long-term rating one notch to AA+, with an outlook of negative. At September 30, 2011, the AA rated fair value amount included $602.1 million of U.S. government securities and $476.3 million of securities issued by U.S. government and federally sponsored agencies. At December 31, 2010, the AAA rated fair value amount included $497.5 million of U.S. government securities and $468.0 million of securities issued by U.S. government and federally sponsored agencies.

(3) Included in this category is $0.1 million fair value of private placement securities not rated by either S&P or Moody s.

(4) This category represents common stocks that are not rated by either S&P or Moody s.

At September 30, 2011, the Company had $332.2 million fair value in commercial mortgage-backed securities (CMBS), primarily in the annuity and life portfolios, with gross unrealized losses of $12.9 million and a net unrealized gain of $25.4 million. Compared to the net unrealized loss at September 30, 2010, market valuation of the CMBS portfolio improved significantly, resulting in an overall fair value to amortized cost ratio of 108.3% at September 30, 2011, compared to 96.2% at September 30, 2010. As a result of risk reduction actions during 2010, and to a lesser extent in the first nine months of 2011, the Company reduced its holdings of conduit/fusion CMBS securities by $120 million of amortized cost, or 64%, compared to December 31, 2009. The CMBS disposals over the last 21 months resulted in a net realized gain of $1.3 million for the nine months ended September 30, 2011 and a net realized loss of $18.6 million for the year ended December 31, 2010. CMBS spreads widened notably in the three month period ended September 30, 2011. The concern over current economic weakness and its impact on commercial real estate values and rising commercial mortgage loan delinquencies has resulted in downward price pressure for certain CMBS securities. At September 30, 2011, the Company s CMBS portfolio was 93% investment grade, with an overall credit rating of A+, and well diversified by property type, geography and sponsor.

To evaluate the CMBS portfolio, the Company uses an estimate of future cash flows expected to be collected. The determination of cash flow estimates is inherently subjective and methodologies may vary depending on facts and circumstances specific to the security. All reasonably available information relevant to the collectability of the security, including past events, current conditions, and reasonable and supportable assumptions and forecasts, are considered when developing the estimate of cash flows expected to be collected. Information includes, but is not limited to, debt-servicing, missed refinancing opportunities and geography. Loan level characteristics such as issuer, payment terms, property type, and economic outlook are also utilized in financial models, along with historical performance, to estimate or measure the loan s propensity to default. Additionally, financial models take into account loan age, lease rollovers, rent volatilities, vacancy rates and exposure to refinancing as additional drivers of default. For transactions where loan level data is not available, financial models use a proxy based on the collateral characteristics. Loss severity is a function of multiple factors including, but not limited to, the unpaid balance, interest rate, assessed property value at origination, change in property valuation and loan-to-value ratio at origination. Cost of capital rates and debt service ratios are also considered. The cash flows generated by the collateral securing these securities are estimated using these default and loss severity assumptions. These collateral cash flows are then utilized, along with consideration for the issue s position in the overall structure, to estimate the cash flows associated with the commercial mortgage-backed security held by the Company.

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The table below presents rating, vintage year and property type information for the Company s CMBS portfolio.

	September 30, 2011			December 31, 2010		
	Number of Positions	Fair Value	Pretax Unrealized Gain (Loss)	Number of Positions	Fair Value	Pretax Unrealized Gain (Loss)
Rating						
AAA (1)	7	$ 28.7	$ 2.6	35	$ 93.1	$ 5.6
AA (1)	54	183.1	29.5	30	79.8	2.0
A	15	80.6	4.4	20	64.3	0.4
BBB	10	17.5	(2.3)	8	19.2	(1.3)
BB and below	7	22.3	(8.8)	8	25.6	(7.3)
Total	93	$ 332.2	$ 25.4	101	$ 282.0	$ (0.6)
Vintage						
2003 and prior	5	$ 10.6	$ 0.7	8	$ 12.8	$ 0.1
2004	8	14.2	(0.1)	10	15.3	(0.1)
2005	15	52.2	(10.8)	17	56.3	(9.5)
2006	17	40.0	4.3	20	38.7	2.4
2007	16	53.1	7.9	19	51.9	3.1
2008	11	36.9	7.3	12	32.3	2.1
2009	7	47.2	10.1	7	38.6	2.3
2010	8	42.4	3.9	8	36.1	(1.0)
2011	6	35.6	2.1	-	-	-
Total	93	$ 332.2	$ 25.4	101	$ 282.0	$ (0.6)
Property type						
Military housing	28	$ 116.6	$ 15.0	26	$ 86.1	$ 0.2
GNMA project loans	28	96.7	18.0	26	66.2	3.0
Conduit/Fusion	26	56.0	(10.7)	37	81.6	(5.3)
Cell tower	3	19.3	1.4	5	20.1	0.9
Timber	5	18.3	1.0	4	8.3	0.6
Single borrower	2	12.9	0.2	2	7.7	*
Credit tenant lease	1	12.4	0.5	1	12.0	*
Total	93	$ 332.2	$ 25.4	101	$ 282.0	$ (0.6)

* Less than $0.1 million.

(1) During the three months ended September 30, 2011, S&P and Moody s concluded on their respective evaluations of ratings for debt issued by the U.S. government. On August 2, 2011, Moody s affirmed its Aaa rating, with an outlook of negative. On August 5, 2011, S&P reduced its AAA long-term rating one notch to AA+, with an outlook of negative. GNMA project loans are issued by agencies sponsored by the U.S. government and their ratings were affected by the S&P U.S. long-term debt ratings downgrade. At September 30, 2011, the AA rated fair value amount included $96.7 million of GNMA project loans. At December 31, 2010, the AAA rated fair value amount included $66.2 million of GNMA project loans.

At September 30, 2011, the Company had $394.6 million fair value in financial institution bonds and preferred stocks with a net unrealized gain of $12.5 million. The Company s holdings in this sector are primarily large, well recognized

institutions, which were broadly supported by government intervention and credit enhancement programs during the 2008 credit crisis.

At September 30, 2011, the Company had $1,260.8 million fair value invested in municipal bonds with a net unrealized gain of $104.9 million. Of the geographically diversified municipal bond holdings, approximately 53% are tax-exempt and 76% are revenue bonds tied to essential services, such as mass transit, water and sewer. The overall credit quality of these securities was AA-, with approximately 33% of the value insured at September 30, 2011. This represents approximately 7% of the Company s total investment portfolio that is guaranteed by the mono-line credit insurers. When selecting securities, the Company focuses primarily on the quality of the underlying security and does not place significant reliance on the additional insurance benefit. Excluding the effect of insurance, the credit quality of the underlying municipal bond portfolio also was AA- at September 30, 2011.

At September 30, 2011, the fixed maturity securities and equity securities portfolios had a combined $40.5 million pretax of gross unrealized losses on $596.8 million fair value related to 300 positions. Of this amount, pretax gross unrealized losses of $20.2 million were on $477.4 million fair value for 248 positions that had been in a continuous unrealized loss position for 9 months or less.

Of the investment positions (fixed maturity securities and equity securities) with unrealized losses, 18 were trading below 80% of book value at September 30, 2011 and were not considered other-than-temporarily impaired. These positions included structured securities and corporate securities. The 18 securities with fair values below 80% of book value at September 30, 2011 had fair value of $33.2 million, representing 0.6% of the Company s total investment portfolio at fair value, and had a gross unrealized loss of $16.3 million.

While the U.S. Treasury yield curve moved significantly lower in the first nine months of 2011, contributing to the improvement in the Company s gross unrealized loss position compared to December 31, 2010, the persisting global uncertainty and concern over prolonged economic weakness continue to have an adverse effect on the liquidity and fair value of certain investments. With respect to fixed income securities involving securitized financial assets, the underlying collateral cash flows were stress tested to determine there was no adverse change in the expected cash flows at September 30, 2011.

The Company views the decrease in value of all of the securities with unrealized losses at September 30, 2011 as temporary. For fixed maturity securities, management does not have the intent to sell the securities and it is not more likely than not the Company will be required to sell the securities before the anticipated recovery of the amortized cost bases. In addition, management expects to recover the entire cost basis of the fixed maturity securities. For equity securities, the Company has the ability and intent to hold the securities for the recovery of cost and recovery of cost is expected within a reasonable period of time. Additionally, as of the date of this Quarterly Report on Form 10-Q, the Company is not aware of any events that call into question the ability of the issuers of the securities to honor their contractual commitments. Therefore, no impairment of these securities was recorded at September 30, 2011. Future changes in circumstances related to these and other securities could require subsequent recognition of other-than-temporary impairment losses.

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Benefits, Claims and Settlement Expenses

	Nine Months Ended September 30,		Change From Prior Year	
	2011	**2010**	**Percent**	**Amount**
Property and casualty	$ 352.6	$ 313.9	12.3%	$ 38.7
Annuity	1.6	1.2	33.3%	0.4
Life	44.6	41.1	8.5%	3.5
Total	$ 398.8	$ 356.2	12.0%	$ 42.6
Property and casualty catastrophe losses, included above (1)	$ 81.3	$ 40.5	100.7%	$ 40.8

(1) See footnote (1) to the table below.

Property and Casualty Claims and Claim Expenses (losses)

	Nine Months Ended September 30,	
	2011	**2010**
Incurred claims and claim expenses:		
Claims occurring in the current year	$ 358.3	$ 328.5
Decrease in estimated reserves for claims occurring in prior years (2)	(5.7)	(14.6)
Total claims and claim expenses incurred	$ 352.6	$ 313.9
Property and casualty loss ratio:		
Total	85.9%	75.5%
Effect of catastrophe costs, included above (1)		