ITEM 8. Consolidated Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors
Horace Mann Educators Corporation:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Horace Mann Educators Corporation and subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes and financial statement schedules I to IV and VI (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 1, 2019 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Change in Accounting Principle

As discussed in Note 1 to the consolidated financial statements, the Company has changed its method of accounting for the change in fair value of equity investments effective January 1, 2018 due to the adoption of ASU No. 2016-01, *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.*

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

KPMG LLP

We have served as the Company's auditor since 1989.

Chicago, Illinois
March 1, 2019

HORACE MANN EDUCATORS CORPORATION
CONSOLIDATED BALANCE SHEETS
As of December 31, 2018 and 2017
($ in thousands, except share data)

	December 31,	
	2018	**2017**
ASSETS		
Investments		
Fixed maturity securities, available for sale, at fair value (amortized cost 2018, $7,373,911; 2017, $7,302,950)	$ 7,515,318	$ 7,724,075
Equity securities, available for sale, at fair value (cost 2017, $116,320)	111,750	135,466
Limited partnership interests	328,516	247,266
Short-term and other investments	295,093	245,541
Total investments	8,250,677	8,352,348
Cash	11,906	7,627
Deferred policy acquisition costs	298,742	257,826
Goodwill	47,396	47,396
Other assets	422,047	381,182
Separate Account (variable annuity) assets	2,001,128	2,151,961
Total assets	$ 11,031,896	$ 11,198,340
LIABILITIES AND SHAREHOLDERS' EQUITY		
Policy liabilities		
Investment contract and life policy reserves	$ 5,711,193	$ 5,573,735
Unpaid claims and claim expenses	396,714	347,749
Unearned premiums	276,225	260,539
Total policy liabilities	6,384,132	6,182,023
Other policyholder funds	767,988	724,261
Other liabilities	290,358	341,053
Long-term debt	297,740	297,469
Separate Account (variable annuity) liabilities	2,001,128	2,151,961
Total liabilities	9,741,346	9,696,767
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, 2018, 65,820,369; 2017, 65,439,245	66	65
Additional paid-in capital	475,109	464,246
Retained earnings	1,216,582	1,231,177
Accumulated other comprehensive income (loss), net of tax:		
Net unrealized investment gains on securities	96,941	300,177
Net funded status of benefit plans	(12,185)	(13,217)
Treasury stock, at cost, 2018, 24,850,484 shares; 2017, 24,721,372 shares	(485,963)	(480,875)
Total shareholders' equity	1,290,550	1,501,573
Total liabilities and shareholders' equity	$ 11,031,896	$ 11,198,340

See accompanying Notes to Consolidated Financial Statements.

HORACE MANN EDUCATORS CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
($ in thousands, except per share data)

	Year Ended December 31,		
	2018	2017	2016
Revenues			
Insurance premiums and contract charges earned	$ 817,333	$ 794,703	$ 759,146
Net investment income	376,507	373,630	361,186
Net investment gains (losses)	(12,543)	(3,406)	4,123
Other income	10,302	6,623	4,455
Total revenues	1,191,599	1,171,550	1,128,910
Benefits, losses and expenses			
Benefits, claims and settlement expenses	637,560	582,306	541,004
Interest credited	206,199	198,635	192,022
DAC amortization expense	109,889	102,185	96,732
Operating expenses	205,413	187,789	173,112
Interest expense	13,001	11,948	11,808
Total benefits, losses and expenses	1,172,062	1,082,863	1,014,678
Income before income taxes	19,537	88,687	114,232
Income tax expense (benefit)	1,194	(80,772)	30,467
Net income	$ 18,343	$ 169,459	$ 83,765
Net income per share			
Basic	$ 0.44	$ 4.10	$ 2.04
Diluted	$ 0.44	$ 4.08	$ 2.02
Weighted average number of shares and equivalent shares			
Basic	41,570,492	41,364,546	41,158,349
Diluted	41,894,232	41,564,979	41,475,516
Net investment gains (losses)			
Total other-than-temporary impairment losses on securities	$ (1,530)	$ (12,620)	$ (11,401)
Portion of losses recognized in other comprehensive income (loss)	—	—	(290)
Net other-than-temporary impairment losses on securities recognized in earnings	(1,530)	(12,620)	(11,111)
Sales and other, net	3,491	7,756	16,286
Change in fair value - equity securities	(18,323)	—	—
Change in fair value and gains realized on settlements - derivative instruments	3,819	1,458	(1,052)
Total	$ (12,543)	$ (3,406)	$ 4,123

See accompanying Notes to Consolidated Financial Statements.

HORACE MANN EDUCATORS CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
($ in thousands)

	Year Ended December 31,		
	2018	**2017**	**2016**
Comprehensive income (loss)			
Net income	$ 18,343	$ 169,459	$ 83,765
Other comprehensive income (loss), net of tax:			
Change in net unrealized investment gains (losses) on securities	(188,195)	74,405	571
Change in net funded status of benefit plans	1,032	734	(23)
Cumulative effect of change in accounting principle	(15,041)	—	—
Other comprehensive income (loss)	(202,204)	75,139	548
Total	$ (183,861)	$ 244,598	$ 84,313

See accompanying Notes to Consolidated Financial Statements.

HORACE MANN EDUCATORS CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
($ in thousands, except per share data)

	Year Ended December 31,		
	2018	**2017**	**2016**
Common stock, $0.001 par value			
Beginning balance	$ 65	$ 65	$ 65
Options exercised, 2018, 145,438 shares; 2017, 208,306 shares; 2016, 142,203 shares	—	—	—
Conversion of common stock units, 2018, 30,368 shares; 2017, 15,981 shares; 2016, 15,629 shares	—	—	—
Conversion of restricted common stock units, 2018, 212,382 shares; 2017, 313,292 shares; 2016, 222,297 shares	1	—	—
Ending balance	66	65	65
Additional paid-in capital			
Beginning balance	464,246	453,479	442,648
Options exercised and conversion of common stock units and restricted common stock units	3,008	2,962	2,696
Share-based compensation expense	7,855	7,805	8,135
Ending balance	475,109	464,246	453,479
Retained earnings			
Beginning balance	1,231,177	1,155,732	1,116,277
Net income	18,343	169,459	83,765
Cash dividends, 2018, $1.14 per share; 2017, $1.10 per share; 2016, $1.06 per share	(47,979)	(46,114)	(44,310)
Reclassification of deferred taxes	—	(47,900)	—
Cumulative effect of change in accounting principle	15,041	—	—
Ending balance	1,216,582	1,231,177	1,155,732
Accumulated other comprehensive income (loss), net of tax:			
Beginning balance	286,960	163,921	163,373
Change in net unrealized investment gains on securities	(188,195)	74,405	571
Change in net funded status of benefit plans	1,032	734	(23)
Reclassification of deferred taxes	—	47,900	—
Cumulative effect of change in accounting principle	(15,041)	—	—
Ending balance	84,756	286,960	163,921
Treasury stock, at cost			
Beginning balance, 2018, 24,721,372 shares; 2017, 24,672,932 shares; 2016, 23,971,522 shares	(480,875)	(479,215)	(457,702)
Acquisition of shares, 2018, 129,112 shares; 2017, 48,440 shares; 2016, 701,410 shares	(5,088)	(1,660)	(21,513)
Ending balance, 2018, 24,850,484 shares; 2017, 24,721,372 shares; 2016, 24,672,932 shares	(485,963)	(480,875)	(479,215)
Shareholders' equity at end of period	$ 1,290,550	$ 1,501,573	$ 1,293,982

See accompanying Notes to Consolidated Financial Statements.

HORACE MANN EDUCATORS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
($ in thousands)

	Year Ended December 31,		
	2018	**2017**	**2016**
Cash flows - operating activities			
Premiums collected	$ 760,367	$ 739,503	$ 710,646
Policyholder benefits paid	(590,479)	(528,501)	(511,017)
Policy acquisition and other operating expenses paid	(305,000)	(283,351)	(277,076)
Income taxes paid	(8,679)	(16,259)	(27,847)
Investment income collected	373,568	363,283	344,778
Interest expense paid	(12,532)	(11,555)	(11,754)
Other	(16,357)	(6,534)	(16,297)
Net cash provided by operating activities	200,888	256,586	211,433
Cash flows - investing activities			
Fixed maturity securities			
Purchases	(1,428,889)	(1,569,220)	(1,566,047)
Sales	625,527	500,760	429,251
Maturities, paydowns, calls and redemptions	737,535	927,665	799,653
Equity securities			
Purchases	(13,430)	(32,312)	(60,135)
Sales and repayments	25,498	53,100	21,210
Limited partnership interests			
Purchases	(93,545)	(103,200)	(70,177)
Sales	16,997	20,234	12,418
Change in short-term and other investments, net	(56,192)	(25,691)	108,467
Net cash used in investing activities	(186,499)	(228,664)	(325,360)
Cash flows - financing activities			
Dividends paid to shareholders	(46,689)	(46,114)	(44,310)
FHLB borrowings	—	50,000	—
Acquisition of treasury stock	(5,088)	(1,660)	(21,513)
Proceeds from exercise of stock options	3,627	4,190	3,329
Withholding tax payments on RSUs tendered	(3,165)	(3,245)	(4,015)
Annuity contracts: variable, fixed and FHLB funding agreements			
Deposits	489,097	453,146	520,211
Benefits, withdrawals and net transfers to Separate Account (variable annuity) assets	(473,003)	(411,061)	(349,915)
Transfer of Company 401(k) to a third-party provider	—	(77,898)	—
Life policy accounts			
Deposits	8,149	4,883	4,018
Withdrawals and surrenders	(4,910)	(4,458)	(3,965)
Change in book overdrafts	21,872	(4,748)	11,248
Net cash provided by (used in) financing activities	(10,110)	(36,965)	115,088
Net increase (decrease) in cash	4,279	(9,043)	1,161
Cash at beginning of period	7,627	16,670	15,509
Cash at end of period	$ 11,906	$ 7,627	$ 16,670

See accompanying Notes to Consolidated Financial Statements.

NOTE 1 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) and with the rules and regulations of the Securities and Exchange Commission (SEC). 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 Company has reclassified the presentation of certain prior period information to conform to the current year's presentation.

The consolidated financial statements include the accounts of Horace Mann Educators Corporation and its wholly-owned subsidiaries (HMEC; and together with its subsidiaries, the Company or Horace Mann). HMEC and its subsidiaries have common management, share office facilities and are parties to intercompany service agreements for management, administrative, utilization of personnel, financial, investment advisory, underwriting, claims adjusting, agency and data processing services. Under these agreements, costs have been allocated among the companies in conformity with GAAP. In addition, certain of the subsidiaries have entered into intercompany reinsurance agreements. HMEC and its subsidiaries file a consolidated federal income tax return, and there are related tax sharing agreements. All significant intercompany balances and transactions have been eliminated in consolidation.

The subsidiaries of HMEC market and underwrite personal lines of property and casualty insurance products (primarily personal lines automobile and property insurance), retirement products (primarily tax-qualified annuities) and life insurance, 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. There were no subsequent events requiring adjustment to the consolidated financial statements or disclosure except as described in Note 15.

Investments

The Company invests predominantly in fixed maturity securities. This category includes primarily bonds and notes, but also includes redeemable preferred stocks. These securities are classified as available for sale and carried at fair value. An adjustment for net unrealized investment gains (losses) on all securities available for sale and carried at fair value, is recognized as a separate component of accumulated other comprehensive income (AOCI) within shareholders' equity, net of applicable deferred taxes and the related impact on deferred policy acquisition costs (DAC) associated with annuity contracts and life insurance

products with account values that would have occurred if the securities had been sold at their aggregate fair value and the proceeds reinvested at current yields.

Beginning January 1, 2018, equity securities are carried at fair value with changes in fair value recognized as Net investment gains (losses). This category includes nonredeemable preferred stocks and common stocks.

Limited partnership interests include investments in private equity funds, real estate funds and other funds. All investments in limited partnership interests are accounted for in accordance with the equity method of accounting.

Short-term and other investments are comprised of short-term fixed maturity securities, generally carried at cost which approximates fair value; derivative instruments (all call options), carried at fair value; policy loans, carried at unpaid principal balances; mortgage loans, carried at unpaid principal balances; and restricted Federal Home Loan Bank (FHLB) membership and activity stocks, carried at redemption value which approximates fair value.

The Company invests in fixed maturity securities and alternative investment funds that could qualify as variable interest entities, including corporate securities, mortgage-backed securities and asset-backed securities. Such securities have been reviewed and determined not to be subject to consolidation as the Company is not the primary beneficiary of these securities because it does not have the power to direct the activities that most significantly impact the entities' economic performance.

Investment income is recognized as earned. Investment income reflects amortization of premiums and accrual of discounts on an effective-yield basis.

Realized gains and losses arising from the disposal (recorded on a trade date basis) or impairment of securities are determined based upon specific identification of securities. The Company evaluates all investments in its portfolio for other-than-temporary declines in fair value as described in the following section.

Other-than-temporary Impairment

The Company's methodology of assessing other-than-temporary impairments (OTTI) for fixed maturity securities is based on security-specific facts and circumstances as of the reporting date. Based on these facts, if (1) the Company has the intent to sell the security, (2) it is more likely than not the Company will be required to sell the security before the anticipated recovery of the amortized cost basis, or (3) management does not expect to recover the entire amortized cost basis of the security, an OTTI 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 fair value.

The Company has a policy and process to evaluate fixed maturity securities (at the cusip/issuer level) on a quarterly basis to assess whether there has been OTTI. 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 the amortized cost basis (3) 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 of the amortized cost basis, (4) the market leadership position of the issuer, (5) the debt ratings of the issuer, and

(6) the cash flows and liquidity of the issuer or the underlying cash flows for asset-backed securities, are all considered in the impairment assessment. When OTTI is deemed to have occurred, the investment is written-down to fair value at the trade lot level and the credit-related loss portion is recognized as a net investment loss during the period. The amount of total OTTI related to non-credit factors for fixed maturity securities is recognized in other comprehensive income (OCI), net of applicable taxes, in which 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 maturity securities involving securitized financial assets — primarily asset-backed and commercial mortgage-backed securities in the Company's portfolio — the securitized financial asset securities' underlying collateral cash flows are stress tested to determine if there has been any adverse change in the expected future cash flows.

A decline in fair value below the amortized cost basis is not assumed to be other-than-temporary for fixed maturity securities 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 amortized cost basis of the security and the Company does not have the intent to sell the security before maturity or a market recovery is realized and it is more likely than not the Company will not be required to sell the security. OTTI loss will be recognized based upon all relevant facts and circumstances for each investment, as appropriate.

Additional considerations for certain types of securities include the following:

Corporate Fixed Maturity Securities

Judgments regarding whether a corporate fixed maturity security is other-than-temporarily impaired include analyzing the issuer's financial condition and whether there has been a decline in the issuer's ability to service the specific security. The analysis of the security issuer is based on asset coverage, cash flow multiples or other industry standards. Several factors assessed include, but are not limited to, credit quality ratings, cash flow sustainability, liquidity, financial strength, industry and market position. Sources of information include, but are not limited to, management projections, independent consultants, external analysts' research, peer analysis and the Company's internal analysis.

If the Company has concerns regarding the viability of the issuer or its ability to service the specific security after this assessment, a cash flow analysis is prepared to determine if the present value of future cash flows has declined below the amortized cost basis of the fixed maturity security. This analysis to determine an estimate of ultimate recovery value is combined with the estimated timing to recovery and any other applicable cash flows that are expected. If a cash flow analysis estimate is not feasible, then the market's view of cash flows implied by the period end fair value, market discount rates and effective yield are the primary factors used to estimate an ultimate recovery value.

Mortgage-Backed Securities Not Issued By the U.S. Government or Federally Sponsored Agencies

The Company uses an estimate of future cash flows expected to be collected to evaluate its mortgage-backed securities for OTTI. 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 future 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, FICO score, payment terms, level of documentation, property or residency 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 that is based on the collateral characteristics. Loss severity is a function of multiple factors including, but not limited to, the unpaid balance, interest rate, mortgage insurance ratios, assessed property value at origination, change in property valuation and loan-to-value ratio at origination. Prepayment speeds, both actual and estimated, cost of capital rates and debt service ratios are also considered. The cash flows generated by the collateral securing these securities are then estimated with these default, loss severity and prepayment assumptions. These collateral cash flows are then utilized, along with consideration for the issuer's position in the overall structure, to estimate the future cash flows associated with the residential or commercial mortgage-backed security held by the Company.

Municipal Bonds

The Company's municipal bond portfolio consists primarily of special revenue bonds, which present unique considerations in evaluating OTTI, but also includes general obligation bonds. The Company evaluates special revenue bonds for OTTI based on guarantees associated with the repayment from revenues generated by the specified revenue-generating activity associated with the purpose of the bonds. Judgments regarding whether a municipal bond is other-than-temporarily impaired include analyzing the issuer's financial condition and whether there has been a decline in the overall financial condition of the issuer or its ability to service the specific security. Security credit ratings are reviewed with emphasis on the economy, finances, debt and management of the municipal issuer. Certain securities may be guaranteed by the mono-line credit insurers or other forms of guarantee.

While not relied upon in the initial security purchase decision, insurance benefits are considered in the assessments for OTTI, including the credit-worthiness of the guarantor. Municipalities possess unique powers, along with a special legal standing and protections, that enable them to act quickly to restore budgetary balance and fiscal integrity. These powers include the sovereign power to tax, access to one-time revenue sources, capacity to issue or restructure debt, and ability to shift spending to other authorities. State governments often provide secondary support to local governments in times of financial stress and the federal government has provided assistance to state governments during recessions.

If the Company has concerns regarding the viability of the municipal issuer or its ability to service the specific security after this analysis, a cash flow analysis is prepared to determine a present value and whether it has declined below the amortized cost basis of the security. If a cash flow analysis is not feasible, then the market's view of the period end fair value, market discount rates and effective yield are the primary factors used to estimate the present value.

Credit Losses

The Company estimates the amount of the credit loss component of a fixed maturity security impairment as the difference between amortized cost basis and the present value of the expected future cash flows of the security. The present value is determined using the best estimate of cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an

asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate of cash flows vary depending on the type of security. Corporate fixed maturity security and municipal bond cash flow estimates are derived from scenario-based outcomes of expected restructurings or the disposition of assets using specific facts and other circumstances, including timing, security interests and loss severity and when not reasonably estimable, such securities are impaired to fair value as management's best estimate of the present value of future cash flows. The cash flow estimates for mortgage-backed and other structured securities are based on security specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds, and structural support, including subordination and guarantees.

Deferred Policy Acquisition Costs

The Company's DAC by reporting segment was as follows:

($ in thousands)	December 31,	
	2018	2017
Retirement (annuity)	$ 209,231	$ 174,661
Life	59,478	53,974
Property and Casualty	30,033	29,191
Total	$ 298,742	$ 257,826

DAC consists of commissions, policy issuance and other costs which are incremental and directly related to the successful acquisition of new or renewal business, which are deferred and amortized on a basis consistent with the type of insurance coverage. For all investment (annuity) contracts, DAC is amortized over 20 years in proportion to estimated gross profits. DAC is amortized in proportion to estimated gross profits over 20 years for certain life insurance products with account values and over 30 years for indexed universal life (IUL) contracts. For other individual life contracts, DAC is amortized in proportion to anticipated premiums over the terms of the insurance policies (10, 15, 20, 30 years). For property and casualty policies, DAC is amortized over the terms of the insurance policies (6 or 12 months).

The Company periodically reviews the assumptions and estimates used in DAC and also periodically reviews its estimations of gross profits, a process sometimes referred to as "unlocking". 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 net investment gains (losses) on fixed maturity and equity securities. For the variable deposit portion of Retirement, the Company amortizes DAC utilizing a future financial market performance assumption of a 8% 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 future financial market performance assumes that long-term appreciation in the financial markets is not changed by short-term market fluctuations, but is only changed when sustained deviations are experienced. The Company monitors these fluctuations and only changes the assumption when long-term expectations change.

The most significant assumptions that are involved in the estimation of life insurance gross profits include interest rates expected to be received on investments, business persistency, and mortality. Conversions from term to permanent insurance cause an immediate write down of the associated DAC. The impact on amortization due to assumption changes has an immaterial impact on the results of operations.

NOTE 1 - Summary of Significant Accounting Policies-(Continued)

In the event actual experience differs significantly from assumptions or assumptions are significantly revised, the Company may be required to recognize a material charge or credit to current period amortization expense for the period in which the adjustment is made. The Company recognized the following adjustments to amortization expense as a result of evaluating actual experience and prospective assumptions, the impact of unlocking:

($ in thousands)	Year Ended December 31,		
	2018	2017	2016
Increase (decrease) to DAC amortization expense:			
Retirement	$ 3,948	$ 1,081	$ (313)
Life	283	(200)	(394)
Total	$ 4,231	$ 881	$ (707)

DAC for investment contracts and life insurance products with account values are adjusted for the impact on estimated future gross profits as if net unrealized investment gains (losses) on securities had been realized at the reporting date. This adjustment reduced DAC by $17,862 thousand and $57,995 thousand at December 31, 2018 and 2017, respectively. The after tax impact of this adjustment is included in AOCI (net unrealized investment gains (losses) on securities) within shareholders' equity.

DAC is reviewed for recoverability from future income, including net investment income, and costs which are deemed unrecoverable are expensed in the period in which the determination is made. No such costs were deemed unrecoverable during the years ended December 31, 2018, 2017 and 2016.

Goodwill

When the Company was acquired in 1989, intangible assets were recognized as goodwill in the application of purchase accounting. In addition, goodwill was recognized in 1994 related to the purchase of Horace Mann Property & Casualty Insurance Company.

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 the reporting unit level 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 a business unit one level below an operating segment, if separate financial information is prepared and regularly reviewed by management at that level. The Company's reporting units, for which goodwill has been allocated, are equivalent to the Company's operating segments.

The allocation of goodwill by reporting unit is as follows:

($ in thousands)	
Retirement	$ 28,025
Life	9,911
Property and Casualty	9,460
Total	$ 47,396

The goodwill impairment test, as defined in GAAP, allows an entity the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity determines it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the entity follows a two-step process. In the first step, the fair value of a reporting unit is compared to its carrying amount. If the carrying amount 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. Any amount of goodwill determined to be impaired will be recognized as an expense in the period in which the impairment determination is made.

The Company completed its annual goodwill assessment for the individual reporting units as of October 1, 2018 and did not utilize the option to perform an initial assessment of qualitative factors. The first step of the Company's analysis indicated that fair value exceeded the carrying amount for all reporting units. The process of evaluating goodwill for impairment required management to make multiple judgments and assumptions to determine the fair value of each reporting unit, 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 expectation 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 October 1, 2018 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 several factors, most notably market sentiment, trading volume and transaction premium. The amount of the transaction premium was determined to be reasonable based on insurance industry and Company-specific facts and circumstances. There were no other events or material changes in circumstances during 2018 that indicated that a material change in the fair value of the Company's reporting units had occurred.

During each year from 2016 through 2018, the Company completed the required annual testing; no impairment charges were necessary as a result of such assessments. The assessment of goodwill recoverability requires significant judgment and is subject to inherent uncertainty. The use of different assumptions, within a reasonable range, could cause the fair value to be below the carrying amount. Subsequent goodwill assessments could result in impairment, particularly for any reporting unit with at-risk goodwill, due to the impact of a volatile financial market on earnings, discount rate assumptions, liquidity and market capitalization.

NOTE 1 - Summary of Significant Accounting Policies-(Continued)

Property and Equipment

Property and equipment are carried at cost less accumulated depreciation, which is calculated using the straight-line method based on the estimated useful lives of the assets. The estimated life for real estate is identified by specific property and ranges from 20 to 45 years. The estimated useful lives of leasehold improvements and other property and equipment, including capitalized software, generally range from 3 to 10 years. The following amounts are included in Other assets in the Consolidated Balance Sheets:

($ in thousands)	December 31,	
	2018	2017
Property and equipment	$ 142,243	$ 133,803
Less: accumulated depreciation	101,267	94,862
Total	$ 40,976	$ 38,941

Separate Account (Variable Annuity) Assets and Liabilities

Separate Account assets represent variable annuity contractholder funds invested in various mutual funds. Separate Account assets are recorded at fair value primarily based on market quotations of the underlying securities. Separate Account liabilities are equal to the estimated fair value of Separate Account assets. The investment income, gains and losses of these accounts accrue directly to the contractholders and are not included in the results of operations of the Company. The activity of the Separate Accounts is not reflected in the Consolidated Statements of Operations except for (1) contract charges earned, (2) the activity related to contract guarantees, which are benefits on existing variable annuity contracts, and (3) the impact of financial market performance on DAC amortization expense. The Company's contract charges earned include fees charged to the Separate Accounts, including mortality charges, risk charges, policy administration fees, investment management fees and surrender charges.

Investment Contract and Life Policy Reserves

This table summarizes the Company's investment contract and life policy reserves.

($ in thousands)	December 31,	
	2018	2017
Investment contract reserves	$ 4,555,856	$ 4,452,972
Life policy reserves	1,155,337	1,120,763
Total	$ 5,711,193	$ 5,573,735

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 including assumptions as to investment yields, mortality, persistency, expenses and other assumptions based on the Company's experience, including a provision for adverse deviation. These assumptions are established at the time the policy is issued and are intended to estimate the experience for the period the policy benefits are payable. If experience is less favorable than the assumptions, additional liabilities may be established, resulting in recognition of a loss for that period. At December 31, 2018, reserve investment yield assumptions ranged from 3.5% to 8.0%.

NOTE 1 - Summary of Significant Accounting Policies-(Continued)

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. The liability also includes provisions for the unearned portion of certain policy charges.

A guaranteed minimum death benefit (GMDB) generally provides an additional benefit if the contractholder dies and the variable annuity contract value is less than a contractually defined amount. The Company has estimated and recorded a GMDB reserve on variable annuity contracts in accordance with GAAP. Contractually defined amounts vary from contract to contract based on the date the contract was entered into as well as the GMDB feature elected by the contractholder. The Company regularly monitors the GMDB reserve considering fluctuations in financial markets. The Company has a relatively low exposure to GMDB risk as shown below.

($ in thousands)	December 31,	
	2018	2017
GMDB reserve	$ 258	$ 152
Aggregate in-the-money death benefits under the GMDB provision	48,083	28,345
Variable annuity contract value distribution based on GMDB feature:		
No guarantee	30%	29%
Return of premium guarantee	65%	65%
Guarantee of premium roll-up at an annual rate of 3% or 5%	5%	6%
Total	100%	100%

Reserves for Fixed Indexed Annuities and Indexed Universal Life Policies

The Company offers fixed indexed annuity (FIA) products with interest crediting strategies linked to the Standard & Poor's (S&P) 500 Index and the Dow Jones Industrial Average (DJIA). The Company purchases call options on the applicable indices as an investment to provide the income needed to fund the annual index credits on the indexed products. These products are deferred fixed annuities with a guaranteed minimum interest rate plus a contingent return based on equity market performance and are considered hybrid financial instruments under GAAP.

The Company elected to not use hedge accounting for derivative transactions related to the FIA products. As a result, the Company accounts for the purchased call options and the embedded derivative related to the provision of a contingent return at fair value, with changes in fair value recognized as Net investment gains (losses) in the Consolidated Statements of Operations. The embedded derivative is bifurcated from the host contract and included in Other policyholder funds in the Consolidated Balance Sheets. The host contract is accounted for as a debt instrument in accordance with GAAP and is included in Investment contract and life policy reserves in the Consolidated Balance Sheets with any discount to the minimum account value being accreted using the effective yield method. In the Consolidated Statements of Operations, accreted interest for FIA products and benefit claims on these products incurred during the reporting period are included in Benefits, claims and settlement expenses.

The Company offers indexed universal life (IUL) products as part of its product portfolio with interest crediting strategies linked to the S&P 500 Index and the DJIA as well as a fixed option. The Company purchases call options monthly to economically hedge the potential liabilities arising in IUL accounts. The Company elected to not use hedge accounting for derivative transactions related to the IUL products. As a result, the Company records the purchased call options and the embedded derivative related to the provision of a contingent return at fair value, with changes in fair value reported in Net investment gains (losses) in the Consolidated Statements of Operations. IUL policies with a balance in one or more indexed accounts are considered to have an embedded derivative. The benefit reserve for the host contract is measured using the retrospective deposit method, which for Horace Mann's IUL product is equal to the account balance. The embedded derivative is bifurcated from the host contract, carried at fair value, and included in Investment contract and life policy reserves in the Consolidated Balance Sheets.

See Note 3 for more information regarding the determination of fair value for the FIA and IUL embedded derivatives and purchased call options.

Unpaid Claims and Claim Expenses

Liabilities for Property and Casualty unpaid claims and claim expenses include provisions for payments to be made on reported claims, claims incurred but not yet reported (IBNR) and associated settlement expenses. All of the Company's reserves for Property and Casualty unpaid claims and claim expenses are carried at the full value of estimated liabilities and are not discounted for interest expected to be earned on reserves. Estimated amounts of salvage and subrogation on unpaid Property and Casualty claims are deducted from the liability for unpaid claims. Due to the nature of the Company's personal lines business, the Company has no exposure to losses related to claims for toxic waste cleanup, other environmental remediation or asbestos-related illnesses other than claims under property insurance policies for environmentally related items such as mold.

Other Policyholder Funds

Other policyholder funds includes supplementary contracts without life contingencies and dividend accumulations, as well as balances outstanding under funding agreements with FHLB and embedded derivatives related to FIA products. Except for embedded derivatives, each of these components is carried at cost. Embedded derivatives are carried at fair value. Amounts received and repaid under FHLB funding agreements are classified as financing activities in the Company's Consolidated Statements of Cash Flows combined with annuity contract deposits and disbursements, respectively.

NOTE 1 - Summary of Significant Accounting Policies-(Continued)

FHLB Funding Agreements

One of the Company's subsidiaries, Horace Mann Life Insurance Company (HMLIC), is a member of FHLB, which provides HMLIC with access to collateralized borrowings and other FHLB products. Any borrowing from FHLB requires the purchase of FHLB activity-based common stock in an amount equal to 4.5% of the borrowing, or a lower percentage — such as 2.0% based on the Reduced Capitalization Advance Program. For FHLB advances and funding agreements combined, HMEC's Board of Directors (Board) has authorized a maximum amount equal to 10% of HMLIC's admitted assets using prescribed statutory accounting principles. On November 11, 2018, the Company received an additional $50,000 thousand under a funding agreement for HMLIC. For the total $625,000 thousand received, $250,000 thousand matures on September 13, 2019, $125,000 thousand matures on December 15, 2023, $200,000 thousand matures on January 16, 2026 and the remaining $50,000 thousand matures on November 15, 2023. Interest on the funding agreements accrues at an annual weighted average rate of 2.47% as of December 31, 2018. HMLIC's FHLB funding agreements of $625,000 thousand are included in Other policyholder funds in the Consolidated Balance Sheets.

Insurance Premiums and Contract Charges Earned

Property and Casualty insurance premiums are recognized as revenue ratably over the related contract periods in proportion to the risks insured. The unexpired portions of these Property and Casualty premiums are recorded as unearned premiums, using the monthly pro rata method.

Premiums and contract charges for life insurance contracts with account values and investment (annuity) contracts consist of charges for the cost of insurance, policy administration and withdrawals. Premiums for long-term traditional life policies are recognized as revenues when due over the premium-paying period. Contract deposits to investment contracts and life insurance contracts with account values represent funds deposited by policyholders and are not included in the Company's premiums or contract charges earned.

Share-Based Compensation

The Company grants stock options and both service-based and performance-based restricted common stock units (RSUs) to executive officers, other employees and Directors in an effort to attract and retain individuals while also aligning compensation with the interests of the Company's shareholders. Additional information regarding the Company's share-based compensation plans is contained in Note 9.

Stock options are accounted for under the fair value method of accounting using a Black-Scholes valuation model to measure stock option expense at the date of grant. The fair value of RSUs is measured at the market price of the Company's common stock on the date of grant, with the exception of market-based performance awards, for which the Company uses a Monte Carlo simulation model to determine fair value for purposes of measuring RSU expense. For the years ended December 31, 2018, 2017 and 2016, the Company recognized $1,217 thousand, $1,347 thousand, and $1,207 thousand, respectively, of stock option expense as a result of the vesting of stock options during the respective periods. For the years ended December 31, 2018, 2017 and 2016, the Company recognized $6,638 thousand, $6,459 thousand and $6,929 thousand, respectively, in RSU expense as a result of the performance and/or vesting of RSUs during the respective periods.

In 2018, 2017 and 2016, the Company granted stock options as quantified in the table below, which also provides the weighted average grant date fair value for stock options granted in each year. The fair value of stock options granted was estimated on the respective dates of grant using the Black-Scholes option pricing model with the weighted average assumptions shown in the following table.

	Year Ended December 31,		
	2018	2017	2016
Number of stock options granted	223,208	222,828	307,176
Weighted average grant date fair value of stock options granted	$ 7.16	$ 6.57	$ 5.01
Weighted average assumptions:			
Risk-free interest rate	2.6%	2.0%	1.3%
Expected dividend yield	2.6%	2.5%	3.2%
Expected life, in years	4.8	4.9	4.9
Expected volatility (based on historical volatility)	21.5%	21.4%	25.6%

The weighted average fair value of nonvested stock options outstanding on December 31, 2018 was $6.65. Total unrecognized compensation expense relating to the nonvested stock options outstanding as of December 31, 2018 was approximately $2,348 thousand. This amount will be recognized as expense over the remainder of the vesting period, which is scheduled to be 2019 through 2022. Expense is reflected on a straight-line basis over the vesting period for the entire award. Forfeitures of unvested amounts due to terminations and/or early retirements are recognized as a reduction to the related expenses.

Total unrecognized compensation expense relating to RSUs outstanding as of December 31, 2018 was approximately $5,747 thousand. This amount will be recognized as expense over the remainder of the performance and/or vesting period, which is scheduled to be 2019 through 2021. Expense is reflected on a straight-line basis from the date of grant through the end of the performance and/or vesting period for the entire award. Forfeitures of unvested amounts due to terminations are recognized as a reduction to the related expenses.

Income Taxes

The Company uses the asset and liability method for calculating deferred federal income taxes. Income tax provisions are generally based on income reported for financial statement purposes. The provisions for federal income taxes for the years ended December 31, 2018, 2017 and 2016 included amounts currently payable and deferred income taxes resulting from the cumulative differences in the Company's assets and liabilities, determined on a tax return versus financial statement basis.

Deferred tax assets and liabilities include provisions for net unrealized investment gains (losses) on securities as well as the net funded status of benefit plans with the changes for each period included in the respective components of AOCI within shareholders' equity.

NOTE 1 - Summary of Significant Accounting Policies-(Continued)

Earnings Per Share

Basic earnings per share is computed based on the weighted average number of common shares outstanding plus the weighted average number of fully vested RSUs and common stock units (CSUs) payable as shares of HMEC common stock. Diluted earnings per share is computed based on the weighted average number of common shares and common stock equivalents outstanding, to the extent dilutive. The Company's common stock equivalents relate to outstanding common stock options, deferred compensation CSUs and incentive compensation RSUs, which are described in Note 9.

The computations of net income per share on both basic and diluted bases, including reconciliations of the numerators and denominators, were as follows:

($ in thousands)	Year Ended December 31,		
	2018	2017	2016
Basic:			
Net income for the period	$ 18,343	$ 169,459	$ 83,765
Weighted average number of common shares during the period (in thousands)	41,570	41,365	41,158
Net income per share - basic	$ 0.44	$ 4.10	$ 2.04
Diluted:			
Net income for the period	$ 18,343	$ 169,459	$ 83,765
Weighted average number of common shares during the period (in thousands)	41,570	41,365	41,158
Weighted average number of common equivalent shares to reflect the dilutive effect of common stock equivalent securities (in thousands):			
Stock options	100	112	100
CSUs related to deferred compensation for employees	25	25	52
RSUs related to incentive compensation	199	63	166
Total common and common equivalent shares adjusted to calculate diluted earnings per share (in thousands)	41,894	41,565	41,476
Net income per share - diluted	$ 0.44	$ 4.08	$ 2.02

Options to purchase 410,644 shares of common stock at $41.95 to $44.75 per share were granted in 2017 and 2018 but were not included in the computation of 2018 diluted earnings per share because of their anti-dilutive effect. These options, which expire in 2027 and 2028, were still outstanding at December 31, 2018.

NOTE 1 - Summary of Significant Accounting Policies-(Continued)

Comprehensive Income (Loss) and Accumulated Other Comprehensive Income (Loss)

Comprehensive income (loss) represents the change in shareholders' equity during a reporting period from transactions and other events and circumstances from non-shareholder sources. For the Company, comprehensive income (loss) is equal to net income plus or minus the after tax change in net unrealized investment gains (losses) on securities and the after tax change in net funded status of benefit plans for the periods as shown in the Consolidated Statements of Changes in Shareholders' Equity. AOCI represents the accumulated change in shareholders' equity from these transactions and other events and circumstances from non-shareholder sources as shown in the Consolidated Balance Sheets.

In the Consolidated Balance Sheets, the Company recognizes the net funded status of benefit plans as a component of AOCI, net of tax.

Comprehensive Income (Loss)

The components of comprehensive income (loss) were as follows:

($ in thousands)	Year Ended December 31,		
	2018	2017	2016
Net income	$ 18,343	$ 169,459	$ 83,765
Other comprehensive income (loss):			
Change in net unrealized investment gains (losses) on securities:			
Net unrealized investment gains (losses) on securities arising during the period	(275,094)	105,475	6,144
Less: reclassification adjustment for net gains (losses) included in income before income tax	(16,363)	(4,863)	5,176
Total, before tax	(258,731)	110,338	968
Income tax expense (benefit)	(55,495)	35,933	397
Total, net of tax	(203,236)	74,405	571
Change in net funded status of benefit plans:			
Before tax	1,294	1,461	(37)
Income tax expense (benefit)	262	727	(14)
Total, net of tax	1,032	734	(23)
Total comprehensive income (loss)	$ (183,861)	$ 244,598	$ 84,313

NOTE 1 - Summary of Significant Accounting Policies-(Continued)

Accumulated Other Comprehensive Income (Loss)

The following table reconciles the components of AOCI for the periods indicated.

($ in thousands)	Net Unrealized Investment Gains (Losses) on Securities [1][2]	Net Funded Status of Benefit Plans [1]	Total [1][3]
Beginning balance, January 1, 2018	$ 300,177	$ (13,217)	$ 286,960
Other comprehensive income (loss) before reclassifications	(201,122)	1,032	(200,090)
Amounts reclassified from AOCI	12,927	—	12,927
Cumulative effect of change in accounting principle [4]	(15,041)	—	(15,041)
Net current period other comprehensive income (loss)	(203,236)	1,032	(202,204)
Ending balance, December 31, 2018	$ 96,941	$ (12,185)	$ 84,756
Beginning balance, January 1, 2017	$ 175,738	$ (11,817)	$ 163,921
Other comprehensive income (loss) before reclassifications	71,244	734	71,978
Amounts reclassified from AOCI	3,161	—	3,161
Reclassification of deferred taxes [3]	50,034	(2,134)	47,900
Net current period other comprehensive income (loss)	124,439	(1,400)	123,039
Ending balance, December 31, 2017	$ 300,177	$ (13,217)	$ 286,960
Beginning balance, January 1, 2016	$ 175,167	$ (11,794)	$ 163,373
Other comprehensive income (loss) before reclassifications	3,935	(23)	3,912
Amounts reclassified from AOCI	(3,364)	—	(3,364)
Net current period other comprehensive income (loss)	571	(23)	548
Ending balance, December 31, 2016	$ 175,738	$ (11,817)	$ 163,921

(1) All amounts are net of tax.

(2) The pretax amounts reclassified from AOCI, $(16,363) thousand, $(4,863) thousand and $5,176 thousand, are included in net investment gains (losses) and the related tax expenses, $(3,436) thousand, $(1,702) thousand and $1,812 thousand, are included in income tax expense in the Consolidated Statements of Operations for the years ended December 31, 2018, 2017 and 2016, respectively.

(3) For the period ended December 31, 2017, deferred taxes attributable to net unrealized investment gains (losses) on fixed maturity and equity securities and Defined benefit plans were re-measured as a result of the enactment of the Tax Cuts and Jobs Act (Tax Act). ASC 740, Income Taxes, requires that the income tax effect from the deferred tax re-measurement be reflected in the Company's income tax expense, even if the deferred taxes being re-measured were originally established through AOCI. The mismatch between deferred taxes established in AOCI at 35% and re-measuring these same deferred taxes at 21% through income tax expense results in stranded deferred taxes in AOCI. On February 14, 2018, the Financial Accounting Standards Board (FASB) issued accounting guidance that permits recognition of a reclassification adjustment between AOCI and Retained earnings for stranded deferred tax amounts related to the reduced corporate tax rate enacted under the Tax Act. As permitted under its provisions, the Company early adopted the accounting guidance effective for the quarterly period that ended December 31, 2017 and has elected to reclassify the stranded deferred tax amounts. The impact from early adoption resulted in an increase to AOCI and a reduction to Retained earnings of approximately $47,900 thousand; representing the stranded deferred tax liabilities of $50,034 thousand and $(2,134) thousand for net unrealized investment gains (losses) on fixed maturity and equity securities and Defined benefit plans, respectively.

(4) The Company adopted guidance on January 1, 2018 that resulted in reclassifying $15,041 thousand of after tax net unrealized gains on equity securities from AOCI to Retained earnings.

Comparative information for elements that are not required to be reclassified in their entirety to net income in the same reporting period is located in Note 2.

NOTE 1 - Summary of Significant Accounting Policies-(Continued)

Statements of Cash Flows

For purposes of the Consolidated Statements of Cash Flows, cash constitutes cash on deposit at banks.

Adopted Accounting Standards

Revenue Recognition

In May 2014, the FASB issued accounting guidance, with an effective date that was deferred to January 1, 2018, to provide a single comprehensive model in accounting for revenue arising from contracts with customers. The guidance applies to all contracts with customers; however, certain insurance contracts are specifically excluded from this updated guidance. The Company adopted the guidance on January 1, 2018, using the modified retrospective transition method. The guidance did not have a significant impact on the Company's consolidated financial position, results of operations, cash flows, or disclosures.

Recognition and Measurement of Financial Assets and Liabilities

In January 2016, the FASB issued accounting guidance to improve certain aspects of the recognition, measurement, presentation and disclosure of financial instruments. Among other things, the guidance revises the accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. The Company adopted the guidance on January 1, 2018 using the modified retrospective approach that resulted in reclassifying $15,041 thousand of after tax net unrealized gains on equity securities from AOCI to Retained earnings. The Company's Consolidated Statements of Operations were impacted as changes in fair value of equity securities are now being reported in Net investment gains (losses) instead of reported in other comprehensive income (loss) (OCI).

Statement of Cash Flows -- Classification

In August 2016, the FASB issued guidance to reduce diversity in practice in the statement of cash flows between operating, investing and financing activities related to the classification of cash receipts and cash payments for eight specific issues. The FASB acknowledged that current GAAP either is unclear or does not include specific guidance on these eight cash flow classification issues: (1) debt prepayment or extinguishment costs; (2) settlement of zero-coupon bonds (pertains to issuers); (3) contingent consideration payments made after a business combination; (4) proceeds from the settlement of insurance claims (pertains to claimants); (5) proceeds from the settlement of corporate-owned life insurance policies; (6) distributions received from equity method investees; (7) beneficial interests in securitization transactions (pertains to transferors) and (8) separately identifiable cash flows and application of the predominance principle. The Company adopted the guidance on January 1, 2018 using a retrospective approach which had no impact to the prior year amounts reported in the Consolidated Statement of Cash Flows.

NOTE 1 - Summary of Significant Accounting Policies-(Continued)

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (Loss)

On February 14, 2018, the FASB issued accounting guidance that permits recognition of a reclassification adjustment between AOCI and Retained earnings for stranded tax amounts related to the reduced corporate tax rate enacted under the Tax Act. As permitted under its provisions, the Company early adopted the accounting guidance effective for the quarterly period that ended December 31, 2017 and elected to reclassify the stranded tax amounts. The impact from early adoption resulted in an increase to AOCI and a reduction to Retained earnings of approximately $47,900 thousand; representing the stranded deferred tax liabilities of $50,034 thousand and $(2,134) thousand for Net unrealized investment gains (losses) on securities and Net funded status of benefit plans, respectively.

Pending Accounting Standards

Accounting for Leases

In February 2016, the FASB issued accounting and disclosure guidance to improve financial reporting and comparability among organizations about leasing transactions. Under the new guidance, a lessee will be required to recognize assets and liabilities on the balance sheet for the rights and obligations created by those leases. Consistent with current accounting guidance, the recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or an operating lease. However, while current guidance requires only capital leases to be recognized on the balance sheet, the new guidance will require both operating and capital leases to be recognized on the balance sheet. This new guidance is effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within those annual periods, with early adoption permitted. The Company adopted the new guidance on January 1, 2019 using the optional transition method which allowed the Company to recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption (i.e., comparative periods presented in the consolidated financial statements will continue to be in conformity with legacy GAAP then in effect for those periods) and resulted in recognition of additional operating liabilities of approximately $14,500 thousand, with corresponding right of use assets of the same amount based on the present value of the expected remaining lease payments under the new guidance.

Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued guidance to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments, including reinsurance receivables, held by companies. The new guidance replaces the incurred loss impairment methodology and requires an organization to measure and recognize all current expected credit losses (CECL) for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Companies will need to utilize forward-looking information to better inform their credit loss estimates. Companies will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Any credit losses related to available for sale debt securities will be recorded through an allowance for credit losses with this allowance having a limit equal to the amount by which fair value is below amortized cost. The guidance also requires enhanced qualitative and quantitative disclosures to provide additional information about the amounts recorded in the financial statements. For public business entities, the guidance is effective for annual reporting periods beginning after December 15, 2019, including interim periods within those years, using a modified-retrospective approach. Early application is permitted for annual reporting periods, and interim periods within those years, beginning after December 15, 2018. Management is evaluating the impact this guidance will have on the results of operations and financial position of the Company.

Simplifying the Test for Goodwill Impairment

In January 2017, the FASB issued guidance to simplify the accounting for goodwill impairment. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. All other goodwill impairment guidance will remain largely unchanged. Entities will continue to have the option to perform a qualitative assessment to determine if a quantitative impairment test is necessary. The same one-step impairment test will be applied to goodwill at all reporting units, even those with zero or negative carrying amounts. Entities will be required to disclose the amount of goodwill for reporting units with zero or negative carrying amounts. Public business entities should adopt the guidance prospectively for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early application is permitted. Management believes the adoption of this accounting guidance will not have a material effect on the results of operations and financial position of the Company.

Accounting for Long-Duration Insurance Contracts

In August 2018, the FASB issued accounting and disclosure guidance that contains targeted changes to the accounting for long-duration insurance contracts. Under the new guidance, the cash flow assumptions used to measure the liability for future policy benefits for traditional insurance contracts will be required to be updated at least annually with changes recognized as a benefit expense (i.e., assumptions will no longer be locked-in). Insurance entities will be required to use a standard discount rate to measure the liabilities that will be equivalent to the yield from a high-quality bond. The new guidance also changes the amortization of DAC to be on a constant-level basis over the expected term of the related contracts with no interest accruing on the DAC balance. The new guidance also introduces a new category of contract features associated with deposit type contracts referred to as market risk benefits (MRBs). Contract features meeting the definition of a MRB will be measured at fair value. New disclosures will be required for long-duration insurance contracts in order to provide better transparency into the exposure of insurance entities and the drivers of their results. For public business entities, the guidance is effective for annual reporting periods beginning after December 15, 2020, including interim periods within those years. With regards to the liability for future policy benefits and DAC, the guidance applies to contracts in force as of the beginning of the earliest period presented and may be applied retrospectively. With regards to MRBs, the guidance is to be applied retrospectively at the beginning of the earliest period presented. Early adoption is permitted. Management is evaluating the impact this guidance will have on the results of operations and financial position of the Company.

NOTE 2 - Investments

Net Investment Income

The components of net investment income for the following periods were:

($ in thousands)	Year Ended December 31,		
	2018	2017	2016
Fixed maturity securities	$ 353,303	$ 354,290	$ 342,773
Equity securities	6,017	6,411	4,703
Limited partnership interests	15,406	12,555	13,609
Short-term and other investments	11,981	10,214	9,668
Total investment income	386,707	383,470	370,753
Investment expenses	(10,200)	(9,840)	(9,567)
Net investment income	$ 376,507	$ 373,630	$ 361,186

Net Investment Gains (Losses)

Net investment gains (losses) for the following periods were:

($ in thousands)	Year Ended December 31,		
	2018	2017	2016
Fixed maturity securities	$ (5,713)	$ (8,867)	$ 5,784
Equity securities	(10,649)	4,003	(608)
Short-term investments and other	3,819	1,458	(1,053)
Net investment gains (losses)	$ (12,543)	$ (3,406)	$ 4,123

The Company, from time to time, sells invested assets subsequent to the reporting date that were considered temporarily impaired at the reporting date. Such sales are due to issuer specific events occurring subsequent to the reporting date that result in a change in the Company's intent or ability to hold an invested asset. The types of events that may result in a sale include significant changes in the economic facts and circumstances related to the invested asset, significant unforeseen changes in liquidity needs, or changes in the Company's investment strategy.

NOTE 2 - Investments-(Continued)

Fixed Maturity and Equity Securities

The Company's investment portfolio is comprised primarily of fixed maturity securities and also includes equity securities. The amortized cost or cost, net unrealized investment gains (losses), fair values and OTTI included in AOCI of all fixed maturity and equity securities in the portfolio were as follows:

($ in thousands)	Amortized Cost/Cost	Unrealized Gains	Unrealized Losses	Fair Value	OTTI in AOCI
December 31, 2018 [1]					
Fixed maturity securities					
U.S. Government and federally sponsored agency obligations [2]:					
Mortgage-backed securities	$ 778,038	$ 22,724	$ 13,321	$ 787,441	$ —
Other, including U.S. Treasury securities	835,096	16,127	17,681	833,542	—
Municipal bonds	1,884,313	133,150	13,494	2,003,969	—
Foreign government bonds	83,343	2,321	760	84,904	—
Corporate bonds	2,054,105	64,296	38,891	2,079,510	—
Other mortgage-backed securities	1,739,016	10,467	23,531	1,725,952	—
Totals	$ 7,373,911	$ 249,085	$ 107,678	$ 7,515,318	$ —
December 31, 2017					
Fixed maturity securities					
U.S. Government and federally sponsored agency obligations [2]:					
Mortgage-backed securities	$ 669,297	$ 30,460	$ 3,032	$ 696,725	$ —
Other, including U.S. Treasury securities	714,613	26,311	5,516	735,408	—
Municipal bonds	1,711,581	184,107	2,435	1,893,253	—
Foreign government bonds	96,780	5,958	—	102,738	—
Corporate bonds	2,409,426	173,862	4,334	2,578,954	—
Other mortgage-backed securities	1,701,253	22,935	7,191	1,716,997	—
Totals	$ 7,302,950	$ 443,633	$ 22,508	$ 7,724,075	$ —
Equity securities [3]	$ 116,320	$ 19,425	$ 279	$ 135,466	$ —

(1) Effective January 1, 2018, with the adoption of new accounting guidance for recognition and measurement of financial instruments, available for sale equity securities were reclassified to equity securities at fair value and are excluded from the table above as of December 31, 2018.

(2) Fair value includes securities issued by Federal National Mortgage Association (FNMA) of $441,308 thousand and $361,955 thousand; Federal Home Loan Mortgage Corporation (FHLMC) of $417,308 thousand and $400,001 thousand; and Government National Mortgage Association (GNMA) of $96,466 thousand and $104,168 thousand as of December 31, 2018 and 2017, respectively.

(3) Includes nonredeemable (perpetual) preferred stocks, common stocks and closed-end funds.

NOTE 2 - Investments-(Continued)

The following table presents the fair value and gross unrealized losses of fixed maturity and equity securities in an unrealized loss position at December 31, 2018 and 2017, respectively. The Company views the decrease in fair value of all of the securities with unrealized losses at December 31, 2018 — which was driven largely by changes in interest rates, spread widening, financial market illiquidity and/or market volatility 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 their amortized cost bases, and management expects to recover the entire amortized cost bases of the fixed maturity securities. Therefore, no impairment of these securities was recognized at December 31, 2018.

($ in thousands)	12 months or less		More than 12 months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2018 [1]						
Fixed maturity securities						
U.S. Government and federally sponsored agency obligations:						
Mortgage-backed securities	$ 193,447	$ 5,026	$ 157,295	$ 8,295	$ 350,742	$ 13,321
Other	263,497	6,746	246,213	10,935	509,710	17,681
Municipal bonds	291,869	7,603	95,297	5,891	387,166	13,494
Foreign government bonds	16,250	760	—	—	16,250	760
Corporate bonds	818,519	27,429	99,171	11,462	917,690	38,891
Other mortgage-backed securities	913,858	16,076	291,442	7,455	1,205,300	23,531
Total	2,497,440	63,640	889,418	44,038	3,386,858	107,678
Number of positions with a gross unrealized loss	1,052		359		1,411	
Fair value as a percentage of total fixed maturities and equity securities fair value	32.7%		11.7%		44.4%	
December 31, 2017						
Fixed maturity securities						
U.S. Government and federally sponsored agency obligations:						
Mortgage-backed securities	$ 134,032	$ 1,053	$ 40,606	$ 1,979	$ 174,638	$ 3,032
Other	168,634	1,849	122,753	3,667	291,387	5,516
Municipal bonds	29,437	100	79,140	2,335	108,577	2,435
Foreign government bonds	—	—	—	—	—	—
Corporate bonds	115,113	2,701	36,081	1,633	151,194	4,334
Other mortgage-backed securities	457,166	2,791	168,972	4,400	626,138	7,191
Total fixed maturity securities	904,382	8,494	447,552	14,014	1,351,934	22,508
Equity securities [2]	6,027	249	1,277	30	7,304	279
Combined totals	$ 910,409	$ 8,743	$ 448,829	$ 14,044	$1,359,238	$ 22,787
Number of positions with a gross unrealized loss	354		158		512	
Fair value as a percentage of total fixed maturities and equity securities fair value	11.6%		5.7%		17.3%	

(1) Effective January 1, 2018, with the adoption of new accounting guidance for recognition and measurement of financial instruments, available for sale equity securities were reclassified to equity securities at fair value and are excluded from the table above as of December 31, 2018.

(2) Includes nonredeemable (perpetual) preferred stocks, common stocks and closed-end funds.

NOTE 2 - Investments-(Continued)

Fixed maturity securities with an investment grade rating represented 95.5% of the gross unrealized losses as of December 31, 2018. With respect to fixed maturity securities involving securitized financial assets, the underlying collateral cash flows were stress tested to determine there was no adverse change in the present value of cash flows below the amortized cost basis.

Limited Partnership Interests

As of December 31, 2018 and 2017, the carrying value of equity method limited partnerships totaled $328,516 thousand and $247,266 thousand, respectively. Principal factors influencing carrying value appreciation or decline include operating performance, comparable public company earnings multiples, capitalization rates and the economic environment. The Company recognizes an impairment loss for equity method limited partnerships when evidence demonstrates that the loss is other than temporary. Evidence of a loss in value that is other than temporary may include the absence of an ability to recover the carrying amount of the investment or the inability of the investee to sustain a level of earnings that would justify the carrying amount of the investment.

Credit Losses

The following table summarizes the cumulative amounts related to the Company's credit loss component of OTTI losses on fixed maturity securities held as of December 31, 2018 and 2017 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 OTTI losses were recognized in OCI:

($ in thousands)	Year Ended December 31,	
	2018	2017
Cumulative credit loss [1]		
Beginning of period	$ 3,825	$ 13,703
New credit losses	—	—
Increases to previously recognized credit losses	246	1,995
Losses related to securities sold or paid down during the period	(2,542)	(11,873)
End of period	$ 1,529	$ 3,825

[1] The cumulative credit loss amounts exclude OTTI 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.

NOTE 2 - Investments-(Continued)

Maturities of Fixed Maturity Securities

The following table presents the distribution of the Company's fixed maturity securities portfolio by estimated expected maturity. Estimated expected maturities differ from contractual maturities, reflecting assumptions regarding borrowers' utilization of the right to call or prepay obligations with or without call or prepayment penalties. 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.

($ in thousands)	December 31, 2018		
	Amortized Cost	Fair Value	Percent of Total Fair Value
Estimated expected maturity:			
Due in 1 year or less	$ 358,797	$ 363,049	4.8%
Due after 1 year through 5 years	1,690,400	1,713,593	22.8%
Due after 5 years through 10 years	2,453,572	2,465,337	32.8%
Due after 10 years through 20 years	1,931,599	1,991,726	26.5%
Due after 20 years	939,543	981,613	13.1%
Total	$ 7,373,911	$ 7,515,318	100.0%
Average option-adjusted duration, in years	5.9		

Sales of Fixed Maturity and Equity Securities

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

($ in thousands)	Year Ended December 31,		
	2018	2017	2016
Fixed maturity securities			
Proceeds received	$ 625,527	$ 500,760	$ 429,251
Gross gains realized	10,536	13,570	15,915
Gross losses realized	(14,932)	(11,842)	(4,163)
Equity securities			
Proceeds received	$ 25,498	$ 50,113	$ 21,210
Gross gains realized	8,592	7,753	2,869
Gross losses realized	(917)	(1,972)	(935)

NOTE 2 - Investments-(Continued)

Net Investment Gains (Losses)

The following table reconciles the net investment gains (losses) by transaction type:

($ in thousands)	Year Ended December 31,		
	2018	2017	2016
Impairment write-downs	$ —	$ (1,778)	$ (6,268)
Change in intent write-downs	(1,530)	(10,842)	(4,843)
Net OTTI losses recognized in earnings	(1,530)	(12,620)	(11,111)
Sales and other, net	3,491	7,756	16,286
Change in fair value - equity securities [1]	(18,323)	—	—
Change in fair value and gains (losses) realized on settlements - derivative instruments	3,819	1,458	(1,052)
Net investment gains (losses)	$ (12,543)	$ (3,406)	$ 4,123

(1) Effective January 1, 2018, with the adoption of new accounting guidance for recognition and measurement of financial instruments, equity securities are reported at fair value with changes in fair value recognized in Net investment gains (losses) and are no longer included in impairment write-downs or change in intent write-downs.

Net Unrealized Investment Gains (Losses) on Securities

Net unrealized investment gains (losses) on securities are computed as the difference between fair value and amortized cost for fixed maturity securities or cost for equity securities. The following table reconciles the net unrealized investment gains (losses) on securities, net of tax, included in AOCI, before the impact on DAC:

($ in thousands)	Year Ended December 31,		
	2018	2017	2016
Net unrealized investment gains (losses) on securities, net of tax			
Beginning of period	$ 286,176	$ 202,941	$ 201,363
Change in unrealized investment gains (losses) on securities	(172,350)	80,073	4,943
Reclassification of net investment (gains) losses on securities to net income	12,927	3,162	(3,365)
Cumulative effect of change in accounting principle [1]	(15,041)	—	—
End of period	$ 111,712	$ 286,176	$ 202,941

(1) Effective January 1, 2018, with the adoption of new accounting guidance for recognition and measurement of financial instruments, available for sale equity securities were reclassified to equity securities at fair value and the related net unrealized gains were reclassified from AOCI to Retained earnings.

Investment in Entities Exceeding 10% of Shareholders' Equity

At December 31, 2018 and 2017, there were no investments which exceeded 10% of total shareholders' equity in entities other than obligations of the U.S. Government and federally sponsored government agencies and authorities.

Offsetting of Assets and Liabilities

The Company's derivative instruments (call options) are subject to enforceable master netting arrangements. Collateral support agreements associated with each master netting arrangement provide that the Company will receive or pledge cash collateral in the event minimum thresholds have been reached.

The following table presents the instruments that were subject to a master netting arrangement for the Company.

($ in thousands)	Gross Amounts	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets/ Liabilities Presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets: Financial Instruments	Gross Amounts Not Offset in the Consolidated Balance Sheets: Cash Collateral Received	Net Amount
December 31, 2018						
Asset derivatives						
Free-standing derivatives	$ 2,647	$ —	$ 2,647	$ —	$ 1,868	$ 779
December 31, 2017						
Asset derivatives						
Free-standing derivatives	15,550	—	15,550	—	15,584	(34)

Deposits

At December 31, 2018 and 2017, fixed maturity securities with a fair value of $17,695 thousand and $17,985 thousand, respectively, were on deposit with governmental agencies as required by law in various states in which the insurance subsidiaries of HMEC conduct business. In addition, at December 31, 2018 and 2017, fixed maturity securities with a fair value of $740,016 thousand and $686,790 thousand, respectively, were on deposit with FHLB as collateral for amounts subject to funding agreements, advances and borrowings which were equal to $675,000 thousand and $625,000 thousand at the respective dates. The deposited securities are included in Fixed maturity securities on the Company's Consolidated Balance Sheets.

NOTE 3 - Fair Value of Financial Instruments

The Company is required under GAAP to disclose estimated fair values for certain financial and nonfinancial assets and liabilities. Fair values of the Company's insurance contracts other than annuity contracts (which are investment contracts) are not required to be disclosed. However, the estimated fair values of liabilities under all insurance contracts are taken into consideration in the Company's overall management of interest rate risk through the matching of investment maturities with amounts due under insurance contracts.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between knowledgeable, unrelated and willing market participants on the measurement date. In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The Company categorizes its financial and nonfinancial assets and liabilities into a three-level hierarchy based on the priority of the inputs to the valuation technique. The three levels of inputs that may be used to measure fair value are:

Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include fixed maturity and equity securities (both common stock and preferred stock) that are traded in an active exchange market, as well as U.S. Treasury securities.

Level 2 Unadjusted observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for the assets or liabilities. Level 2 assets and liabilities include fixed maturity securities (1) with quoted prices that are traded less frequently than exchange-traded instruments or (2) values based on discounted cash flows with observable inputs. This category generally includes certain U.S. Government and agency mortgage-backed securities, non-agency structured securities, corporate fixed maturity securities, preferred stocks, derivative instruments and embedded derivatives.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, certain discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation and for which the significant inputs are unobservable. This category generally includes certain private debt and equity investments, as well as embedded derivatives.

When the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement in its entirety. As a result, a Level 3 fair value measurement may include inputs that are observable (Level 1 or Level 2) and unobservable (Level 3). Net transfers into or out of each of the three levels are reported as having occurred at the end of the reporting period in which the transfers were determined.

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

The following discussion describes the valuation methodologies used for financial assets and financial liabilities measured at fair value. The techniques utilized in estimating the fair values are affected by the assumptions used, including discount rates and estimates of the amount and timing of expected future cash flows. The use of different methodologies, assumptions and inputs may have a material effect on the estimated fair values of the Company's investment holdings. Care is exercised in deriving conclusions about the Company's business, its value or financial position based on the fair value information of financial assets and liabilities presented below.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset or financial liability, including estimates of both the timing and amount of expected future cash flows and the credit standing of the issuer. In some cases, fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial asset or financial liability. The disclosed fair values do not reflect any premium or discount that could result from offering for sale at one time an entire holding of a particular financial asset or financial liability. In periods of market disruption, the ability to observe prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or from Level 2 to Level 3. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in amounts disclosed.

Investments

The Company utilizes its investment managers and its custodian bank to obtain fair value prices from independent third-party valuation service providers, broker-dealer quotes, and model prices. Each month, the Company obtains fair value prices from its investment managers and custodian bank, each of which use a variety of independent, nationally recognized pricing sources to determine market valuations for fixed maturity securities. 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. Typical inputs used by these pricing sources include, but are not limited to, reported trades, benchmark yield curves, benchmarking of like securities, rating designations, sector groupings, issuer spreads, bids, offers, and/or estimated cash flows and prepayment speeds. 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.

When the pricing sources cannot provide fair value determinations, the investment managers and custodian bank obtain non-binding price quotes from broker-dealers. And for those securities where the investment manager cannot obtain broker-dealer quotes, they will model the security, generally using anticipated cash flows of the underlying collateral. Broker-dealers' valuation methodologies as well as investment managers' modeling methodologies are 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, ratings and corresponding issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data including anticipated cash flows, 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

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

Company gains assurance that its fixed maturity securities portfolio is appropriately valued through the execution of various processes and controls designed to ensure the overall reasonableness and consistent application of valuation methodologies, including inputs and assumptions, and compliance with accounting standards. The Company's processes and controls are designed to ensure (1) the valuation methodologies are appropriate and consistently applied, (2) the inputs and assumptions are reasonable and consistent with the objective of determining fair value, and (3) the fair values are accurately recorded. For example, on a continuing basis, the Company assesses the reasonableness of individual fair values that have stale security prices or that exceed certain thresholds as compared to previous fair values received from valuation service providers. The Company performs procedures to understand and assess the methodologies, processes and controls of valuation service providers. In addition, the Company may validate the reasonableness of fair values by comparing information obtained from valuation service providers or broker-dealers to other third party valuation sources for selected securities.

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 92.3% and 90.7% of the portfolio, based on fair value, was priced through pricing services or index priced as of December 31, 2018 and 2017, respectively. The remainder of the portfolio was priced by broker-dealers or pricing models. When non-binding broker-dealer quotes can be corroborated by comparison to other vendor quotes, pricing models or analyses, the securities are generally classified as Level 2, otherwise they are classified as Level 3. There were no significant changes to the valuation process during 2018.

When a public quotation is not available, equity securities are valued by using non-binding broker-dealer quotes or through the use of pricing models or analyses that are 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. In addition, credit rating (or credit quality equivalent information) of securities is also factored into a pricing matrix. 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 2018. At December 31, 2018, all of the publicly traded equity securities were priced from observable market quotations. Fair values of equity securities have been determined by the Company from observable market quotations, when available.

Policy loans and mortgage loans as well as certain alternative investments which are accounted for using the equity method of accounting are excluded from the fair value hierarchy.

In summary, the following investments are carried at fair value:

- Fixed maturity securities, as described above.
- Equity securities, as described above.
- Short-term fixed maturity securities — Because of the nature of these assets, carrying amounts generally approximate fair values.
- Derivative instruments, all call options — Fair values are based on the amount of cash expected to be received to settle each derivative instrument on the reporting date. These amounts are obtained from each of the counterparties using industry accepted valuation models and observable inputs. Significant inputs include contractual terms, underlying index prices, market volatilities, interest rates and dividend yields.
- FHLB membership and activity stocks — Fair value is based on redemption value, which is equal to par value.

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

Financial Instruments Measured and Carried at Fair Value

The following table presents the Company's fair value hierarchy for those assets and liabilities measured and carried at fair value on a recurring basis. At December 31, 2018, Level 3 investments comprised approximately 3.0% of the Company's total investment portfolio at fair value.

($ in thousands)	Carrying Amount	Fair Value	Fair Value Measurements at Reporting Date Using		
			Level 1	Level 2	Level 3
December 31, 2018					
Financial Assets					
Investments					
Fixed maturity securities					
U.S. Government and federally sponsored agency obligations:					
Mortgage-backed securities	$ 787,441	$ 787,441	$ —	$ 784,224	$ 3,217
Other, including U.S. Treasury securities	833,542	833,542	13,291	820,251	—
Municipal bonds	2,003,969	2,003,969	—	1,956,438	47,531
Foreign government bonds	84,904	84,904	—	84,904	—
Corporate bonds	2,079,510	2,079,510	12,281	1,986,487	80,742
Other mortgage-backed securities	1,725,952	1,725,952	—	1,608,958	116,994
Total fixed maturity securities	7,515,318	7,515,318	25,572	7,241,262	248,484
Equity securities	111,750	111,750	64,330	47,415	5
Short-term investments	122,222	122,222	117,296	4,926	—
Other investments	16,147	16,147	—	16,147	—
Totals	$ 7,765,437	$ 7,765,437	$ 207,198	$ 7,309,750	$ 248,489
Financial Liabilities					
Investment contract and life policy reserves, embedded derivatives	$ 248	$ 248	$ —	$ 248	$ —
Other policyholder funds, embedded derivatives	$ 78,700	$ 78,700	$ —	$ —	$ 78,700
December 31, 2017					
Financial Assets					
Investments					
Fixed maturity securities					
U.S. Government and federally sponsored agency obligations:					
Mortgage-backed securities	$ 696,725	$ 696,725	$ —	$ 693,375	$ 3,350
Other, including U.S. Treasury securities	735,408	735,408	13,393	722,015	—
Municipal bonds	1,893,253	1,893,253	—	1,843,925	49,328
Foreign government bonds	102,738	102,738	—	102,738	—
Corporate bonds	2,578,954	2,578,954	14,345	2,491,630	72,979
Other mortgage-backed securities	1,716,997	1,716,997	—	1,612,403	104,594
Total fixed maturity securities	7,724,075	7,724,075	27,738	7,466,086	230,251
Equity securities	135,466	135,466	82,208	53,252	6
Short-term investments	62,593	62,593	62,593	—	—
Other investments	28,050	28,050	—	28,050	—
Totals	$ 7,950,184	$ 7,950,184	$ 172,539	$ 7,547,388	$ 230,257
Financial Liabilities					
Investment contract and life policy reserves, embedded derivatives	$ 594	$ 594	$ —	$ 594	$ —
Other policyholder funds, embedded derivatives	$ 80,733	$ 80,733	$ —	$ —	$ 80,733

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

The Company did not have any transfers between Levels 1 and 2 during 2018. The Company transferred one equity security between Levels 2 and 1 during 2017. The following tables present reconciliations for the periods indicated for all Level 3 assets and liabilities measured at fair value on a recurring basis.

($ in thousands)

	Financial Assets							Financial Liabilities[1]
	Municipal Bonds	Corporate Bonds	Other Mortgage-Backed Securities [2]	Total Fixed Maturity Securities	Equity Securities	Short-term Investments	Total	
Beginning balance, January 1, 2018	$ 49,328	$ 72,979	$ 107,944	$ 230,251	$ 6	$ —	$ 230,257	$ 80,733
Transfers into Level 3 [3]	—	40,488	50,771	91,259	—	—	91,259	—
Transfers out of Level 3 [3]	—	(11,279)	(5,200)	(16,479)	—	—	(16,479)	—
Total gains or losses								
Net investment gains (losses) included in net income related to financial assets	—	(487)	—	(487)	3	—	(484)	—
Net realized (gains) losses included in net income related to financial liabilities	—	—	—	—	—	—	—	(7,518)
Net unrealized investment gains (losses) included in OCI	(1,195)	(2,840)	(5,570)	(9,605)	—	—	(9,605)	—
Purchases	—	—	—	—	—	—	—	—
Issuances	—	—	—	—	—	—	—	11,183
Sales	—	(6,135)	(187)	(6,322)	(4)	—	(6,326)	—
Settlements	—	—	—	—	—	—	—	—
Paydowns, maturities and distributions	(602)	(11,984)	(27,547)	(40,133)	—	—	(40,133)	(5,698)
Ending balance, December 31, 2018	$ 47,531	$ 80,742	$ 120,211	$ 248,484	$ 5	$ —	$ 248,489	$ 78,700
Beginning balance, January 1, 2017	$ 46,497	$ 60,191	$ 104,659	$ 211,347	$ 6	$ 751	$ 212,104	$ 59,393
Transfers into Level 3 [3]	5,214	38,483	43,091	86,788	—	—	86,788	—
Transfers out of Level 3 [3]	(5,557)	(16,252)	(6,542)	(28,351)	—	(751)	(29,102)	—
Total gains or losses								
Net investment gains (losses) included in net income related to financial assets	—	(1)	(1,832)	(1,833)	—	—	(1,833)	—
Net realized (gains) losses included in net income related to financial liabilities	—	—	—	—	—	—	—	12,942
Net unrealized investment gains (losses) included in OCI	3,977	661	2,075	6,713	—	—	6,713	—
Purchases	—	—	—	—	—	—	—	—
Issuances	—	—	—	—	—	—	—	12,605
Sales	—	(1,999)	(9,179)	(11,178)	—	—	(11,178)	—
Settlements	—	—	—	—	—	—	—	—
Paydowns, maturities and distributions	(803)	(8,104)	(24,328)	(33,235)	—	—	(33,235)	(4,207)
Ending balance, December 31, 2017	$ 49,328	$ 72,979	$ 107,944	$ 230,251	$ 6	$ —	$ 230,257	$ 80,733

(1) Represents embedded derivatives, all related to the Company's FIA products, reported in Other policyholder funds in the Company's Consolidated Balance Sheets.
(2) Includes U.S. Government and federally sponsored agency obligations for mortgage-backed securities and other mortgage-backed securities.
(3) Transfers into and out of Level 3 during the years ended December 31, 2018 and 2017 were attributable to changes in the availability of observable market information for individual fixed maturity securities and short-term investments. The Company's policy is to recognize transfers into and transfers out of the levels as having occurred at the end of the reporting period in which the transfers were determined.

At December 31, 2018, the Company realized a loss of $484 thousand on Level 3 securities. At December 31, 2017 the Company impaired Level 3 securities for a $1,833 thousand realized loss. For the years ended December 31, 2018 and 2017, a realized gain of $7,518 thousand and a realized loss of $12,942 thousand, respectively, were included in earnings that were attributable to the changes in the fair value of Level 3 liabilities (embedded derivatives) still held.

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

The valuation techniques and significant unobservable inputs used in the fair value measurement for financial assets and liabilities classified as Level 3 are subject to the control processes as previously described in this Note. Generally, valuation techniques for fixed maturity securities include spread pricing, matrix pricing and discounted cash flow methodologies; include inputs such as quoted prices for identical or similar securities that are less liquid; and are based on lower levels of trading activity than securities classified as Level 2. The valuation techniques and significant unobservable inputs used in the fair value measurement for equity securities classified as Level 3 use similar valuation techniques and significant unobservable inputs as those used for fixed maturity securities.

The sensitivity of the estimated fair values to changes in the significant unobservable inputs for fixed maturity and equity securities included in Level 3 generally relates to interest rate spreads, illiquidity premiums and default rates. Significant spread widening in isolation will adversely impact the overall valuation, while significant spread tightening will lead to substantial valuation increases. Significant increases (decreases) in illiquidity premiums in isolation will result in substantially lower (higher) valuations. Significant increases (decreases) in expected default rates in isolation will result in substantially lower (higher) valuations.

Financial Instruments Not Carried at Fair Value; Disclosure Required

The Company has various other financial assets and financial liabilities used in the normal course of business that are not carried at fair value, but for which fair value disclosure is required. The following table presents the carrying value, fair value and fair value hierarchy of these financial assets and financial liabilities.

($ in thousands)	Carrying	Fair	Fair Value Measurements at Reporting Date Using		
	Amount	Value	Level 1	Level 2	Level 3
December 31, 2018					
Financial Assets					
Investments					
Other investments	$ 156,725	$ 161,449	$ —	$ —	$ 161,449
Financial Liabilities					
Investment contract and life policy reserves, fixed annuity contracts	4,555,849	4,478,338	—	—	4,478,338
Investment contract and life policy reserves, account values on life contracts	87,229	90,402	—	—	90,402
Other policyholder funds	689,287	689,287	—	626,325	62,962
Long-term debt	297,740	291,938	—	291,938	—
December 31, 2017					
Financial Assets					
Investments					
Other investments	$ 154,898	$ 159,575	$ —	$ —	$ 159,575
Financial Liabilities					
Investment contract and life policy reserves, fixed annuity contracts	4,452,972	4,366,334	—	—	4,366,334
Investment contract and life policy reserves, account values on life contracts	82,911	88,620	—	—	88,620
Other policyholder funds	643,528	643,528	—	575,622	67,906
Long-term debt	297,469	311,315	—	311,315	—

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

Other Investments

Other investments includes policy loans and mortgage loans. For policy loans, fair value is based on estimates using discounted cash flow analysis and current interest rates being offered for new loans. For mortgage loans, fair value is estimated by discounting the future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and similar remaining maturities.

Investment Contract and Life Policy Reserves

The fair values of fixed annuity contract liabilities and policyholder account balances on life contracts are equal to the discounted estimated future cash flows (using the Company's current interest rates for similar products including consideration of minimum guaranteed interest rates). The Company carries these financial liabilities at cost.

Also, included in investment contract and life policy reserves are embedded derivatives related to the Company's IUL products. These embedded derivatives are carried at fair value with fair value equal to the fair value of the current call options purchased to hedge the liability.

Other Policyholder Funds

Other policyholder funds are liabilities related to supplementary contracts without life contingencies and dividend accumulations, as well as balances outstanding under funding agreements with the FHLB and embedded derivatives related to the FIA products. Except for embedded derivatives, each of these components is carried at cost, which management believes is a reasonable estimate of fair value due to the relatively short duration of these items, based on the Company's past experience.

The fair value of the embedded derivatives related to FIA products is estimated at each reporting date by (1) projecting policy contract values and minimum guaranteed contract values over the expected lives of the contracts and (2) discounting the excess of the projected contract value amounts at the applicable risk free interest rates adjusted for the Company's nonperformance risk related to those liabilities. The projections of policy contract values are based on the Company's best estimate assumptions for future contract growth and decrements. The assumptions for future contract growth include the expected index credits which are derived from the fair values of the underlying call options purchased to fund such index credits and the expected costs of annual call options that will be purchased in the future to fund index credits beyond the next contract anniversary. Projections of minimum guaranteed contract values include the same best estimate assumptions for contract decrements used to project policy contract values.

Long-term Debt

The Company carries long-term debt at amortized cost. The fair value of long-term debt is estimated based on unadjusted quoted market prices of the Company's securities or unadjusted market prices based on similar publicly traded issues when trading activity for the Company's securities is not sufficient to provide a market price.

NOTE 4 - Derivative Instruments

The Company offers FIA products, which are deferred fixed annuities that guarantee the return of principal to the contractholder and credit interest based on a percentage of the gain in a specified market index. The Company also offers IUL products which credit interest based on a percentage of the gain in a specified market index. When deposits are received for FIA and IUL contracts, a portion is used to purchase derivatives consisting of call options on the applicable market indices to fund the index credits due to FIA and IUL policyholders. For the Company, substantially all such call options are one-year options purchased to match the funding requirements of the underlying contracts. The call options are carried at fair value with changes in fair value included in Net investment gains (losses), a component of revenues, in the Consolidated Statements of Operations.

The change in fair value of derivatives includes the gains or losses recognized at the expiration of the option term or early termination and the changes in fair value for open positions. Call options are not purchased to fund the index liabilities which may arise after the next deposit anniversary date. On the respective anniversary dates of the indexed deposits, the index used to compute the annual index credit is reset and new one-year call options are purchased to fund the next annual index credit. The cost of these purchases is managed through the terms of the FIA and IUL contracts, which permit changes to index return caps, participation rates and/or asset fees, subject to guaranteed minimums on each contract's anniversary date. By adjusting the index return caps, participation rates or asset fees, crediting rates generally can be managed except in cases where the contractual features would prevent further modifications.

The future annual index credits on FIA are accounted for as a "series of embedded derivatives" over the expected life of the applicable contract with a corresponding reserve recognized. For IUL, the embedded derivative represents a single year liability for the index return.

The Company carries all derivative instruments at fair value in the Consolidated Balance Sheets. The Company elected to not use hedge accounting for derivative transactions related to the FIA and IUL products. As a result, the Company recognizes the purchased call options and the embedded derivatives related to the provision of a contingent return at fair value, with changes in the fair value of the derivatives recognized immediately as Net investment gains (losses) in the Consolidated Statements of Operations. The fair values of derivative instruments, including derivative instruments embedded in FIA and IUL contracts are presented in the Consolidated Balance Sheets as follows:

($ in thousands)	**December 31,**	
	2018	**2017**
Assets		
Derivative instruments, included in Short-term and other investments	$ 2,647	$ 15,550
Liabilities		
Fixed indexed annuities - embedded derivatives, included in Other policyholder funds	78,700	80,733
Indexed universal life - embedded derivatives, included in Investment contract and life policy reserves	248	594

NOTE 4 - Derivative Instruments-(Continued)

In general, the change in the fair value of the embedded derivatives related to FIA will not correspond to the change in fair value of the purchased call options because the purchased call options are one-year options while the options valued in the embedded derivatives represent the rights of the policyholder to receive index credits over the entire period the FIA contracts are expected to be in force, which typically exceeds 10 years. The changes in fair value of derivatives included in the Consolidated Statements of Operations were as follows:

($ in thousands)	Years Ended December 31,		
	2018	2017	2016
Change in fair value of derivatives [1]:			
Revenues			
Net investment gains (losses)	$ (4,112)	$ 14,867	$ 4,024
Change in fair value of embedded derivatives:			
Revenues			
Net investment gains (losses)	7,931	(13,410)	(5,076)

[1] Includes gains or losses recognized at the expiration of the option term or early termination and the changes in fair value for open options.

The Company's strategy attempts to mitigate potential risk of loss under these agreements through a regular monitoring process, which evaluates the program's effectiveness. The Company is exposed to risk of loss in the event of nonperformance by the counterparties and, accordingly, option contracts are purchased from multiple counterparties, which are evaluated for creditworthiness prior to purchase of the contracts. All of these options have been purchased from nationally recognized financial institutions with a Standard & Poor's Global Inc. (S&P)/Moody's Investors Service, Inc. (Moody's) long-term credit rating of "BBB+/A1" or higher at the time of purchase and the maximum credit exposure to any single counterparty is subject to concentration limits. The Company also obtains credit support agreements that allow it to request the counterparty to provide cash collateral when the fair value of the exposure to the counterparty exceeds specified amounts.

The notional amount and fair value of call options by counterparty and each counterparty's long-term credit ratings were as follows:

($ in thousands)	December 31, 2018				December 31, 2017	
	Credit Rating		Notional	Fair	Notional	Fair
Counterparty	S&P	Moody's	Amount	Value	Amount	Value
Bank of America, N.A.	A+	Aa3	$ 144,500	$ 870	$ 85,100	$ 6,320
Barclays Bank PLC	A	A2	28,500	247	48,900	1,828
Citigroup Inc.	BBB+		—	—	—	—
Credit Suisse International	A	A1	16,100	55	21,100	1,444
Societe Generale	A		89,100	1,475	91,700	5,958
Total			$ 278,200	$ 2,647	$ 246,800	$ 15,550

As of December 31, 2018 and 2017, the Company held $1,868 thousand and $15,584 thousand, respectively, of cash received from counterparties for derivative collateral, which is included in Other liabilities on the Consolidated Balance Sheets. This derivative collateral limits the Company's maximum amount of economic loss due to credit risk that would be incurred if parties to the call options failed completely to perform according to the terms of the contracts to $250 thousand per counterparty.

NOTE 5 - Property and Casualty Unpaid Claims and Claim Expenses

The following table is a summary reconciliation of the beginning and ending Property and Casualty unpaid claims and claim expense reserves for the periods indicated. The table presents reserves on both gross and net (after reinsurance) bases. The total net Property and Casualty insurance claims and claim expense incurred amounts are reflected in the Consolidated Statements of Operations. The end of the year gross reserve (before reinsurance) balances and the reinsurance recoverable balances are reflected on a gross basis in the Consolidated Balance Sheets.

($ in thousands)	Years Ended December 31,		
	2018	2017	2016
Property and Casualty segment			
Gross reserves, beginning of year [(1)]	$ 319,182	$ 307,757	$ 301,569
Less: reinsurance recoverables	57,409	61,199	50,332
Net reserves, beginning of year [(2)]	261,773	246,558	251,237
Incurred claims and claim expenses:			
Claims occurring in the current year	547,959	498,989	471,099
Decrease in estimated reserves for claims occurring in prior years [(3)]	(300)	(2,700)	(7,000)
Total claims and claim expenses incurred [(4)]	547,659	496,289	464,099
Claims and claim expense payments for claims occurring during:			
Current year	369,194	333,385	323,025
Prior years	162,783	147,689	145,753
Total claims and claim expense payments	531,977	481,074	468,778
Net reserves, end of year [(2)]	277,455	261,773	246,558
Plus: reinsurance recoverables	89,725	57,409	61,199
Gross reserves, end of year [(1)]	$ 367,180	$ 319,182	$ 307,757

(1) Unpaid claims and claim expenses as reported in the Consolidated Balance Sheets also include reserves for Life and Retirement of $29,534 thousand, $28,567 thousand and $22,131 thousand as of December 31, 2018, 2017 and 2016, respectively, in addition to Property and Casualty reserves.

(2) Reserves net of anticipated reinsurance recoverables.

(3) Shows the amounts by which the Company decreased its reserves in each of the periods indicated for claims occurring in previous periods to reflect subsequent information on such claims and changes in their projected final settlement costs. Also refer to the paragraphs below for additional information regarding the reserve development recorded in 2018, 2017 and 2016.

(4) Benefits, claims and settlement expenses as reported in the Consolidated Statements of Operations also include amounts for Life and Retirement of $89,901 thousand, $86,017 thousand, and $76,905 thousand for the years ended December 31, 2018, 2017 and 2016, respectively, in addition to Property and Casualty amounts.

Underwriting results for Property and Casualty 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, which 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), IBNR claims and associated settlement expenses (together, loss reserves). The process by which these reserves are established requires reliance upon estimates based on known facts and on interpretations of circumstances, including the Company's experience with similar cases and historical trends involving claim payments and related patterns, pending levels of unpaid claims and product mix, as well as other factors including court decisions, economic conditions, public attitudes and medical costs.

The Company believes the Property and Casualty loss reserves are appropriately established based on available facts, laws, and regulations. The Company calculates and records a single best estimate of the reserve (which is equal to the actuarial point estimate) as of each reporting date, for each line of business and its coverages for reported losses and for IBNR losses and as a result believes no other estimate is better than the recognized amount. Due to uncertainties involved, the ultimate cost of losses may vary materially from recognized amounts.

The Company continually updates loss estimates using both quantitative and qualitative information from its reserving actuaries and information derived from other sources. Adjustments may be required as information develops which varies from experience, or, in some cases, augments data which previously were not considered sufficient for use in determining liabilities. The effects of these adjustments may be significant and are charged or credited to income in the period in which the adjustments are made.

Numerous risk factors will affect more than one product line. One of these factors is changes in claim department practices, including claim closure rates, number of claims closed without payment, the use of third-party claim adjusters and the level of needed case reserve estimated by the adjuster. Other risk factors include changes in claim frequency, changes in claim severity, regulatory and legislative actions, court actions, changes in economic conditions and trends (e.g., medical costs, labor rates and the cost of materials), the occurrence of unusually large or frequent catastrophic loss events, timeliness of claim reporting, the state in which the claim occurred and degree of claimant fraud. The extent of the impact of a risk factor will also vary by coverages within a product line. Individual risk factors are also subject to interactions with other risk factors within product line coverages.

While all product lines are exposed to these risks, there are some loss types or product lines for which the financial effect will be more significant. For instance, given the relatively large proportion (approximately 80.0% as of December 31, 2018) of the Company's reserves that are in the longer-tail automobile liability coverages, regulatory and court actions, changes in economic conditions and trends, and medical costs could be expected to impact this product line more extensively than others.

Reserves are established for claims as they occur for each line of business based on estimates of the ultimate cost to settle the claims. The actual loss results are compared to prior estimates and differences are recorded as re-estimates. The primary actuarial techniques (development of paid loss dollars, development of reported loss dollars, methods based on expected loss ratios and methods utilizing frequency and severity of claims) used to estimate reserves and provide for losses are applied to actual paid losses and reported losses (paid losses plus individual case reserves set by claim adjusters) for an accident year to create an estimate of how losses are likely to develop over time.

An accident year refers to classifying claims based on the year in which the claims occurred. For estimating short-tail coverage reserves (e.g., homeowners and automobile physical damage), which comprise approximately 20.0% of the Company's total loss reserves as of December 31, 2018, the primary actuarial technique utilized is the development of paid loss dollars due to the relatively quick claim settlement period. As it relates to estimating long-tail coverage reserves (primarily related to automobile liability), which comprise approximately 80.0% of the Company's total loss reserves as of December 31, 2018, the primary actuarial technique utilized is the development of reported loss dollars due to the relatively long claim settlement period.

In all of the loss estimation techniques referred to above, a ratio (development factor) is calculated which compares current results to results in the prior period for each accident year. Various development factors, based on historical results, are multiplied by the current experience to estimate the development of losses of each accident year from the current time period into the next time period. The development factors for the next time period for each accident year are compounded over the remaining calendar years to calculate an estimate of ultimate losses for each accident year. Occasionally, unusual aberrations in loss patterns are caused by factors such as changes in claim reporting, settlement patterns, unusually large losses, process changes, legal or regulatory environment changes, and other influences. In these instances, analyses of alternate development factor selections are performed to evaluate the effect of these factors and judgment is applied to make appropriate development factor assumptions needed to develop a best estimate of ultimate losses. Paid losses are then subtracted from estimated ultimate losses to determine the indicated loss reserves. The difference between indicated reserves and recorded reserves is the amount of reserve re-estimate.

Reserves are re-estimated quarterly. When new development factors are calculated from actual losses, and they differ from estimated development factors used in previous reserve estimates, assumptions about losses and required reserves are revised based on the new development factors. Changes to reserves are recognized in the period in which development factor changes result in reserve re-estimates.

Claim count estimates are also established for claims as they occur for each line of business based on estimates of the ultimate claim counts. (These counts are derived by counting the number of claimants by insurance coverage.) The primary actuarial techniques (development of paid claim counts and development of reported claim counts) used to estimate ultimate claim counts are applied to actual paid claim counts and reported claim counts (paid claims plus individual unpaid claims set by claim adjusters) for an accident year to create an estimate of how claims are likely to develop over time. An accident year refers to classifying claims based on the year in which the claim occurred. The ultimate claim count generally gives equal consideration to the results of the two actuarial techniques described.

Occasionally, unusual aberrations in claim reporting patterns or claims payment patterns may occur. In these instances, analyses of alternate development factor selections are performed to evaluate the effect of these factors and judgment is applied to make appropriate development factor assumptions needed to develop a best estimate of ultimate claims.

See tables on the following pages of Note 5 for details of the average annual percentage payout of incurred claims by age, also referred to as a history of claims duration and tables illustrating the incurred and paid claims development information by accident year on a net basis for the lines of Homeowners, Auto Liability, and Auto Physical Damage, which represents 99.0% of the Company's incurred losses for 2018.

Numerous actuarial estimates of the types described above are prepared each quarter to monitor losses for each line of business, including the line's individual coverages; for reported losses and IBNR. Often, several different estimates are prepared for each detailed component, incorporating alternative analyses of changing claim settlement patterns and other influences on losses, from which the Company selects the best estimate for each component, occasionally incorporating additional analyses and judgment, as described above. These estimates also incorporate the historical impact of inflation into reserve estimates, the implicit assumption being that a multi-year average development factor represents an adequate provision. Based on the Company's review of these estimates, as well as the review of the independent reserve studies, the best estimate of required reserves for each line of business, including the line's individual coverages, is determined by management and is recognized for each accident year, then the required reserves for each component are summed to create the reserve balances carried on the Company's Consolidated Balance Sheets.

NOTE 5 - Property and Casualty Unpaid Claims and Claim Expenses-(Continued)

Based on the Company's products and coverages, historical experience, and 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 6.0% of reserves, which equates to plus or minus approximately $13.0 thousand of net income as of December 31, 2018. Although this evaluation reflects the most likely outcomes, it is possible the final outcome may fall below or above these estimates.

Net favorable development of total reserves for Property and Casualty claims occurring in prior years was $300 thousand in 2018, $2,700 thousand in 2017 and $7,000 thousand in 2016. In 2018, the favorable development was predominantly the result of favorable severity trends in property for accident years 2016 and prior. In 2017, the favorable development was predominantly the result of favorable severity trends in property for accident years 2015 and prior. In 2016, the favorable development was predominantly the result of favorable severity trends in property for accident years 2014 and prior.

The Company completes a detailed study of Property and Casualty reserves based on information available at the end of each quarter and year. Trends of reported losses (paid amounts and case reserves on claims reported to the Company) for each accident year are reviewed and ultimate loss costs for those accident years are estimated. The Company engages an independent property and casualty actuarial consulting firm to prepare an independent study of the Company's Property and Casualty reserves at December 31st of each year. The result of the independent actuarial study at December 31, 2018 was consistent with management's analysis and selected estimates and did not result in any adjustments to the Company's Property and Casualty reserves recognized.

At the time each of the reserve analyses was performed, the Company believed that each estimate was based upon sound methodology and such methodologies were appropriately applied and that there were no trends which indicated the likelihood of future loss reserve development. The financial impact of the net reserve development was therefore accounted for in the period that the development was determined.

No other adjustments were made in the determination of the liabilities during the periods covered by these consolidated financial statements. Management believes that, based on data currently available, it has reasonably estimated the Company's ultimate losses.

Below is the average annual percentage payout of incurred claims by age, also referred to as a history of claims duration:

Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance

Years	1	2	3	4	5	6	7	8	9	10
Homeowners	78.5%	17.3%	2.4%	0.9%	0.7%	0.2%	—	—	—	—
Auto liability	40.9%	35.1%	13.7%	6.1%	2.7%	1.1%	0.3%	0.1%	—	—
Auto physical damage	95.6%	4.4%	—	—	—	—	—	—	—	—

NOTE 5 - Property and Casualty Unpaid Claims and Claim Expenses-(Continued)

The following tables illustrate the incurred and paid claims development by accident year on a net basis for the lines of homeowners, auto liability and auto physical damage. Conditions and trends that have affected the development of these reserves in the past will not necessarily reoccur in the future. It may not be appropriate to use this cumulative history in the projection of future performance.

The information about incurred and paid claims development for the years ended December 31, 2009 to 2017 is presented as unaudited supplementary information.

($ in thousands)

Homeowners

Incurred Claims and Allocated Claim Adjustment Expense, Net of Reinsurance

	Years Ended December 31,										As of December 31, 2018	
Accident Year	Unaudited 2009	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	Unaudited 2017	2018	Total of Incurred-But-Not-Reported Liabilities Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
2009	$ 113,274	$ 112,280	$ 112,970	$ 113,096	$ 113,357	$ 113,230	$ 113,216	$ 112,900	$ 112,958	$ 113,168	$ —	21,810
2010		140,994	136,907	133,358	133,235	133,216	133,136	132,859	132,905	132,627	—	25,149
2011			150,141	150,334	150,791	148,860	148,755	148,414	148,370	148,079	—	29,530
2012				108,754	109,156	109,360	106,486	106,308	106,348	106,000	—	21,578
2013					105,584	107,489	103,982	102,407	102,345	101,769	88	19,221
2014						111,647	113,505	109,059	106,844	106,554	257	20,083
2015							111,706	115,134	114,404	114,053	362	18,706
2016								115,931	118,604	117,009	724	19,830
2017									126,285	129,818	759	19,741
2018										166,793	27,697	19,515
									Total	$ 1,235,870		

($ in thousands)

Homeowners

Cumulative Paid Claims and Allocated Claim Adjustment Expense, Net of Reinsurance

	Years Ended December 31,									
Accident Year	Unaudited 2009	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	Unaudited 2017	2018
2009	$ 81,570	$ 104,407	$ 108,217	$ 110,324	$ 112,554	$ 112,720	$ 112,827	$ 112,848	$ 112,851	$ 112,858
2010		98,190	124,326	129,790	132,246	132,523	132,604	132,599	132,602	132,602
2011			123,046	142,846	145,852	146,908	147,451	148,026	148,014	148,069
2012				84,260	101,566	104,203	105,156	105,561	105,909	105,993
2013					76,890	96,599	99,361	100,968	101,527	101,677
2014						83,314	103,030	105,704	106,081	106,258
2015							90,704	109,303	111,882	113,321
2016								95,772	113,186	115,053
2017									106,800	128,518
2018										130,548
								Total		1,194,897
								Outstanding prior to 2009		66
								Prior years paid		—
								Liabilities for claims and claim adjustment expenses, net of reinsurance		$ 41,039

($ in thousands)

Auto Liability

Incurred Claims and Allocated Claim Adjustment Expense, Net of Reinsurance

	Years Ended December 31,										As of December 31, 2018	
Accident Year	Unaudited 2009	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	Unaudited 2017	2018	Total of Incurred-But-Not-Reported Liabilities Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
2009	$ 159,934	$ 158,703	$ 153,662	$ 157,941	$ 151,418	$ 150,919	$ 150,568	$ 149,822	$ 149,888	$ 149,807	$ (64)	49,230
2010		157,712	160,058	156,369	154,222	152,483	151,653	149,818	149,425	149,542	3	48,942
2011			150,803	146,713	145,735	143,133	142,488	139,840	138,891	138,949	210	45,976
2012				156,448	153,815	150,336	149,346	147,594	145,847	145,620	305	45,984
2013					153,860	152,858	150,720	150,657	148,111	147,993	748	47,368
2014						155,105	157,249	158,470	159,937	159,794	1,887	49,380
2015							165,517	172,553	177,021	178,325	2,441	50,596
2016								180,380	184,440	184,567	5,637	51,934
2017									187,983	188,756	19,007	48,587
2018										200,314	71,139	43,522
									Total	$ 1,643,667		

($ in thousands)

Auto Liability

Cumulative Paid Claims and Allocated Claim Adjustment Expense, Net of Reinsurance

	Years Ended December 31,									
Accident Year	Unaudited 2009	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	Unaudited 2017	2018
2009	$ 60,011	$ 110,921	$ 133,568	$ 142,524	$ 146,383	$ 148,783	$ 149,608	$ 149,801	$ 149,855	$ 149,871
2010		63,416	118,345	137,012	144,255	147,337	148,751	149,247	149,364	149,439
2011			61,070	108,837	126,812	133,931	136,906	138,151	138,358	138,689
2012				61,279	109,574	127,185	138,641	142,916	144,622	145,121
2013					62,224	108,856	131,214	139,954	145,291	146,770
2014						61,329	117,468	139,463	149,059	155,758
2015							70,836	134,473	157,980	170,088
2016								73,073	140,901	166,815
2017									70,682	139,531
2018										77,528
								Total		1,439,610
								Outstanding prior to 2009		183
								Prior years paid		—
								Liabilities for claims and claim adjustment expenses, net of reinsurance		$ 204,240

NOTE 5 - Property and Casualty Unpaid Claims and Claim Expenses-(Continued)

($ in thousands)

Auto Physical Damage

Incurred Claims and Allocated Claim Adjustment Expense, Net of Reinsurance

	Years Ended December 31,										As of December 31, 2018	
Accident Year	Unaudited 2009	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	Unaudited 2017	2018	Total of Incurred-But-Not-Reported Liabilities Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
2009	$ 84,539	$ 83,515	$ 83,202	$ 82,635	$ 82,000	$ 81,986	$ 81,972	$ 81,963	$ 81,972	$ 81,941	$ —	77,449
2010		84,112	83,420	83,103	83,046	83,052	83,050	83,036	83,028	83,018	2	81,581
2011			86,205	85,507	86,023	85,120	85,143	85,116	85,108	85,102	8	80,803
2012				83,770	82,337	83,402	83,431	83,354	83,342	83,334	8	78,163
2013					91,448	88,856	88,672	88,627	88,455	88,525	54	80,919
2014						95,572	95,634	95,422	95,239	95,232	(21)	87,899
2015							99,291	97,994	97,624	97,455	(188)	87,491
2016								112,430	109,515	109,348	(207)	93,200
2017									115,483	111,798	924	91,160
2018										109,040	(6,859)	91,070
									Total	$ 944,793		

($ in thousands)

Auto Physical Damage

Cumulative Paid Claims and Allocated Claim Adjustment Expense, Net of Reinsurance

	Years Ended December 31,									
Accident Year	Unaudited 2009	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	Unaudited 2017	2018
2009	$ 78,456	$ 82,117	$ 82,039	$ 82,015	$ 82,000	$ 81,985	$ 81,973	$ 81,963	$ 81,955	$ 81,941
2010		79,329	83,120	83,103	83,087	83,067	83,051	83,036	83,028	83,015
2011			83,227	85,254	85,181	85,148	85,127	85,116	85,108	85,095
2012				80,519	83,418	83,372	83,355	83,347	83,342	83,326
2013					85,110	88,688	88,580	88,532	88,484	88,471
2014						88,939	95,444	95,266	95,256	95,258
2015							92,138	97,850	97,685	97,638
2016								106,459	109,686	109,536
2017									105,156	110,817
2018										103,559
								Total		938,656
								Outstanding prior to 2009		—
								Prior years paid		—
								Liabilities for claims and claim adjustment expenses, net of reinsurance		$ 6,137

NOTE 5 - Property and Casualty Unpaid Claims and Claim Expenses-(Continued)

The reconciliation of the net incurred and paid claims development tables to the liability for claims and claim adjustment expenses in the Consolidated Balance Sheet is as follows:

($ in thousands)	Years Ended December 31, 2018
Property and Casualty segment	
Net reserves	
Homeowners	$ 41,039
Auto liability	204,240
Auto physical damage	6,137
Other short duration lines	3,556
Total net reserves for unpaid claims and claim adjustment expense, net of reinsurance	254,972
Reinsurance recoverable on unpaid claims	
Homeowners	26,646
Auto liability	55,971
Other short duration lines	7,108
Total reinsurance recoverable on unpaid claims	89,725
Insurance lines other than short duration [(1)]	29,534
Unallocated claims adjustment expenses	22,483
Total other than short duration and unallocated claims adjustment expenses	52,017
Gross reserves, end of year [(1)]	$ 396,714

(1) This line includes Retirement and Life reserves as included in the Consolidated Balance Sheet.

NOTE 6 - Reinsurance and Catastrophes

In the normal course of business, the Company's insurance subsidiaries assume and cede reinsurance with other insurers. Reinsurance is ceded primarily to limit losses from large events and to permit recovery of a portion of direct losses; however, such a transfer does not relieve the originating insurance company of primary liability.

The Company is a national underwriter and therefore has exposure to catastrophic losses in certain coastal states and other regions throughout the U.S. Catastrophes can be caused by various events including hurricanes, windstorms, hail, severe winter weather, wildfires and earthquakes, and the frequency and severity of catastrophes are inherently unpredictable. The financial impact from catastrophic losses results from both the total amount of insured exposure in the area affected by the catastrophe as well as the severity of the event. The Company seeks to reduce its exposure to catastrophe losses through the geographic diversification of its insurance coverage, deductibles, maximum coverage limits and the purchase of catastrophe reinsurance.

The Company's catastrophe losses incurred of approximately $107,345 thousand, $61,814 thousand and $60,043 thousand for the years ended December 31, 2018, 2017 and 2016, respectively. For 2018, catastrophe losses were impacted by a number of storm and wildfire events throughout the year.

NOTE 6 - Reinsurance and Catastrophes-(Continued)

The total amounts of reinsurance recoverable on unpaid insurance reserves classified as assets and reported in Other assets in the Consolidated Balance Sheets were as follows:

($ in thousands)	December 31, 2018	December 31, 2017
Reinsurance recoverables on reserves and unpaid claims		
Property and Casualty		
Reinsurance companies	$ 33,754	$ 6,696
State insurance facilities	55,971	50,713
Life and health	9,785	11,037
Total	$ 99,510	$ 68,446

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, IBNR claims 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:

($ in thousands)	Gross Amount	Ceded to Other Companies	Assumed from Other Companies	Net Amount
Year Ended December 31, 2018				
Premiums written and contract deposits [(1)]	$ 1,255,557	$ 28,773	$ 8,259	$ 1,235,043
Premiums and contract charges earned	841,147	28,837	5,023	817,333
Benefits, claims and settlement expenses	769,664	136,601	4,497	637,560
Year Ended December 31, 2017				
Premiums written and contract deposits [(1)]	1,244,500	21,989	4,606	1,227,117
Premiums and contract charges earned	812,099	22,036	4,640	794,703
Benefits, claims and settlement expenses	588,621	10,472	4,157	582,306
Year Ended December 31, 2016				
Premiums written and contract deposits [(1)]	1,280,903	22,728	4,324	1,262,499
Premiums and contract charges earned	777,651	22,826	4,321	759,146
Benefits, claims and settlement expenses	562,385	25,739	4,358	541,004

(1) This measure is not based on accounting principles generally accepted in the U.S. (non-GAAP). An explanation of this non-GAAP measure is contained in the Glossary of Selected Terms included as an exhibit in the Company's reports filed with the SEC.

There were no losses from uncollectible reinsurance recoverables in the three years ended December 31, 2018. Past due reinsurance recoverables as of December 31, 2018 were not material.

The Company maintains catastrophe excess of loss reinsurance coverage. For 2018, the Company's catastrophe excess of loss coverage consisted of one contract in addition to a minimal amount of coverage by the Florida Hurricane Catastrophe Fund (FHCF). The catastrophe excess of loss contract provided 95% coverage for catastrophe losses above a retention of $25,000 thousand per occurrence up to $175,000 thousand per occurrence. This contract consisted of three layers, each of which provided for one mandatory reinstatement. The layers were $25,000 thousand excess of $25,000 thousand, $40,000 thousand excess of $50,000 thousand and $85,000 thousand excess of $90,000 thousand.

For liability coverages, in 2018, the Company reinsured each loss above a retention of $1,000 thousand with coverage up to $5,000 thousand on a per occurrence basis and $20,000 thousand in a clash event. (A clash cover is a reinsurance casualty excess contract requiring two or more casualty coverages or policies issued by the Company to be involved in the same loss occurrence for coverage to apply.) For property coverages, in 2018, the Company reinsured each loss above a retention of $1,000 thousand up to $5,000 thousand on a per risk basis, including catastrophe losses. Also, the Company could submit to the reinsurers two per risk losses from the same occurrence for a total of $8,000 thousand of property recovery in any one event.

The maximum individual life insurance risk retained by the Company is $300 thousand on any individual life, while either $100 thousand or $125 thousand is retained on each group life policy depending on the type of coverage. Excess amounts are reinsured. The Company also maintains a life catastrophe reinsurance program. For 2018, the Company reinsured 100% of the catastrophe risk in excess of $1,000 thousand up to $35,000 thousand per occurrence, with one reinstatement. The Company's life catastrophe risk reinsurance program covers acts of terrorism and includes nuclear, biological and chemical explosions but excludes other acts of war.

NOTE 7 - Debt

Indebtedness and scheduled maturities consisted of the following:

($ in thousands)	Effective Interest Rates	Final Maturity	December 31, 2018	December 31, 2017
Short-term debt				
Bank Credit Facility	Variable	2023	$ —	$ —
Long-term debt [(1)]				
4.50% Senior Notes, Aggregate principal amount of $250,000 less unaccrued discount of $488 and $547 and unamortized debt issuance costs of $1,772 and $1,984	4.50%	2025	247,740	247,469
Federal Home Loan Bank borrowing	2.70%	2022	50,000	50,000
Total			$ 297,740	$ 297,469

(1) The Company designates debt obligations as "long-term" based on maturity date at issuance.

Credit Agreement with Financial Institutions (Bank Credit Facility)

In 2018, HMEC's Bank Credit Agreement (the Bank Credit Facility) was amended and restated to extend the commitment termination date to June 27, 2023 from the previous termination date of July 30, 2019. The interest rate spread relative to Eurodollar base rates and the financial covenants within the agreement were not changed. The Bank Credit Facility is by and between HMEC, certain financial institutions named therein and JPMorgan Chase Bank, N.A., as administrative agent, and provides for unsecured borrowings of up to $150,000 thousand. Interest accrues at varying spreads relative to prime or Eurodollar base rates and is payable monthly or quarterly depending on the applicable base rate. The unused portion of the Bank Credit Facility is subject to a variable commitment fee, which was 0.15% on an annual basis at December 31, 2018.

NOTE 7 - Debt-(Continued)

4.50% Senior Notes due 2025 (Senior Notes due 2025)

On November 23, 2015, the Company issued $250,000 thousand aggregate principal amount of 4.50% senior notes, which will mature on December 1, 2025, issued at a discount of 0.265% resulting in an effective yield of 4.533%. Interest on the Senior Notes due 2025 is payable semi-annually at a rate of 4.50%. The Senior Notes due 2025 are redeemable in whole or in part, at any time, at the Company's option, at a redemption price equal to the greater of (1) 100% of the principal amount of the notes being redeemed or (2) the sum of the present values of the remaining scheduled payments of principal and interest thereon discounted, on a semi-annual basis, at the Treasury yield (as defined in the indenture) plus 35 basis points, plus, in either of the above cases, accrued interest to the date of redemption.

Federal Home Loan Bank Borrowings

In 2017, HMIC became a member of the FHLB, which provides HMIC with access to collateralized borrowings and other FHLB products. As membership requires the ownership of membership stock, in June 2017, HMIC purchased common stock to meet the membership requirement. Any borrowing from the FHLB requires the purchase of FHLB activity-based common stock in an amount equal to 4.5% of the borrowing, or a lower percentage - such as 2.0% based on the Reduced Capitalization Advance Program. In the fourth quarter of 2017, HMIC purchased common stock to meet the activity-based requirement. For FHLB borrowings, the Board has authorized a maximum amount equal to the greater of 10% of admitted assets or 20% of surplus of the consolidated property and casualty companies. During the fourth quarter of 2017, the Company received $50,000 thousand in executed borrowings for HMIC. Of the total $50,000 thousand received, $25,000 thousand matures on October 5, 2022 and $25,000 thousand matures on December 2, 2022. Interest on the borrowings accrues at an annual weighted average rate of 2.70% as of December 31, 2018. HMIC's FHLB borrowings of $50,000 thousand are included in Long-term debt in the Consolidated Balance Sheets.

Covenants

The Company is in compliance with all of the financial covenants contained in the Senior Notes due 2025 indenture and the Bank Credit Facility agreement, consisting primarily of relationships of (1) debt to capital, (2) net worth, as defined in the financial covenants, (3) insurance subsidiaries' risk-based capital and (4) securities subject to funding agreements and repurchase agreements.

Note 8 - Income Taxes

As the result of the Tax Cuts and Jobs Act (Tax Act) enacted December 2017, the Company had recorded provisional amounts for the taxes associated with its partnership investments and the changes in discounting unpaid loss reserves based on information available at December 31, 2017. As a result of the guidance issued in 2018, the Company has determined there is no change in its estimates related to partnership investments. Updated estimates of the transition liability related to loss reserve discounting were less than the provisional amounts by approximately $1.1 million. Updated estimates of the transition liability related to life insurance reserves decreased the liability by approximately $6.8 million. The adjustments to the Company’s provisional amounts for the year ended December 31, 2018 did not impact the effective tax rate. As of December 31, 2018, there are no provisional amounts related to the impact of the Tax Act that remain in the Company’s Consolidated Financial Statements.

NOTE 8 - Income Taxes-(Continued)

The income tax assets and liabilities included in Other assets and Other liabilities, respectively, in the Consolidated Balance Sheets were as follows:

($ in thousands)	December 31, 2018	December 31, 2017
Income tax (asset) liability		
Current	$ (20,793)	$ (16,266)
Deferred	103,686	157,775

Deferred tax assets and liabilities are recognized for all future tax consequences attributable to "temporary differences" between the financial statement carrying value of existing assets and liabilities and their respective tax bases. There are no deferred tax liabilities that have not been recognized. The "temporary differences" that gave rise to the deferred tax balances were as follows:

($ in thousands)	December 31, 2018	December 31, 2017
Deferred tax assets		
Unearned premium reserve reduction	$ 12,112	$ 11,472
Compensation accruals	6,866	8,359
Impaired securities	1,295	2,240
Other comprehensive income - net funded status of benefit plans	3,254	3,526
Discounting of unpaid claims and claim expense tax reserves	2,772	3,889
Postretirement benefits other than pensions	302	321
Charitable contributions carryforwards	89	62
Net operating loss carryforwards	10,969	148
Total gross deferred tax assets	37,659	30,017
Deferred tax liabilities		
Other comprehensive income - net unrealized gains on securities	32,897	95,583
Deferred policy acquisition costs	60,330	52,438
Life insurance future policy benefit reserve	9,304	102
Life insurance future policy benefit reserve (transitional rule)	14,910	23,869
Discounting of unpaid claims and claim expense tax reserves (transitional rule)	1,203	2,513
Investment related adjustments	17,531	8,661
Intangibles	2,557	2,557
Other, net	2,613	2,069
Total gross deferred tax liabilities	141,345	187,792
Net deferred tax liability	$ 103,686	$ 157,775

The Company evaluated sources and character of income, including historical earnings, loss carryback potential, taxable income from future reversals of existing taxable temporary differences, future taxable income exclusive of reversing temporary differences, and taxable income from prudent and feasible tax planning strategies. Although realization of deferred tax assets is not assured, the Company believes it is more likely than not that gross deferred tax assets will be fully realized and that a valuation allowance with respect to the realization of the total gross deferred tax assets was not necessary as of December 31, 2018 and 2017.

NOTE 8 - Income Taxes-(Continued)

At December 31, 2018, the Company had available the following carryforwards or credits.

($ in thousands)	Pretax Amount	Expiration Years
Operating loss carryforwards	$ 52,232	2037 - 2038
Charitable contributions carryforwards	424	2021 - 2023

The components of the provision for income tax expense were as follows:

($ in thousands)	Years Ended December 31,		
	2018	2017	2016
Current	$ 4,152	$ 3,813	$ 26,359
Deferred	(2,958)	(84,585)	4,108
Total income tax expense (benefit)	$ 1,194	$ (80,772)	$ 30,467

Income tax expense for the following periods differed from the expected tax computed by applying the federal corporate tax rate of 21% for 2018 and 35% for 2017 and 2016 to income before income taxes as follows:

($ in thousands)	Years Ended December 31,		
	2018	2017	2016
Expected federal tax on income	$ 4,103	$ 31,041	$ 39,981
Add (deduct) tax effects of:			
Tax-exempt interest	(3,726)	(5,335)	(5,789)
Dividend received deduction	(412)	(4,810)	(5,751)
Tax Act DTL re-measurement	—	(98,988)	—
Employee share-based compensation	(1,134)	(3,258)	127
Compensation deduction limitation	1,754	326	—
Prior year adjustments	300	(293)	91
Other, net	309	545	1,808
Income tax expense (benefit) provided on income	$ 1,194	$ (80,772)	$ 30,467

The Company's federal income tax returns for years prior to 2014 are no longer subject to examination by the Internal Revenue Service (IRS).

The Company recognizes tax benefits from tax return positions only if it is more likely than not the position will be sustainable, upon examination, on its technical merits and any relevant administrative practices or precedents. As a result, the Company applies a more likely than not recognition threshold for all tax uncertainties.

The Company records liabilities for uncertain tax filing positions where it is more likely than not that the position will not be sustainable upon audit by taxing authorities. These liabilities are reevaluated routinely and are adjusted appropriately based upon changes in facts or law. The Company has no unrecorded liabilities from uncertain tax filing positions.

NOTE 8 - Income Taxes-(Continued)

HMEC and its subsidiaries file a consolidated federal income tax return. The federal income tax sharing agreements between HMEC and its subsidiaries, as approved by the Board, provide that tax on income is charged to each subsidiary as if it were filing a separate tax return with the limitation that each subsidiary will receive the benefit of any losses or tax credits to the extent utilized in the consolidated tax return. Intercompany balances are settled quarterly with a final settlement after filing the consolidated federal income tax return with the IRS.

A reconciliation of the beginning and ending amounts of unrecognized tax benefits, excluding interest and penalties, is as follows:

($ in thousands)	Years Ended December 31,		
	2018	2017	2016
Balance as of the beginning of the year	$ 1,790	$ 1,594	$ 1,039
Increases related to prior year tax positions	—	101	348
Decreases related to prior year tax positions	(152)	—	—
Increases related to current year tax positions	96	422	283
Settlements	—	—	—
Lapse of statute	—	(327)	(76)
Balance as of the end of the year	$ 1,734	$ 1,790	$ 1,594

The Company's effective tax rate would be affected to the extent there were unrecognized tax benefits that could be recognized. There are no positions for which it is reasonably possible that the total amount of unrecognized tax benefit will significantly change within the next 12 months.

The Company classifies all tax related interest and penalties as income tax expense.

Interest and penalties were both immaterial in each of the years ended December 31, 2018, 2017 and 2016.

NOTE 9 - Shareholders' Equity and Common Stock Equivalents

Share Repurchase Programs and Treasury Shares Held (Common Stock)

In December 2011, the Board authorized a share repurchase program allowing repurchases of up to $50,000 thousand (the 2011 Plan). In September 2015, the Board authorized an additional share repurchase program allowing repurchases of up to $50,000 thousand (the 2015 Plan) to begin following the completion of the 2011 Plan. Both share repurchase programs authorize the repurchase of HMEC's common shares in open market or privately negotiated transactions, from time to time, depending on market conditions. The share repurchase programs do not have expiration dates and may be limited or terminated at any time without notice.

During 2016, the Company repurchased 701,410 shares of its common stock, or 1.7% of the shares outstanding as of December 31, 2015, at an aggregate cost of $21,513 thousand, or an average price of $30.67 per share, under the 2011 and the 2015 Plans. Utilization of the remaining authorization under the 2011 program was completed in January 2016. During 2017, the Company repurchased 48,440 shares of its common stock, or 0.1% of the shares outstanding as of December 31, 2016, at an aggregate cost of $1,660 thousand, or an average price of $34.28 per share, under the 2015 Plan. During 2018, the Company repurchased 129,112 shares of its common stock, or 0.3% of the shares outstanding as of December 31, 2017, at an aggregate cost of $5,088 thousand, or an average price of $39.41 per share, under the 2015

Plans. In total and through December 31, 2018, 2,977,162 shares were repurchased under the 2011 and 2015 Plans at an average price of $25.96 per share. The repurchase of shares was financed through use of cash. As of December 31, 2018, $22,766 thousand remained authorized for future share repurchases under the 2015 Plan authorization.

At December 31, 2018, the Company held 24,850 thousand shares in treasury.

Authorization of Preferred Stock

In 1996, the shareholders of HMEC approved authorization of 1,000,000 shares of $0.001 par value preferred stock. The Board is authorized to (1) direct the issuance of the preferred stock in one or more series, (2) fix the dividend rate, conversion or exchange rights, redemption price and liquidation preference, of any series of the preferred stock, (3) fix the number of shares for any series and (4) increase or decrease the number of shares of any series. No shares of preferred stock were outstanding at December 31, 2018 and 2017.

2010 Comprehensive Executive Compensation Plan

In 2010, the shareholders of HMEC approved the 2010 Comprehensive Executive Compensation Plan (the Comprehensive Plan). The purpose of the Comprehensive Plan is to aid the Company in attracting, retaining, motivating and rewarding employees and non-employee Directors; to provide for equitable and competitive compensation opportunities, including deferral opportunities; to encourage long-term service; to recognize individual contributions and reward achievement of Company goals; and to promote the creation of long-term value for the Company's shareholders by closely aligning the interests of plan participants with those of shareholders. The Comprehensive Plan authorizes share-based and cash-based incentives for plan participants. In 2012, the shareholders of HMEC approved the implementation of a fungible share pool under which grants of full value shares will count against the share limit as two and one half shares for every share subject to a full value award. In 2015, the shareholders of HMEC approved an amendment and restatement of the Comprehensive Plan which included an increase of 3.25 million in the number of shares of common stock reserved for issuance under the Comprehensive Plan. As of December 31, 2018, approximately 1,826 thousand shares were available for grant under the Comprehensive Plan. Shares of common stock issued under the Comprehensive Plan may be either authorized and unissued shares of HMEC or shares that have been reacquired by HMEC; however, new shares have been issued historically.

As further described in the paragraphs below, CSUs, stock options and RSUs under the Comprehensive Plan were as follows:

	December 31,		
	2018	2017	2016
CSUs related to deferred compensation for Directors	32,288	61,677	74,058
CSUs related to deferred compensation for employees	24,498	24,903	51,502
Stock options	774,821	719,015	747,032
RSUs related to incentive compensation	1,008,249	1,149,679	1,419,268
Total	1,839,856	1,955,274	2,291,860

NOTE 9 - Shareholders' Equity and Common Stock Equivalents-(Continued)

Director Common Stock Units

Deferred compensation of Directors is in the form of CSUs, which represent an equal number of common shares to be issued in the future. The outstanding units of Directors serving on the Board accrue dividends at the same rate as dividends paid to HMEC's shareholders; outstanding units of retired Directors do not accrue dividends. These dividends are reinvested into additional CSUs.

Employee Common Stock Units

Deferred compensation of employees is in the form of CSUs, which represent an equal number of common shares to be issued in the future. Distributions of employee deferred compensation are allowed to be either in common shares or cash. Through December 31, 2018, all distributions have been in cash. The outstanding units accrue dividends at the same rate as dividends paid to HMEC's shareholders. These dividends are reinvested into additional CSUs.

Stock Options

Options to purchase shares of HMEC common stock may be granted to executive officers, other employees and Directors. The options become exercisable in installments based on service generally beginning in the first year from the date of grant and generally become fully vested 4 years from the date of grant. The options generally expire 7 to 10 years from the date of grant. The exercise price of the option is equal to the market price of HMEC's common stock on the date of grant resulting in a grant date intrinsic value of $0.

Changes in outstanding options were as follows:

	Weighted Average Option Price per Share	Range of Option Prices per Share	Options	
			Outstanding	Vested and Exercisable
December 31, 2017	$32.80	$17.01-$41.95	719,015	258,321
Granted	$43.04	$42.95-$44.75	223,208	—
Vested	$31.42	$17.32-$41.95	—	158,233
Exercised	$27.07	$17.01-$41.95	(145,438)	(145,438)
Forfeited	$39.07	$31.01-$42.95	(21,964)	—
Expired	—	—	—	—
December 31, 2018	$36.65	$17.32-$44.75	774,821	271,116

Option information segregated by ranges of exercise prices was as follows:

	December 31, 2018					
	Total Outstanding Options			Vested and Exercisable Options		
Range of Option Prices per Share	Options	Weighted Average Option Price per Share	Weighted Average Remaining Term	Options	Weighted Average Option Price per Share	Weighted Average Remaining Term
$17.01-$22.69	36,524	$19.77	0.82	36,524	$19.77	0.82 years
$28.88-$33.41	320,897	$31.01	6.68	183,685	$30.85	6.40 years
$38.05-$41.95	199,452	$41.82	8.19	50,907	$41.82	8.19 years
$41.95-$44.75	217,948	$43.05	9.19	—	—	0 years
Total	774,821	$36.65	7.50	271,116	$31.42	5.98 years

The weighted average exercise prices of vested and exercisable options as of December 31, 2017 and 2016 were $27.12 and $22.73, respectively.

As of December 31, 2018, based on a closing stock price of $37.45 per share, the aggregate intrinsic (in-the-money) values of vested options and all options outstanding were $1,857 thousand and $2,713 thousand, respectively.

Restricted Common Stock Units

RSUs may be granted to executive officers, other employees and Directors and represent an equal number of common shares to be issued in the future. The RSUs vest in installments based on service or attainment of performance criteria generally beginning in the first year from the date of grant and generally become fully vested 1 to 5 years from the date of grant. The outstanding units accrue dividends at the same rate as dividends paid to HMEC's shareholders. These dividends are reinvested into additional RSUs.

Changes in outstanding RSUs were as follows:

	Total Outstanding Units		Vested Units	
	Units	Weighted Average Grant Date Fair Value per Unit	Units	Weighted Average Grant Date Fair Value per Unit
December 31, 2017	1,149,679	$32.05	558,139	$19.80
Granted [(1)]	188,675	$42.21	—	—
Vested	—	—	144,290	$31.58
Forfeited	(44,855)	$38.08	—	—
Distributed [(2)]	(285,250)	$25.15	(285,250)	$25.15
December 31, 2018	1,008,249	$35.64	417,179	$20.22

(1) Includes dividends reinvested into additional RSUs.
(2) Includes distributed units which were utilized to satisfy withholding taxes due on the distribution.

NOTE 10 - Statutory Information and Restrictions

The insurance departments of various states in which the insurance subsidiaries of HMEC are domiciled recognize as net income and surplus those amounts determined in conformity with statutory accounting principles prescribed or permitted by the insurance departments, which differ in certain respects from GAAP.

Reconciliations of statutory capital and surplus and net income, as determined using statutory accounting principles, to the amounts included in the accompanying consolidated financial statements are as follows:

($ in thousands)	December 31, 2018	December 31, 2017
Statutory capital and surplus of insurance subsidiaries	$ 903,564	$ 944,139
Increase (decrease) due to:		
Deferred policy acquisition costs	298,742	257,826
Difference in policyholder reserves	142,601	111,188
Goodwill	47,396	47,396
Investment fair value adjustments on fixed maturity securities	142,512	415,775
Difference in investment reserves	105,430	111,225
Federal income tax liability	(115,667)	(162,634)
Net funded status of benefit plans	(15,495)	(16,789)
Non-admitted assets and other, net	20,412	28,870
Shareholders' equity of parent company and non-insurance subsidiaries	8,795	12,046
Parent company short-term and long-term debt	(247,740)	(247,469)
Shareholders' equity as reported herein	$ 1,290,550	$ 1,501,573

($ in thousands)	Years Ended December 31, 2018	2017	2016
Statutory net income of insurance subsidiaries	$ 45,977	$ 82,587	$ 74,574
Net loss of non-insurance companies	(9,755)	(4,496)	(5,135)
Interest expense	(11,892)	(11,836)	(11,808)
Tax benefit of interest expense and other parent company current tax adjustments	121	5,654	5,637
Combined net income	24,451	71,909	63,268
Increase (decrease) due to:			
Deferred policy acquisition costs	1,015	9,385	19,442
Policyholder benefits	26,318	30,609	14,919
Federal income tax (expense) benefit	3,020	84,198	(5,312)
Investment reserves	(31,529)	(20,966)	(1,320)
Other adjustments, net	(4,932)	(5,676)	(7,232)
Net income as reported herein	$ 18,343	$ 169,459	$ 83,765

HMEC has principal insurance subsidiaries domiciled in Illinois and Texas. The statutory financial statements of these subsidiaries are prepared in accordance with accounting principles prescribed or permitted by the Illinois Department of Insurance and the Texas Department of Insurance, as applicable. Prescribed statutory accounting principles include a variety of publications of the National Association of Insurance Commissioners (NAIC), as well as state laws, regulations and general administrative rules.

NOTE 10 - Statutory Information and Restrictions-(Continued)

The NAIC has risk-based capital guidelines to evaluate the adequacy of statutory capital and surplus in relation to risks assumed in investments, reserving policies, and volume and types of insurance business written. At December 31, 2018 and 2017, the minimum statutory-basis capital and surplus required to be maintained by HMEC's insurance subsidiaries was $108,470 thousand and $101,463 thousand, respectively. At December 31, 2018 and 2017, statutory capital and surplus of each of the Company's insurance subsidiaries was above required levels. The restricted net assets of HMEC's insurance subsidiaries were $17,695 thousand and $17,985 thousand as of December 31, 2018 and 2017, respectively. The minimum statutory basis capital and surplus amount at each date is the total estimated authorized control level risk-based capital for all of HMEC's insurance subsidiaries combined. Authorized control level risk-based capital represents the minimum level of statutory basis capital and surplus necessary before the insurance commissioner in the respective state of domicile is authorized to take whatever regulatory actions considered necessary to protect the best interests of the policyholders and creditors of the insurer. The amount of restricted net assets represents the combined fair value of securities on deposit with governmental agencies for the insurance subsidiaries as required by law in various states in which the insurance subsidiaries of HMEC conduct business.

HMEC relies largely on dividends from its insurance subsidiaries to meet its obligations for payment of principal and interest on debt, dividends to shareholders and parent company operating expenses, including tax payments pursuant to tax sharing agreements. Payments for share repurchase programs also have this dependency. HMEC's insurance subsidiaries are subject to various regulatory restrictions which limit the amount of annual dividends or other distributions, including loans or cash advances, available to HMEC without prior approval of the insurance regulatory authorities. As a result, HMEC may not be able to receive dividends from such subsidiaries at times and in amounts necessary to pay desired dividends to shareholders. The aggregate amount of dividends that may be paid in 2019 from all of HMEC's insurance subsidiaries without prior regulatory approval is $90,700 thousand.

As disclosed in the reconciliation of the statutory capital and surplus of insurance subsidiaries to the consolidated GAAP shareholders' equity, the insurance subsidiaries have statutory capital and surplus of $903,564 thousand as of December 31, 2018, which is subject to regulatory restrictions.

At the time of this Annual Report on Form 10-K and during each of the years in the three year period ended December 31, 2018, the Company had no financial reinsurance agreements in effect.

NOTE 11 - Retirement Plans and Other Postretirement Benefits

The Company sponsors two qualified and three non-qualified retirement plans. Substantially all employees participate in the 401(k) plan. Both the qualified defined benefit plan and the two non-qualified supplemental defined benefit plans have been frozen since 2002. All participants in the frozen plans are 100% vested in their accrued benefit and all non-qualified supplemental defined benefit plan participants are receiving payments. Certain employees participate in a non-qualified defined contribution plan.

Qualified Plans

All employees participate in the 401(k) plan and receive a 100% vested 3% "safe harbor" company contribution based on employees' eligible earnings. The Company matches each dollar of employee contributions up to a 5% maximum — in addition to maintaining the automatic 3% "safe harbor" contribution. The matching company contribution vests after 5 years of service. The 401(k) plan is fully funded.

NOTE 11 - Retirement Plans and Other Postretirement Benefits-(Continued)

In 2002, participants ceased accruing benefits for earnings and years of service in the frozen defined benefit plan. A substantial number of those participants are former employees of the Company who are not eligible to receive an immediate annuity benefit until age 65 and/or are not eligible for a lump sum distribution. In August of 2016, the Company announced a cash-out election "window" ending in September 2016 for all vested terminated participants. During this window, 52 former employees elected to receive a total of approximately $1,400 thousand in lump sum distributions.

The Company's policy for the frozen defined benefit plan is to contribute to the plan amounts which are actuarially determined to provide sufficient funding to meet future benefit payments as defined by federal laws and regulations.

For the two qualified plans, all assets are held in their respective plan trusts.

Non-qualified Plans

The non-qualified plans were established for specific employees whose otherwise eligible earnings exceeded the statutory limits under the qualified plans. Benefit accruals under the non-qualified supplemental defined benefit plans were frozen in 2002 and all participants are currently in payment status. Both the non-qualified frozen supplemental defined benefit plans and the non-qualified contribution plan are unfunded plans with the Company's contributions made at the time payments are made to participants.

Total Expense and Contribution Plans' Information

Total expense recorded for the non-qualified defined contribution, 401(k), defined benefit and supplemental retirement plans was $8,851 thousand, $9,114 thousand and $8,527 thousand for the years ended December 31, 2018, 2017 and 2016, respectively.

Contributions to employees' accounts under the 401(k) plan and the non-qualified defined contribution plan, as well as total assets of the plans, were as follows:

($ in thousands)	**Year Ended December 31,**		
	2018	**2017**	**2016**
401(k) plan			
Contributions to employees' accounts	$ 7,655	$ 7,637	$ 6,918
Total assets at the end of the year	167,767	180,514	177,352
Non-qualified defined contribution plan			
Contributions to employees' accounts	70	84	72
Total assets at the end of the year	—	—	—

NOTE 11 - Retirement Plans and Other Postretirement Benefits-(Continued)

Defined Benefit Plan and Supplemental Retirement Plans

The following tables summarize the funded status of the defined benefit and supplemental retirement pension plans as of December 31, 2018, 2017 and 2016 (the measurement dates) and identify (1) the assumptions used to determine the projected benefit obligation and (2) the components of net pension cost for the defined benefit plan and supplemental retirement plans for the following periods:

($ in thousands)	Defined Benefit Plan			Supplemental Defined Benefit Plans		
	December 31,			December 31,		
	2018	2017	2016	2018	2017	2016
Change in benefit obligation:						
Projected benefit obligation at beginning of year	$ 28,432	$ 29,407	$ 31,233	$ 16,832	$ 16,847	$ 17,004
Service cost	650	650	650	—	—	—
Interest cost	947	1,091	1,244	566	631	687
Plan amendments	—	—	—	—	—	—
Actuarial loss (gain)	(2,208)	(721)	(220)	(789)	805	488
Benefits paid	(2,746)	(1,995)	(3,500)	(1,205)	(1,451)	(1,332)
Settlements	—	—	—	—	—	—
Projected benefit obligation at end of year	$ 25,075	$ 28,432	$ 29,407	$ 15,404	$ 16,832	$ 16,847
Change in plan assets:						
Fair value of plan assets at beginning of year	$ 25,843	$ 25,446	$ 27,667	$ —	$ —	$ —
Actual return on plan assets	(640)	2,909	1,766	—	—	—
Employer contributions	—	—	—	1,205	1,451	1,332
Benefits paid	(2,746)	(1,995)	(3,500)	(1,205)	(1,451)	(1,332)
Expenses paid	(367)	(517)	(487)	—	—	—
Settlements	—	—	—	—	—	—
Fair value of plan assets at end of year	$ 22,090	$ 25,843	$ 25,446	$ —	$ —	$ —
Funded status	$ (2,985)	$ (2,589)	$ (3,961)	$ (15,404)	$ (16,832)	$ (16,847)
Prepaid (accrued) benefit expense	$ 7,425	$ 8,016	$ 8,653	$ (10,320)	$ (10,648)	$ (11,210)
Total amount recognized in Consolidated Balance Sheets, all in Other liabilities	$ (2,985)	$ (2,589)	$ (3,961)	$ (15,404)	$ (16,832)	$ (16,847)
Amounts recognized in accumulated other comprehensive income (loss) (AOCI):						
Prior service cost	$ —	$ —	$ —	$ —	$ —	$ —
Net actuarial loss	10,410	10,605	12,613	5,084	6,184	5,637
Total amount recognized in AOCI	$ 10,410	$ 10,605	$ 12,613	$ 5,084	$ 6,184	$ 5,637
Information for pension plans with an accumulated benefit obligation greater than plan assets:						
Projected benefit obligation	$ 25,075	$ 28,432	$ 29,407	$ 15,404	$ 16,832	$ 16,847
Accumulated benefit obligation	25,075	28,432	29,407	15,404	16,832	16,847
Fair value of plan assets	22,090	25,843	25,446	—	—	—

NOTE 11 - Retirement Plans and Other Postretirement Benefits-(Continued)

The change in the Company's AOCI for the defined benefit plans for the year ended December 31, 2018 was primarily attributable to lower than expected asset returns and updates to mortality assumptions and an increase in the discount rate. The change in the Company's AOCI for the defined benefit plans for the year ended December 31, 2017 was primarily attributable to better than expected asset returns and updates to mortality assumptions partially offset by a decrease in the discount rate. The change in the Company's AOCI for the defined benefit plans for the year ended December 31, 2016 was primarily attributable to a decrease in the discount rate, partially offset by the performance of plan assets.

($ in thousands)	Defined Benefit Plan			Supplemental Defined Benefit Plans		
	Year Ended December 31,			Year Ended December 31,		
	2018	2017	2016	2018	2017	2016
Components of net periodic pension (income) expense:						
Service cost:						
Benefit accrual	$ —	$ —	$ —	$ —	$ —	$ —
Other expenses	650	650	650	—	—	—
Interest cost	947	1,091	1,244	566	631	687
Expected return on plan assets	(1,377)	(1,493)	(1,675)	—	—	—
Settlement loss	—	—	—	—	—	—
Amortization of:						
Prior service cost	—	—	—	—	—	—
Actuarial loss	371	389	393	310	258	233
Net periodic pension expense	$ 591	$ 637	$ 612	$ 876	$ 889	$ 920
Changes in plan assets and benefit obligations included in other comprehensive income (loss):						
Prior service cost	$ —	$ —	$ —	$ —	$ —	$ —
Net actuarial loss (gain)	177	(1,619)	175	(789)	805	488
Amortization of:						
Prior service cost	—	—	—	—	—	—
Actuarial loss	(371)	(389)	(393)	(310)	(258)	(233)
Total recognized in other comprehensive income (loss)	$ (194)	$ (2,008)	$ (218)	$ (1,099)	$ 547	$ 255
Weighted average assumptions used to determine expense:						
Discount rate	3.50%	3.90%	4.20%	3.50%	3.90%	4.20%
Expected return on plan assets	5.90%	6.25%	6.50%	*	*	*
Annual rate of salary increase	*	*	*	*	*	*
Weighted average assumptions used to determine benefit obligations as of December 31:						
Discount rate	4.20%	3.50%	3.90%	4.20%	3.50%	3.90%
Expected return on plan assets	5.90%	6.25%	6.50%	*	*	*
Annual rate of salary increase	*	*	*	*	*	*

* Not applicable.

NOTE 11 - Retirement Plans and Other Postretirement Benefits-(Continued)

The discount rates at December 31, 2018 were based on the average yield for long-term, high-grade securities available during the benefit payout period. To set its discount rate, the Company looks to leading indicators, including the Mercer Above Mean Yield Curve.

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.

The Company has an investment policy for the defined benefit pension plan that aligns the assets within the plan's trust to an approximate allocation of 50% equity and 50% fixed income funds. Management believes this allocation will produce the targeted long-term rate of return on assets necessary for payment of future benefit obligations, while providing adequate liquidity for payments to current beneficiaries. Assets are reviewed against the defined benefit pension plan's investment policy and the trustee has been directed to adjust invested assets at least quarterly to maintain the target allocation percentages.

Fair values of the equity security funds and fixed income funds have been determined from public quotations. The following table presents the fair value hierarchy for the Company's defined benefit pension plan assets, excluding cash held.

($ in thousands)		Fair Value Measurements at Reporting Date Using		
	Total	Level 1	Level 2	Level 3
December 31, 2018				
Asset category				
Equity security funds [1]				
United States	$ 8,198	$ —	$ 8,198	$ —
International	2,089	—	2,089	—
Fixed income funds	11,003	—	11,003	—
Short-term investment funds	800	800	—	—
Total	$ 22,090	$ 800	$ 21,290	$ —
December 31, 2017				
Asset category				
Equity security funds [1]				
United States	$ 10,517	$ —	$ 10,517	$ —
International	2,573	—	2,573	—
Fixed income funds	12,165	—	12,165	—
Short-term investments funds	588	588	—	—
Total	$ 25,843	$ 588	$ 25,255	$ —

[1] None of the trust fund assets for the defined benefit pension plan have been invested in shares of HMEC's common stock.

There were no Level 3 assets held during the years ended December 31, 2018 and 2017.

In 2019, the Company expects amortization of net losses of $310 thousand and $256 thousand for the defined benefit plan and the supplemental retirement plans, respectively, and expects no amortization of prior service cost for the supplemental retirement plans to be included in net periodic pension expense.

NOTE 11 - Retirement Plans and Other Postretirement Benefits-(Continued)

Postretirement Benefits Other than Pensions

As of December 31, 2006, upon discontinuation of retiree medical benefits, Health Reimbursement Accounts (HRAs) were established for eligible participants and totaled $7,310 thousand. As of December 31, 2018, the balance of the previously established HRAs was $1,438 thousand. Funding of HRAs was $88 thousand, $133 thousand and $218 thousand for the years ended December 31, 2018, 2017 and 2016, respectively.

2019 Contributions

In 2019, there is no minimum funding requirement for the Company's defined benefit plan. The following table discloses that minimum funding requirement and the expected full year contributions for the Company's plans.

($ in thousands)	Defined Benefit Pension Plans	
	Defined Benefit Plan	Supplemental Defined Benefit Plans
Minimum funding requirement for 2018	$ —	N/A
Expected contributions (approximations) for the year ended December 31, 2019 as of the time of this Form 10-K [1]	—	$ 1,307

N/A - Not applicable.

[1] HMEC's Annual Report on Form 10-K for the year ended December 31, 2018.

Estimated Future Benefit Payments

The Company's defined benefit plan may be subject to settlement accounting. Assumptions for both the number of individuals retiring in a calendar year and their elections regarding lump sum distributions are significant factors impacting the payout patterns for each of the plans below. Therefore, actual results could vary from the estimates shown. Estimated future benefit payments as of December 31, 2018 were as follows:

($ in thousands)	2019	2020	2021	2022	2023	2024-2028
Pension plans						
Defined benefit plan	$ 2,668	$ 2,482	$ 2,225	$ 2,346	$ 1,971	$ 8,700
Supplemental retirement plans	1,307	1,292	1,275	1,255	1,232	5,701

NOTE 12 - Contingencies and Commitments

Lawsuits and Legal Proceedings

Companies in the insurance industry have been subject to substantial litigation resulting from claims, disputes and other matters. For instance, they have faced expensive claims, including class action lawsuits, alleging, among other things, improper sales practices and improper claims settlement procedures. Negotiated settlements of certain such actions have had a material adverse effect on many insurance companies.

At the time of this Annual Report on Form 10-K, the Company does not have pending litigation from which there is a reasonable possibility of material loss.

NOTE 12 - Contingencies and Commitments - (Continued)

Assessments for Insolvencies of Unaffiliated Insurance Companies

The Company is contingently liable for possible assessments under regulatory requirements pertaining to potential insolvencies of unaffiliated insurance companies. Liabilities, which are established based upon regulatory guidance, have generally been insignificant.

Leases

The Company has entered into various operating lease agreements, primarily for real estate (claims and marketing offices in a few states) as well as for computer equipment and copier machines. Rental expenses were $2,794 thousand, $2,870 thousand and $2,546 thousand for the years ended December 31, 2018, 2017 and 2016, respectively. Future minimum lease payments under leases expiring subsequent to December 31, 2018 are as follows:

($ in thousands)	As of December 31, 2018						
	2019	2020	2021	2022	2023	2024-2028	2029 and beyond
Minimum operating lease payments	$ 2,580	$ 1,725	$ 1,200	$ 1,177	$ 483	$ —	$ —

Investment Commitments

From time to time, the Company has outstanding commitments to purchase investments and/or commitments to lend funds under bridge loans. Unfunded commitments to purchase investments were $145,445 thousand and $106,381 thousand for the years ended December 31, 2018 and 2017, respectively.

NOTE 13 - Supplementary Data on Cash Flows

A reconciliation of net income to net cash provided by operating activities as presented in the Consolidated Statements of Cash Flows is as follows:

($ in thousands)	Years Ended December 31,		
	2018	2017	2016
Cash flows from operating activities			
Net income	$ 18,343	$ 169,459	$ 83,765
Adjustments to reconcile net income to net cash provided by operating activities:			
Net investment (gains) losses	12,543	3,406	(4,123)
Increase in accrued investment income	4,449	(3,404)	(2,208)
Increase (decrease) in accrued expenses	(1,088)	(2,240)	4,378
Depreciation and amortization	7,357	6,615	6,896
Increase in insurance liabilities	197,472	154,061	176,315
Increase in premium receivables	(10,026)	(12,917)	(11,496)
Increase in deferred policy acquisition costs	(783)	(7,967)	(15,859)
(Increase) decrease in reinsurance recoverables	(21,317)	11	(481)
Increase (decrease) in income tax liabilities	5,971	(21,291)	(1,293)
Other	(12,033)	(29,147)	(24,461)
Total adjustments	182,545	87,127	127,668
Net cash provided by operating activities	$ 200,888	$ 256,586	$ 211,433

NOTE 14 - 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, primarily personal lines automobile and property insurance products; Retirement, primarily tax-qualified fixed and variable annuities; and Life, life insurance. The Company does not allocate the impact of corporate-level transactions to these operating 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 corporate debt service, net investment gains (losses) and certain public company expenses, such items also have included corporate debt retirement costs, when applicable.

The accounting policies of the segments are the same as those described in Note 1 — Summary of Significant Accounting Policies. The Company accounts for intersegment transactions, primarily the allocation of operating and agency costs from Corporate and Other to Property and Casualty, Retirement and Life, on a direct cost basis.

Summarized financial information for these segments is as follows:

($ in thousands)	Years Ended December 31,		
	2018	2017	2016
Insurance premiums and contract charges earned			
Property and Casualty	$ 665,734	$ 648,263	$ 620,514
Retirement	31,269	28,003	24,937
Life	120,330	118,437	113,695
Total	$ 817,333	$ 794,703	$ 759,146
Net investment income			
Property and Casualty	$ 40,104	$ 36,178	$ 38,998
Retirement	262,634	261,994	249,410
Life	74,399	76,195	73,567
Corporate and Other	142	78	66
Intersegment eliminations	(772)	(815)	(855)
Total	$ 376,507	$ 373,630	$ 361,186
Net income (loss)			
Property and Casualty	$ (14,243)	$ 17,790	$ 25,644
Retirement	41,736	88,473	50,674
Life	18,754	77,595	16,559
Corporate and Other	(27,904)	(14,399)	(9,112)
Total	$ 18,343	$ 169,459	$ 83,765

($ in thousands)	December 31,		
	2018	2017	2016
Assets			
Property and Casualty	$ 1,236,362	$ 1,217,394	$ 1,110,958
Retirement	7,866,969	8,063,912	7,449,777
Life	1,821,351	1,815,732	1,912,771
Corporate and Other	149,014	143,784	140,104
Intersegment eliminations	(41,800)	(42,482)	(36,786)
Total	$ 11,031,896	$ 11,198,340	$ 10,576,824

NOTE 14 - Segment Information

Additional significant financial information for these segments is as follows:

($ in thousands)	Years Ended December 31,		
	2018	2017	2016
DAC amortization expense			
Property and Casualty	$ 79,073	$ 76,967	$ 74,950
Retirement	23,186	17,759	14,635
Life	7,630	7,459	7,147
Total	$ 109,889	$ 102,185	$ 96,732
Income tax expense (benefit)			
Property and Casualty	$ (6,622)	$ (3,279)	$ 4,627
Retirement	10,000	(19,498)	20,334
Life	4,979	(51,876)	9,775
Corporate and Other	(7,163)	(6,119)	(4,269)
Total	$ 1,194	$ (80,772)	$ 30,467

NOTE 15 - Acquisitions

On October 30, 2018, the Company and Benefit Consultants Group, Inc. (BCG) entered into a Stock Purchase Agreement under which the Company acquired all of the outstanding capital stock of BCG for $25 million. The acquisition was approved by the Company's Board and closed on January 2, 2019.

On December 10, 2018, the Company and NTA Life Enterprises, LLC and Ellard Enterprises, Inc. (collectively, NTA) holding companies and their supplemental insurance subsidiaries entered into a Purchase Agreement under which the Company will acquire all of the equity interests in NTA for $405 million. The acquisition has been approved by the Company's Board and is expected to close in mid-2019, pending regulatory approvals and other customary closing conditions.

Note 16 - Unaudited Selected Quarterly Financial Data

Selected quarterly financial data is presented below.

($ in thousands, except per share data)	Three Months Ended			
	December 31,	September 30,	June 30,	March 31,
2018				
Insurance premiums written and contract deposits [1]	$ 311,216	$ 338,097	$ 301,722	$ 284,008
Total revenues	278,535	311,318	306,257	295,489
Net income (loss)	(20,257)	12,528	5,917	20,155
Per share information				
Basic				
Net income (loss)	$ (0.49)	$ 0.30	$ 0.14	$ 0.49
Shares of common stock - weighted average [2]	41,596	41,683	41,600	41,497
Diluted				
Net income (loss)	$ (0.49)	$ 0.30	$ 0.14	$ 0.48
Shares of common stock and equivalent shares - weighted average [2]	41,911	41,850	41,735	41,653
2017				
Insurance premiums written and contract deposits [1]	$ 300,416	$ 318,355	$ 311,614	$ 296,732
Total revenues	302,993	289,817	291,436	287,304
Net income	125,329	26,551	2,261	15,318
Per share information				
Basic				
Net income [3]	$ 3.03	$ 0.64	$ 0.05	$ 0.37
Shares of common stock - weighted average [2]	41,419	41,433	41,368	41,135
Diluted				
Net income [3]	$ 3.00	$ 0.64	$ 0.05	$ 0.37
Shares of common stock and equivalent shares - weighted average [2]	41,718	41,575	41,493	41,342
2016				
Insurance premiums written and contract deposits [1]	$ 315,917	$ 351,534	$ 311,879	$ 283,169
Total revenues	282,873	291,176	283,558	271,303
Net income	19,823	26,923	11,866	25,153
Per share information				
Basic				
Net income	$ 0.48	$ 0.66	$ 0.29	$ 0.61
Shares of common stock - weighted average [2]	41,093	41,092	41,082	41,297
Diluted				
Net income	$ 0.48	$ 0.65	$ 0.29	$ 0.61
Shares of common stock and equivalent shares - weighted average [2]	41,482	41,347	41,314	41,492

[1] This measure is not based on accounting principles generally accepted in the U.S. (non-GAAP). An explanation of this measure is contained in the Glossary of Selected Terms included as an exhibit in the Company's reports filed with the SEC.

[2] Rounded to thousands.

[3] For the three months ended December 31, 2017, net income per basic share of $3.03 and net income per diluted share of $3.00 benefited $2.39 and $2.37, respectively, from the Tax Act.