

ITEM 8. | Financial Statements and Supplementary Data

HORACE MANN EDUCATORS CORPORATION INDEX TO FINANCIAL INFORMATION

	<u>Page</u>
Report of Independent Registered Public Accounting Firm	67
Consolidated Balance Sheets	70
Consolidated Statements of Operations	71
Consolidated Statements of Comprehensive Income (Loss)	72
Consolidated Statements of Changes in Shareholders' Equity	73
Consolidated Statements of Cash Flows	74
Notes to Consolidated Financial Statements	75
Note 1 - Summary of Significant Accounting Policies	75
Note 2 - Acquisitions	90
Note 3 - Investments	91
Note 4 - Fair Value of Financial Instruments	97
Note 5 - Derivatives	103
Note 6 - Deposit Asset on Reinsurance	105
Note 7 - Goodwill and Intangible Assets, net	106
Note 8 - Property and Casualty Unpaid Claims and Claim Expenses	107
Note 9 - Reinsurance and Catastrophes	114
Note 10 - Debt	116
Note 11 - Income Taxes	117
Note 12 - Operating Leases	120
Note 13 - Shareholders' Equity and Common Stock Equivalents	121
Note 14 - Statutory Information and Restrictions	124
Note 15 - Retirement Plans and Other Postretirement Benefits	125
Note 16 - Contingencies and Commitments	130
Note 17 - Supplemental Disclosure of Consolidated Cash Flow Information	131
Note 18 - Segment Information	131
Note 19 - Unaudited Selected Quarterly Financial Data	134

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 2019, 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, 2019, 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, 2019 and 2018, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2019, 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, 2019, 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 February 28, 2020 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 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.

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current period audit of the consolidated financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Assessment of the estimate of fair value for hard-to-value fixed maturity securities

As discussed in Notes 1 and 4 to the consolidated financial statements, as of December 31, 2019, the Company has recorded an estimated fair value for fixed maturity securities, of which a portion represent securities that are

hard-to-value. This includes securities that use both level II (observable) and level III (unobservable) inputs in the estimation of fair value. The Company estimates the fair value of hard-to-value fixed maturity securities, which includes securities that do not have market observable prices or that trade infrequently. The Company uses judgment to determine the appropriate inputs and assumptions used to estimate the fair value of these hard-to-value securities. The significant inputs and assumptions include benchmark yields, liquidity premium, estimated cash flows, and prepayment and default speeds. As of December 31, 2019, the estimated fair value of fixed maturity securities was \$5,791.7 million.

We identified the assessment of the Company's estimate of the fair value of hard-to-value fixed maturity securities as a critical audit matter. Due to the significant measurement uncertainty associated with the fair value of such securities, there was a high degree of subjectivity and judgment in evaluating the fair value and certain related assumptions. Our assessment included evaluating the specific inputs and assumptions to which the estimate is most sensitive.

The primary procedures we performed to address this critical audit matter included the following. We tested certain internal controls over the Company's process to measure the fair value of hard-to-value securities. In addition, we tested internal controls over the Company's pricing assumptions and methodologies for hard-to-value fixed maturity securities. We involved valuation professionals with specialized skills and knowledge, who assisted in:

- Developing an independent range of fair value estimates using information from the Company, market data sources, models, and key assumptions for a selection of securities; and
- Comparing the Company's fair value estimates of hard-to-value securities to our independent range of fair value estimates for the same selection of securities.

Assessment of the estimate of property and casualty unpaid claims and claim expenses

As discussed in Notes 1 and 8 of the consolidated financial statements, the Company employs actuarial techniques to estimate the liability for property and casualty unpaid claims and claims expenses (reserves). The Company develops reserves based on the application of appropriate methods and assumptions to historical claim experience. The reserves are continually updated by the Company as experience develops and new information becomes known. The Company recorded an estimated liability of \$266.5 million for property and casualty unpaid claims and claim expenses as of December 31, 2019.

We identified the assessment of the estimate of reserves as a critical audit matter because it involved measurement uncertainty requiring complex auditor judgment. Complex auditor judgment and specialized skills and knowledge were required in evaluating the Company's methods and key assumptions, including the selection of loss development factors and changes in claim frequency and severity trends. The assumptions included a range of potential inputs and changes to these assumptions could affect the reserves recorded by the Company.

The primary procedures we performed to address this critical audit matter included the following. We tested certain internal controls over the Company's process for the development of the estimate of reserves, including controls over methods and assumptions used for the Company's best estimate. We also involved an actuarial professional with specialized skills and knowledge, who assisted in:

- Evaluating the Company's reserving methods, procedures, key assumptions and judgments by comparing to generally accepted actuarial standards;
- Developing an independent estimate of the reserves for certain lines of business;
- Examining the Company's internal actuarial analyses for certain remaining lines of business;
- Developing an independent range of reserves based on actuarial methodologies in order to evaluate the Company's recorded reserves; and
- Assessing any movement of the Company's recorded reserves within the range of reserves.

Assessment of the fair value of insurance contracts acquired in the National Teachers Association business combination

As discussed in Notes 1, 2, and 7 to the consolidated financial statements, on July 1, 2019, the Company acquired NTA Life Enterprises, LLC (NTA) in a business combination. As a result of the transaction, the Company acquired the assets and assumed the liabilities of NTA. The Company uses judgment to determine the appropriate assumptions used to estimate the fair value of the insurance contracts, consisting of the value of business acquired (VOBA) and insurance policy reserves, and the future business to be written by the existing distribution channel (VODA). The acquisition-date balance was \$94.4 million, \$366.8 million and \$49.0 million for VOBA, insurance policy reserves, and VODA, respectively.

We identified the assessment of the fair value of the insurance contracts acquired, consisting of VOBA and insurance policy reserves, and VODA, as a critical audit matter. There was a high degree of subjective auditor judgment in evaluating the valuation methods and certain assumptions used to estimate the fair value of the insurance contracts, consisting of VOBA and insurance policy reserves, and VODA. Changes in certain assumptions, specifically morbidity and discount rate, could affect the fair value of the balances recorded by the Company. Specialized skills and knowledge were required to assess the valuation methods, models, and assumptions used to estimate fair value.

The primary procedures we performed to address this critical audit matter included the following. We tested certain internal controls over the Company's acquisition-date valuation process to develop the key assumptions as well as the valuation methods and models used to estimate the fair value of the insurance contracts, consisting of VOBA and insurance policy reserves, and VODA.

We involved actuarial professionals with specialized skills and knowledge, who assisted in:

- Evaluating the valuation methods, models, and assumptions used to estimate the fair value of the insurance contracts, consisting of VOBA and insurance policy reserves, and VODA, in light of the generally accepted actuarial standards;
- Performing independent estimates of insurance policy reserves using the Company's policy data and assumptions for a selection of policies; and
- Assessing the morbidity and discount rate assumptions in light of NTA's historical experience as well as industry trends.

We involved valuation professionals with specialized skills and knowledge, who assisted in:

- Comparing the Company's discount rate, to a discount rate that was independently developed using publicly available market data for comparable entities; and
- Comparing the estimated fair value of VODA to an independent estimate derived using a multi-period excess earnings method under the income approach based on NTA's forecasted business production.

KPMG LLP
KPMG LLP

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

Chicago, Illinois

February 28, 2020

HORACE MANN EDUCATORS CORPORATION
CONSOLIDATED BALANCE SHEETS
As of December 31, 2019 and 2018
(\$ in thousands, except share data)

	December 31,	
	2019	2018
ASSETS		
Investments		
Fixed maturity securities, available for sale, at fair value (amortized cost 2019, \$5,456,980; 2018, \$7,373,911)	\$ 5,791,676	\$ 7,515,318
Equity securities at fair value	101,864	111,750
Limited partnership interests	383,717	328,516
Short-term and other investments	361,976	295,093
Total investments	6,639,233	8,250,677
Cash	25,508	11,906
Deferred policy acquisition costs	276,668	298,742
Deposit asset on reinsurance	2,346,166	—
Intangible assets, net	177,217	—
Goodwill	49,079	47,396
Other assets	474,364	422,047
Separate Account (variable annuity) assets	2,490,469	2,001,128
Total assets	<u>\$ 12,478,704</u>	<u>\$ 11,031,896</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Policy liabilities		
Investment contract and policy reserves	\$ 6,234,452	\$ 5,711,193
Unpaid claims and claim expenses	442,854	396,714
Unearned premiums	279,163	276,225
Total policy liabilities	6,956,469	6,384,132
Other policyholder funds	647,283	767,988
Other liabilities	384,173	290,358
Short-term debt	135,000	—
Long-term debt	298,025	297,740
Separate Account (variable annuity) liabilities	2,490,469	2,001,128
Total liabilities	10,911,419	9,741,346
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, 2019, 66,088,808; 2018, 65,820,369	66	66
Additional paid-in capital	480,962	475,109
Retained earnings	1,352,539	1,216,582
Accumulated other comprehensive income (loss), net of tax:		
Net unrealized investment gains on fixed maturity securities	230,448	96,941
Net funded status of benefit plans	(10,767)	(12,185)
Treasury stock, at cost, 2019, 24,850,484 shares; 2018, 24,850,484 shares	(485,963)	(485,963)
Total shareholders' equity	1,567,285	1,290,550
Total liabilities and shareholders' equity	<u>\$ 12,478,704</u>	<u>\$ 11,031,896</u>

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,		
	2019	2018	2017
Revenues			
Insurance premiums and contract charges earned	\$ 897,954	\$ 817,333	\$ 794,703
Net investment income	365,064	376,507	373,630
Net investment gains (losses)	153,340	(12,543)	(3,406)
Other income	14,127	10,302	6,623
Total revenues	1,430,485	1,191,599	1,171,550
Benefits, losses and expenses			
Benefits, claims and settlement expenses	585,068	637,560	582,306
Interest credited	212,786	206,199	198,635
Operating expenses	234,609	205,413	187,789
DAC unlocking and amortization expense	109,181	109,889	102,185
Intangible asset amortization expense	8,790	—	—
Interest expense	15,577	13,001	11,948
Other expense - goodwill impairment	28,025	—	—
Total benefits, losses and expenses	1,194,036	1,172,062	1,082,863
Income before income taxes	236,449	19,537	88,687
Income tax expense (benefit)	52,006	1,194	(80,772)
Net income	\$ 184,443	\$ 18,343	\$ 169,459
Net income per share			
Basic	\$ 4.42	\$ 0.44	\$ 4.10
Diluted	\$ 4.40	\$ 0.44	\$ 4.08
Weighted average number of shares and equivalent shares			
Basic	41,737,876	41,570,492	41,364,546
Diluted	41,948,531	41,894,232	41,564,979
Net investment gains (losses)			
Total other-than-temporary impairment losses on securities	\$ (1,380)	\$ (1,530)	\$ (12,620)
Portion of losses recognized in other comprehensive income (loss)	—	—	—
Net other-than-temporary impairment losses on securities recognized in earnings	(1,380)	(1,530)	(12,620)
Sales and other, net	151,495	3,491	7,756
Change in fair value - equity securities	7,308	(18,323)	—
Change in fair value and gains realized on settlements - derivatives	(4,083)	3,819	1,458
Total	\$ 153,340	\$ (12,543)	\$ (3,406)

See accompanying Notes to Consolidated Financial Statements.

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

	Year Ended December 31,		
	2019	2018	2017
Comprehensive income (loss)			
Net income	\$ 184,443	\$ 18,343	\$ 169,459
Other comprehensive income (loss), net of tax:			
Change in net unrealized investment gains (losses) on securities	133,507	(188,195)	74,405
Change in net funded status of benefit plans	1,418	1,032	734
Cumulative effect of change in accounting principle	—	(15,041)	—
Other comprehensive income (loss)	134,925	(202,204)	75,139
Total	<u>\$ 319,368</u>	<u>\$ (183,861)</u>	<u>\$ 244,598</u>

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,		
	2019	2018	2017
Common stock, \$0.001 par value			
Beginning balance	\$ 66	\$ 65	\$ 65
Options exercised	—	—	—
Conversion of common stock units	—	—	—
Conversion of restricted common stock units	—	1	—
Ending balance	66	66	65
Additional paid-in capital			
Beginning balance	475,109	464,246	453,479
Options exercised and conversion of common stock units and restricted stock units	(555)	3,008	2,962
Share-based compensation expense	6,408	7,855	7,805
Ending balance	480,962	475,109	464,246
Retained earnings			
Beginning balance	1,216,582	1,231,177	1,155,732
Net income	184,443	18,343	169,459
Dividends, 2019, \$1.15 per share; 2018, \$1.14 per share; 2017, \$1.10 per share	(48,486)	(47,979)	(46,114)
Reclassification of deferred taxes	—	—	(47,900)
Cumulative effect of change in accounting principle	—	15,041	—
Ending balance	1,352,539	1,216,582	1,231,177
Accumulated other comprehensive income (loss), net of tax:			
Beginning balance	84,756	286,960	163,921
Change in net unrealized investment gains (losses) on securities	133,507	(188,195)	74,405
Change in net funded status of benefit plans	1,418	1,032	734
Reclassification of deferred taxes	—	—	47,900
Cumulative effect of change in accounting principle	—	(15,041)	—
Ending balance	219,681	84,756	286,960
Treasury stock, at cost			
Beginning balance	(485,963)	(480,875)	(479,215)
Acquisition of shares	—	(5,088)	(1,660)
Ending balance	(485,963)	(485,963)	(480,875)
Shareholders' equity at end of period	<u>\$ 1,567,285</u>	<u>\$ 1,290,550</u>	<u>\$ 1,501,573</u>

See accompanying Notes to Consolidated Financial Statements.

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

	Year Ended December 31,		
	2019	2018	2017
Cash flows from operating activities			
Net income	\$ 184,443	\$ 18,343	\$ 169,459
Adjustments to reconcile net income to net cash provided by operating activities:			
Net investment (gains) losses	(153,340)	12,543	3,406
Amortization of premiums and accretion of discounts on fixed maturity securities, net	3,806	(10,095)	(13,385)
Depreciation and intangible asset amortization	15,629	7,357	6,615
Share-based compensation expense	7,338	8,346	8,592
Other expense - goodwill impairment	28,025	—	—
Changes in:			
Accrued investment income	46,858	4,449	(3,404)
Insurance liabilities	(96,802)	203,370	119,311
Premium receivables	(5,031)	(10,026)	(12,917)
Deferred policy acquisition costs	(1,274)	(783)	(7,967)
Reinsurance recoverables	22,006	(21,317)	11
Income tax liabilities	28,726	(3,383)	(4,620)
Other operating assets and liabilities	53,406	(2,048)	(1,692)
Other	(6,217)	(5,868)	(6,823)
Net cash provided by operating activities	<u>127,573</u>	<u>200,888</u>	<u>256,586</u>
Cash flows from investing activities			
Fixed maturity securities			
Purchases	(1,058,747)	(1,428,889)	(1,569,220)
Sales	805,887	625,527	500,760
Maturities, paydowns, calls and redemptions	799,526	737,535	927,665
Equity securities			
Purchases	(15,583)	(13,430)	(32,312)
Sales and repayments	33,502	25,498	53,100
Limited partnership interests			
Purchases	(129,389)	(93,545)	(103,200)
Sales	91,587	16,997	20,234
Change in short-term and other investments, net	(49,325)	(56,192)	(25,691)
Acquisition of businesses, net of cash acquired	(421,516)	—	—
Net cash provided by (used in) investing activities	<u>55,942</u>	<u>(186,499)</u>	<u>(228,664)</u>
Cash flows from financing activities			
Dividends paid to shareholders	(47,333)	(46,689)	(46,114)
Principal borrowings on senior revolving credit facility	135,000	—	—
FHLB borrowings	—	—	50,000
Acquisition of treasury stock	—	(5,088)	(1,660)
Proceeds from exercise of stock options	1,730	3,627	4,190
Withholding tax payments on RSUs tendered	(3,680)	(3,165)	(3,245)
Annuity contracts: variable, fixed and FHLB funding agreements			
Deposits	637,538	489,097	453,146
Benefits, withdrawals and net transfers to Separate Account	(419,001)	(473,003)	(411,061)
Principal repayment on FHLB funding agreements	(305,005)	—	—
Transfer of Company 401(k) to a third-party provider	—	—	(77,898)
Life policy accounts			
Deposits	9,391	8,149	4,883
Withdrawals and surrenders	(3,558)	(4,910)	(4,458)
Change in deposit asset on reinsurance, net	(150,434)	—	—
Change in book overdrafts	(24,561)	21,872	(4,748)
Net cash used in financing activities	<u>(169,913)</u>	<u>(10,110)</u>	<u>(36,965)</u>
Net increase (decrease) in cash	13,602	4,279	(9,043)
Cash and restricted cash at beginning of period	11,906	7,627	16,670
Cash and restricted cash at end of period	<u>\$ 25,508</u>	<u>\$ 11,906</u>	<u>\$ 7,627</u>

See accompanying Notes to Consolidated Financial Statements.

HORACE MANN EDUCATORS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019, 2018 and 2017

NOTE 1 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying audited consolidated financial statements of Horace Mann Educators Corporation and its wholly-owned subsidiaries (HMEC; and together with its subsidiaries, the Company or Horace Mann) 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.

Effective for the year ended December 31, 2019, the Company decided to change the approach it uses for presentation in its Consolidated Statements of Cash Flows from the direct method to the indirect method as management considers presentation under the indirect method as more comparable to the method used by others in the insurance industry. Accordingly, the Company has recast all prior periods presented in the Consolidated Statements of Cash Flows to conform to the current year's presentation.

The consolidated financial statements include the accounts of HMEC and its wholly-owned subsidiaries. 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 (with exception of National Teachers Associates Life Insurance Company and NTA Life Insurance Company of New York) 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), supplemental insurance products (primarily heart, cancer, accident and limited supplemental disability coverages), 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, Horace Mann Lloyds, National Teachers Associates Life Insurance Company and NTA Life Insurance Company of New York.

As described more fully in Note 2, the Company acquired NTA Life Enterprises, LLC (NTA) on July 1, 2019. As a result, the Company's reporting segments have changed effective in the third quarter of 2019. A new reporting segment titled "Supplemental" was added to report on the personal lines of supplemental insurance products (primarily heart, cancer, accident and limited short-term supplemental disability coverages) that are marketed and underwritten by NTA.

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.

Cash

Cash reported on the Consolidated Balance Sheet at December 31, 2019 includes restricted cash in the amount of \$0.3 million, representing funds held in segregated accounts for insurance premiums to be remitted to insurance companies on behalf of the Company's customers or for the purpose of reimbursement to cafeteria plan participants.

NOTE 1 - Summary of Significant Accounting Policies (continued)

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, of which a portion represent securities that are hard-to-value.

The fair value of a fixed maturity security is the estimated amount at which the security could be exchanged in an orderly transaction between knowledgeable, unrelated and willing parties. 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, bids, offers, benchmark yield curves, benchmarking of like securities, rating designations, sector groupings, issuer spreads, and/or estimated cash flows, prepayment and default speeds, among others. 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 94.1% of the portfolio, based on fair value, was priced through pricing services or index priced using observable inputs as of December 31, 2019.

The valuation of hard-to-value fixed maturity securities (generally 100 -150 securities) is more subjective because the markets are less liquid and there is a lack of observable market-based inputs. This may increase the potential that the estimated fair value of an investment is not reflective of the price at which an actual transaction would occur. When the pricing sources cannot provide fair value determinations, the investment managers and custodian bank obtain non-binding price quotes from broker-dealers. 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 selection of the market inputs and assumptions used to estimate the fair value of hard-to-value fixed maturity securities require judgment and include: benchmark yield, liquidity premium, estimated cash flows, prepayment and default speeds, spreads, weighted average life, and credit rating. The extent of the use of each market input depends on the market sector and 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.

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 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 commercial mortgage loans, infrastructure, corporate credit, private equity, real estate 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; derivatives, 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 interests in variable interest entities (VIEs), including corporate securities, mortgage-backed securities and asset-backed securities. Such interests in VIEs have been reviewed and the Company determined that those VIEs are not subject to consolidation as the Company is not the primary beneficiary because it does not have the power to direct the activities that most significantly impact those VIEs' economic performance.

NOTE 1 - Summary of Significant Accounting Policies (continued)

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, 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 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 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 to be collected. If a cash flow analysis estimate is not feasible, then the market's view of cash

NOTE 1 - Summary of Significant Accounting Policies (continued)

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 Company'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 revenue bonds, which present unique considerations in evaluating OTTI, but also includes general obligation bonds. The Company evaluates 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.

NOTE 1 - Summary of Significant Accounting Policies (continued)

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 deferred policy acquisition costs (DAC) by reporting segment was as follows:

(\$ in thousands)	December 31,	
	2019	2018
Property and Casualty	\$ 28,616	\$ 30,033
Supplemental	1,967	N/A
Retirement (annuity)	185,294	209,231
Life	60,791	59,478
Total	\$ 276,668	\$ 298,742

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 property and casualty policies, DAC is amortized over the terms of the insurance policies (6 or 12 months). For supplemental policies, DAC is amortized in proportion to anticipated premiums over the terms of the insurance policies (approximately 6 years, based on an estimated average duration across all supplemental products). 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) products. 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).

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 an 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.

The most significant assumptions that are involved in the estimation of supplemental gross profits include morbidity, persistency, expenses and interest rates expected to be received on investments. When a supplemental policy lapses, there is 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.

Annually, the Company performs a gross premium valuation on life insurance and supplemental policies to assess whether a loss recognition event has occurred. This involves discounting expected future benefits and expenses less expected future premiums. To the extent that this amount is greater than the liability for future benefits less the DAC asset, in aggregate for the life insurance or the supplemental block, a loss would be recognized by first writing off the DAC and then increasing the liability.

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,		
	2019	2018	2017
Increase (decrease) to DAC amortization expense:			
Retirement	\$ 3,480	\$ 3,948	\$ 1,081
Life	(267)	283	(200)
Total	\$ 3,213	\$ 4,231	\$ 881

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 \$41.2 million and \$17.9 million at December 31, 2019 and 2018, 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 that 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, 2019, 2018 and 2017.

Intangible Assets

The value of business acquired (VOBA) represents the difference between the fair value of insurance contracts and insurance policy reserves measured in accordance with the Company's accounting policies for insurance contracts acquired. VOBA was based on an actuarial estimate of the present value of future distributable earnings for insurance in force on the acquisition date. VOBA was \$90.7 million as of December 31, 2019 and is being amortized by product based on the present value of future premiums to be received. The Company estimates that it will recognize VOBA amortization of \$7.1 million in 2020, \$6.7 million in 2021, \$6.2 million in 2022, \$5.8 million in 2023 and \$5.4 million in 2024.

The Company accounts for the value of distribution acquired (VODA) associated with the acquisition of NTA based on an actuarial estimate of the present value of future business to be written by the existing distribution channel. VODA was \$47.5 million as of December 31, 2019 and is being amortized on a straight-line basis. The Company estimates that it will recognize VODA amortization of \$2.9 million in each of the years 2020 through 2024, respectively.

The Company accounts for VODA associated with the acquisition of Benefit Consultants Group, Inc. (BCG) based on management's estimate of the present value of future business to be written by the existing distribution channel. VODA was \$4.6 million as of December 31, 2019 and is being amortized based on the present value of future profits to be received. The Company estimates that it will recognize VODA amortization of \$0.4 million in each of the years 2020 through 2024, respectively.

The Company accounts for the value of agency relationships based on the present value of commission overrides retained by NTA. Agency relationships was \$15.5 million as of December 31, 2019 and is being amortized based on the present value of future premiums to be received. The Company estimates that it will recognize agency relationships amortization of \$2.6 million in 2020, \$2.2 million in 2021, \$1.9 million in 2022, \$1.6 million in 2023 and \$1.4 million in 2024.

The Company accounts for the value of customer relationships based on the present value of expected profits from existing BCG customers in force at the date of acquisition. Customer relationships was \$7.3 million as of December 31, 2019 and is being amortized based on the present value of future profits to be received. The Company estimates that it will recognize customer relationships amortization of \$1.5 million in 2020, \$1.2 million in 2021, \$1.0 million in 2022, \$0.9 million in 2023 and \$0.7 million in 2024.

Trade names represents the present value of future savings accruing to NTA and BCG by virtue of not having to pay royalties for the use of the trade names, valued using the relief from royalty method. State licenses

NOTE 1 - Summary of Significant Accounting Policies (continued)

represents the regulatory licenses held by NTA that were valued using the cost approach. Both trade names and state licenses are indefinite-lived intangibles that are not subject to amortization.

VOBA 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 year ended December 31, 2019.

Amortizing intangible assets (i.e., VODA, agency relationships and customer relationships) are tested for recoverability whenever events or changes in circumstances indicate that its carrying value may not be recoverable. The carrying amount of an amortizing intangible asset is not recoverable if it exceeds the sum of undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the carrying value is not recoverable from undiscounted cash flows, the impairment is measured as the difference between the carrying value and fair value.

Intangible assets that are not subject to amortization (i.e., trade names and state licenses) are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test consists of a comparison of the fair value of an intangible asset with its carrying value. If the carrying value of an intangible asset that is not subject to amortization exceeds its fair value, an impairment loss is to be recognized in an amount equal to that excess.

Goodwill

When the Company was acquired from CIGNA Corporation by HME Holdings, Inc. in 1989, intangible assets were recognized as goodwill in the application of purchase accounting. In addition, goodwill was recognized in 1994 related to the acquisition of Horace Mann Property & Casualty Insurance Company and in 2019 related to the acquisitions of BCG and NTA.

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. Refer to Note 7 for the allocation of goodwill by reporting unit as of December 31, 2019.

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 value. If an entity determines it is more likely than not that the fair value of a reporting unit is less than its carrying value, then the entity performs a quantitative goodwill impairment test by comparing the fair value of a reporting unit to its carrying value for purposes of confirming and measuring an impairment. In the second quarter of 2019, the Company adopted guidance to eliminate Step 2 of the goodwill impairment test. Goodwill impairment is now the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. Any amount of goodwill determined to be impaired will be recognized as an expense in the period in which the impairment determination is made.

As of October 1, 2019, the Company performed a qualitative assessment to determine whether it was necessary to perform a quantitative goodwill impairment test. Based on the assessment of qualitative factors, there were no events or circumstances that lead to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying value.

During each year from 2017 through 2019, the Company completed the required annual goodwill impairment testing. With exception to the goodwill impairment charge described in Note 7, no other goodwill 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 value. 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,	
	2019	2018
Property and equipment	\$ 166,583	\$ 142,243
Less: accumulated depreciation	106,458	101,267
Total	<u>\$ 60,125</u>	<u>\$ 40,976</u>

Separate Account (Variable Annuity) Assets and Liabilities

Separate Account assets represent variable annuity contractholder funds invested in various mutual funds. The Separate Account assets comprise actively traded mutual funds that have daily quoted net asset values that are readily determinable for identical assets that the Company can access. Net asset values for the actively traded mutual funds in which the Separate Account assets are invested are obtained daily from the fund managers. 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 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 the amortization of DAC. 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 Policy Reserves

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

(\$ in thousands)	December 31,	
	2019	2018
Investment contract reserves	\$ 4,675,774	\$ 4,555,856
Policy reserves	1,558,678	1,155,337
Total	<u>\$ 6,234,452</u>	<u>\$ 5,711,193</u>

Liabilities for future benefits on supplemental, 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 supplemental and life insurance policies are computed using the net level premium method including assumptions as to investment yields, mortality, morbidity, 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.

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.

NOTE 1 - Summary of Significant Accounting Policies (continued)

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,	
	2019	2018
GMDB reserve	\$ 126	\$ 258
Aggregate in-the-money death benefits under the GMDB provision	29,367	48,083
Variable annuity contract value distribution based on GMDB feature:		
No guarantee	28%	30%
Return of premium guarantee	67%	65%
Guarantee of premium roll-up at an annual rate of 3% or 5%	5%	5%
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 4 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

NOTE 1 - Summary of Significant Accounting Policies (continued)

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 payout annuity 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.

FHLB Funding Agreements

In 2013, Horace Mann Life Insurance Company (HMLIC), and in 2019, NTA became members of FHLB, which provides both subsidiaries 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. In 2019, HMEC's Board of Directors (Board) authorized a maximum amount equal to 15% of net aggregate admitted assets less separate account assets of the insurance subsidiaries for FHLB advances and funding agreements combined. In 2019, HMLIC received an additional \$175.0 million from FHLB under funding agreements as well as repaid FHLB \$305.0 million of principal. Outstanding advances under funding agreements are reported as Other policyholder funds in the Consolidated Balance Sheets and totaled \$495.0 million as of December 31, 2019 of which \$125.0 million matures on September 11, 2020, \$20.0 million matures on November 15, 2023, \$100.0 million matures on December 15, 2023, \$50.0 million matures on January 12, 2024 and the remaining \$200.0 million matures on January 16, 2026. Interest on the funding agreements accrues at an annual weighted average rate of 1.87% as of December 31, 2019.

Reinsurance

The Company enters into reinsurance arrangements pursuant to which it cedes certain insurance risks to unaffiliated reinsurers. Cessions under reinsurance agreements do not discharge the Company's obligations as the primary insurer. The accounting for reinsurance arrangements depends on whether the arrangement provides indemnification against loss or liability relating to insurance risk in accordance with GAAP.

If the Company determines that a reinsurance agreement exposes the reinsurer to a reasonable possibility of a significant loss from insurance risk, the ceded unearned premiums and reinsurance balances recoverable on paid and unpaid losses and settlement expenses are reported separately as assets, instead of being netted with the related liabilities, since reinsurance does not relieve the Company of its legal liability to its policyholders. See Note 9 for further details.

If the Company determines that a reinsurance agreement does not expose the reinsurer to a reasonable possibility of a significant loss from insurance risk, the Company recognizes the reinsurance agreement using the deposit method of accounting. The assets transferred to the reinsurer as consideration paid is reported as a Deposit asset on reinsurance on the Company's Consolidated Balance Sheet. As amounts are received or paid or received, consistent with the underlying reinsured contracts, the Deposit asset on reinsurance is adjusted. The Deposit asset on reinsurance is accreted to the estimated ultimate cash flows using the interest method and the adjustment is reported as Net investment income. See Note 6 for further details.

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 and supplemental policies are recognized as revenues when due over the premium-paying

NOTE 1 - Summary of Significant Accounting Policies (continued)

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 13.

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, 2019, 2018 and 2017, the Company recognized \$1.2 million, \$1.2 million, and \$1.3 million, respectively, of stock option expense as a result of the vesting of stock options during the respective periods. For the years ended December 31, 2019, 2018 and 2017, the Company recognized \$5.2 million, \$6.6 million and \$6.5 million, respectively, in RSU expense as a result of the performance and/or vesting of RSUs during the respective periods.

In 2019, 2018 and 2017, 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,		
	2019	2018	2017
Number of stock options granted	282,040	223,208	222,828
Weighted average grant date fair value of stock options granted	\$ 6.26	\$ 7.16	\$ 6.57
Weighted average assumptions:			
Risk-free interest rate	2.5%	2.6%	2.0%
Expected dividend yield	2.9%	2.6%	2.5%
Expected life, in years	5.0	4.8	4.9
Expected volatility (based on historical volatility)	21.9%	21.5%	21.4%

The weighted average fair value of nonvested stock options outstanding on December 31, 2019 was \$6.42. Total unrecognized compensation expense relating to the nonvested stock options outstanding as of December 31, 2019 was approximately \$2.4 million. This amount will be recognized as expense over the remainder of the vesting period, which is scheduled to be 2020 through 2023. 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, 2019 was approximately \$6.6 million. This amount will be recognized as expense over the remainder of the performance and/or vesting period, which is scheduled to be 2020 through 2022. 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, 2019, 2018 and 2017 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 13.

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,		
	2019	2018	2017
Basic:			
Net income for the period	\$ 184,443	\$ 18,343	\$ 169,459
Weighted average number of common shares during the period (in thousands)	41,738	41,570	41,365
Net income per share - basic	<u>\$ 4.42</u>	<u>\$ 0.44</u>	<u>\$ 4.10</u>
Diluted:			
Net income for the period	\$ 184,443	\$ 18,343	\$ 169,459
Weighted average number of common shares during the period (in thousands)	41,738	41,570	41,365
Weighted average number of common equivalent shares to reflect the dilutive effect of common stock equivalent securities (in thousands):			
Stock options	79	100	112
CSUs related to deferred compensation for employees	—	25	25
RSUs related to incentive compensation	132	199	63
Total common and common equivalent shares adjusted to calculate diluted earnings per share (in thousands)	41,949	41,894	41,565
Net income per share - diluted	<u>\$ 4.40</u>	<u>\$ 0.44</u>	<u>\$ 4.08</u>

Options to purchase 622,500 shares of common stock at \$38.05 to \$44.75 per share were granted in 2017, 2018 and 2019 but were not included in the computation of 2019 diluted earnings per share because of their anti-dilutive effect. These options, which expire in 2027, 2028 and 2029, were still outstanding at December 31, 2019.

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,		
	2019	2018	2017
Net income	\$ 184,443	\$ 18,343	\$ 169,459
Other comprehensive income (loss):			
Change in net unrealized investment gains (losses) on securities:			
Net unrealized investment gains (losses) on securities arising during the period	327,363	(275,094)	105,475
Less: reclassification adjustment for net investment gains (losses) included in income before income tax	157,423	(16,363)	(4,863)
Total, before tax	169,940	(258,731)	110,338
Income tax expense (benefit)	36,433	(55,495)	35,933
Total, net of tax	133,507	(203,236)	74,405
Change in net funded status of benefit plans:			
Before tax	1,805	1,294	1,461
Income tax expense	387	262	727
Total, net of tax	1,418	1,032	734
Total comprehensive income (loss)	\$ 319,368	\$ (183,861)	\$ 244,598

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, 2019	\$ 96,941	\$ (12,185)	\$ 84,756
Other comprehensive income (loss) before reclassifications	257,871	1,418	259,289
Amounts reclassified from AOCI	(124,364)	—	(124,364)
Net current period other comprehensive income (loss)	133,507	1,418	134,925
Ending balance, December 31, 2019	<u>\$ 230,448</u>	<u>\$ (10,767)</u>	<u>\$ 219,681</u>
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	<u>\$ 96,941</u>	<u>\$ (12,185)</u>	<u>\$ 84,756</u>
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	<u>\$ 300,177</u>	<u>\$ (13,217)</u>	<u>\$ 286,960</u>

⁽¹⁾ All amounts are net of tax.

⁽²⁾ The pretax amounts reclassified from AOCI, \$157.4 million, \$(16.4) million and \$(4.9) million, are included in net investment gains (losses) and the related tax expenses, \$33.1 million, \$(3.4) million and \$(1.7) million, are included in income tax expense in the Consolidated Statements of Operations for the years ended December 31, 2019, 2018 and 2017, 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 of 2017 (TCJA). 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 TCJA. 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 \$47.9 million; representing the stranded deferred tax liabilities of \$50.0 million and \$(2.1) million 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 \$15.0 million 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 3.

Statements of Cash Flows

For purposes of the Consolidated Statements of Cash Flows, cash constitutes cash on deposit at banks as well as restricted cash. See Note 17 for further information.

NOTE 1 - Summary of Significant Accounting Policies (continued)

Adopted Accounting Standards

Accounting for Leases

Effective for the quarter ended March 31, 2019, the Company adopted guidance for leases and elected to utilize a cumulative-effect adjustment to the opening balance of retained earnings. Accordingly, the Company's reporting for the comparative periods prior to adoption continues to be presented in the financial statements in accordance with previous lease accounting guidance. The Company elected to apply all practical expedients in the guidance for transition for leases in effect at adoption, including using hindsight to determine the lease term of existing leases, the option to not reassess whether an existing contract is a lease or contains a lease and whether the lease is an operating or finance lease. The adoption of the guidance resulted in the Company recognizing a \$14.5 million lease liability equal to the present value of lease payments and a \$13.9 million right-of-use (ROU) asset, which is the corresponding lease liability adjusted for qualifying accrued lease payments. The lease liability and ROU asset are reported in Other liabilities and Other assets on the Consolidated Balance Sheets. The impact of these changes at adoption had no impact on net income or shareholders' equity.

Simplifying the Test for Goodwill Impairment

Effective for the quarter ended June 30, 2019, the Company adopted guidance to simplify the accounting for goodwill impairment. Adoption of this guidance removed Step 2 of the goodwill impairment test, which required a hypothetical purchase price allocation. Goodwill impairment is now the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill.

Pending Accounting Standards

Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued guidance which revises the credit loss recognition criteria for certain financial assets measured at amortized cost, including reinsurance recoverables. The new guidance replaces the existing incurred loss recognition model with an expected loss recognition model. The objective of the expected credit loss model is for a reporting entity to recognize its estimate of expected credit losses for affected financial assets in a valuation allowance that when deducted from the amortized cost basis of the related financial assets results in a net carrying value at the amount expected to be collected. A reporting entity must consider all relevant information available when estimating expected credit losses, including details about past events, current conditions, and reasonable and supportable forecasts over the life of an asset. Financial assets may be evaluated individually or on a pooled basis when they share similar risk characteristics. The measurement of credit losses for available-for-sale debt securities measured at fair value is not affected except that credit losses recognized are limited to the amount by which fair value is below amortized cost and the carrying value adjustment is recognized through a valuation allowance which may change over time but once recorded cannot subsequently be reduced to an amount below zero. The guidance is effective for reporting periods beginning after December 15, 2019, and for most affected instruments must be adopted using a modified retrospective approach, with a cumulative effect adjustment recorded to beginning retained earnings.

The Company's implementation activities are substantially complete and the impacts relate primarily to the Company's commercial mortgage portfolio, property and casualty reinsurance recoverables and off-balance-sheet credit exposures for unfunded commercial mortgage loan commitments. The Company adopted the new guidance on January 1, 2020 and recognized a cumulative effect adjustment that decreased retained earnings by an insignificant amount.

Accounting for Long-Duration Insurance Contracts

In August 2018, the FASB issued accounting and disclosure guidance that contains targeted improvements 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

NOTE 1 - Summary of Significant Accounting Policies (continued)

entities, the guidance is effective for annual reporting periods beginning after December 15, 2021, 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 - Acquisitions

On January 2, 2019, the Company acquired all of the equity interests in BCG for a total purchase consideration of \$25.0 million. BCG provides advisory and benefit plan record keeping services. BCG's results are reported in Retirement. The acquisition of BCG resulted in the recognition of intangible assets of \$16.2 million and goodwill of \$10.1 million as a result of the purchase accounting. The intangible assets that are amortizable have lives of 10 to 16 years. See Note 7 for further information. The amount of goodwill that is expected to be deductible for federal income tax purposes is \$10.1 million.

On July 1, 2019, the Company acquired all the equity interests in NTA pursuant to a Purchase Agreement (Agreement) dated as of December 10, 2018. The purchase price of the transaction was \$425.9 million which includes \$20.9 million representing NTA's share of "adjusted earnings" (as determined in accordance with the terms of the Agreement) from July 1, 2018 to July 1, 2019. As a result of the acquisition, NTA became a wholly owned subsidiary of the Company. NTA provides supplemental insurance products (primarily heart, cancer, accident and limited short-term supplemental disability coverages) primarily within the public sector for which approximately 80% are individuals employed by educational institutions, with the remainder employed in state and local governments and emergency services facilities. NTA's results are being reported in a newly created reporting segment titled "Supplemental".

During the fourth quarter of 2019, the Company finalized its estimates of the fair value of NTA assets acquired and liabilities assumed, including, but not limited to, intangible assets, policy reserves, certain tax-related balances and certain investments. In accordance with Accounting Standards Codification (ASC) 805, Business Combinations, changes to the preliminary estimates and allocation as a result of events or conditions as of the acquisition date have been reported in the Company's consolidated financial statements as adjustments to the assets acquired and liabilities assumed. Such adjustments were insignificant. The Company has allocated all of the goodwill associated with the NTA acquisition to the Supplemental segment. The factors that contributed to recognition of goodwill include synergies from economies of scale within underwriting operations, acquiring a talented workforce and cost savings opportunities.

Based on the Company's final allocation of the purchase price, the fair value of the assets acquired and liabilities assumed were as follows:

(\$ in millions)	
Assets:	
Investments	\$ 542.6
Cash and short-term investments	73.8
Intangible assets ⁽¹⁾	169.8
Other assets	18.3
Liabilities:	
Policy reserves	366.8
Policy claims	21.8
Unearned premiums	4.1
Other liabilities	5.5
Total identifiable net assets acquired	406.3
Goodwill ⁽²⁾	19.6
Purchase price	\$ 425.9

⁽¹⁾ Intangible assets consist of the value of business acquired, value of distribution acquired, agency relationships, trade names and state licenses. The intangible assets that are amortizable have a total weighted average useful life of 23 years. See Note 7 for further information.

⁽²⁾ The amount of goodwill that is expected to be deductible for federal income tax purposes is \$17.9 million.

NOTE 2 - Acquisitions (continued)

The following unaudited pro forma information presents the Company's results of operations as if the acquisition of NTA occurred on January 1, 2018. The adjustments to arrive at the unaudited pro forma information below includes, among other things, adjustments for lost investment income on the cash used to fund the acquisition, amortization of an estimated fair value adjustment on NTA's policy reserves, amortization of acquired intangible assets, interest expense on debt incurred to finance the acquisition and exclusion of certain transaction costs attributable to the acquisition as such costs are considered non-recurring.

(\$ in thousands, except per share data)	Unaudited	
	Year Ended December 31,	
	2019	2018
Total revenues	\$ 1,507,352	\$ 1,339,896
Total expenses	1,259,213	1,288,690
Income before income taxes	248,139	51,206
Net income	\$ 193,755	\$ 43,373
Net income per share: ⁽¹⁾		
Basic	\$ 4.64	\$ 1.04
Diluted	\$ 4.62	\$ 1.04

⁽¹⁾ The unaudited pro forma basic and diluted net income per share calculations are based on the Company's historical basic and diluted weighted average number of shares outstanding for the years ended December 31, 2019 and 2018, respectively.

The unaudited pro forma financial information is not necessarily indicative of the consolidated results of operations that might have been achieved had the transaction in fact occurred at the beginning of the periods presented, nor does the information project results for any future period. The unaudited pro forma information does not include the impact of any future cost savings or synergies that may be achieved as a result of the acquisition.

NOTE 3 - Investments

Net Investment Income

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

(\$ in thousands)	Year Ended December 31,		
	2019	2018	2017
Fixed maturity securities	\$ 283,228	\$ 353,303	\$ 354,290
Equity securities	4,923	6,017	6,411
Limited partnership interests	25,694	15,406	12,555
Short-term and other investments	60,703	11,981	10,214
Total investment income	374,548	386,707	383,470
Investment expenses	(9,484)	(10,200)	(9,840)
Net investment income	\$ 365,064	\$ 376,507	\$ 373,630

NOTE 3 - Investments (continued)

Net Investment Gains (Losses)

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

(\$ in thousands)	Year Ended December 31,		
	2019	2018	2017
Fixed maturity securities ⁽¹⁾	\$ 141,448	\$ (5,713)	\$ (8,867)
Equity securities	15,975	(10,649)	4,003
Short-term investments and other	(4,083)	3,819	1,458
Net investment gains (losses)	<u>\$ 153,340</u>	<u>\$ (12,543)</u>	<u>\$ (3,406)</u>

⁽¹⁾ Net investment gains realized on fixed maturity securities include a \$135.3 million realized investment gain associated with a transfer of investments to a reinsurer as consideration paid during the second quarter of 2019 in connection with the reinsurance of a \$2.9 billion block of in force fixed and variable annuity business. See Notes 6 and 17 for further information.

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.

Net Investment Gains (Losses) by Transaction Type

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

(\$ in thousands)	Year Ended December 31,		
	2019	2018	2017
Impairment write-downs	\$ (1,105)	\$ —	\$ (1,778)
Change in intent write-downs	(275)	(1,530)	(10,842)
Net OTTI losses recognized in earnings	(1,380)	(1,530)	(12,620)
Sales and other, net	151,495	3,491	7,756
Change in fair value - equity securities ⁽¹⁾	7,308	(18,323)	—
Change in fair value and gains (losses) realized on settlements - derivatives	(4,083)	3,819	1,458
Net investment gains (losses)	<u>\$ 153,340</u>	<u>\$ (12,543)</u>	<u>\$ (3,406)</u>

⁽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.

NOTE 3 - Investments (continued)

Fixed Maturity Securities

The Company's investment portfolio is comprised primarily of fixed maturity securities. Amortized cost, net unrealized investment gains (losses) and fair values of all fixed maturity securities in the portfolio were as follows:

(\$ in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2019				
Fixed maturity securities				
U.S. Government and federally sponsored agency obligations: ⁽¹⁾				
Mortgage-backed securities	\$ 684,543	\$ 41,263	\$ 1,487	\$ 724,319
Other, including U.S. Treasury securities	436,665	22,824	621	458,868
Municipal bonds	1,545,787	141,996	1,580	1,686,203
Foreign government bonds	42,801	2,569	—	45,370
Corporate bonds	1,464,444	118,775	1,795	1,581,424
Other mortgage-backed securities	1,282,740	20,883	8,131	1,295,492
Totals	<u>\$ 5,456,980</u>	<u>\$ 348,310</u>	<u>\$ 13,614</u>	<u>\$ 5,791,676</u>
December 31, 2018				
Fixed maturity securities				
U.S. Government and federally sponsored agency obligations: ⁽¹⁾				
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	<u>\$ 7,373,911</u>	<u>\$ 249,085</u>	<u>\$ 107,678</u>	<u>\$ 7,515,318</u>

⁽¹⁾ Fair value includes securities issued by Federal National Mortgage Association (FNMA) of \$405.1 million and \$441.3 million; Federal Home Loan Mortgage Corporation (FHLMC) of \$283.1 million and \$417.3 million; and Government National Mortgage Association (GNMA) of \$147.4 million and \$96.5 million as of December 31, 2019 and 2018, respectively.

NOTE 3 - Investments (continued)

The following table presents the fair value and gross unrealized losses securities in an unrealized loss position at December 31, 2019 and 2018, respectively. The Company views the decrease in fair value of all of the securities with unrealized losses at December 31, 2019 — which was driven largely by increasing interest rates, spread widening, financial market illiquidity and/or market volatility from the date of acquisition — as temporary. As of December 31, 2019, the Company has not made the decision to sell and it is not more likely than not the Company will be required to sell fixed maturity securities with unrealized losses before recovery of the amortized cost basis. Therefore, it was determined that the unrealized losses on the securities presented in the table below were not other-than-temporarily impaired as of December 31, 2019.

(\$ 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, 2019						
Fixed maturity securities						
U.S. Government and federally sponsored agency obligations:						
Mortgage-backed securities	\$ 72,422	\$ 1,282	\$ 2,620	\$ 205	\$ 75,042	\$ 1,487
Other	38,341	619	1,527	2	39,868	621
Municipal bonds	91,195	977	9,160	603	100,355	1,580
Foreign government bonds	—	—	—	—	—	—
Corporate bonds	58,198	886	16,622	909	74,820	1,795
Other mortgage-backed securities	218,710	1,970	442,791	6,161	661,501	8,131
Total	<u>\$ 478,866</u>	<u>\$ 5,734</u>	<u>\$ 472,720</u>	<u>\$ 7,880</u>	<u>\$ 951,586</u>	<u>\$ 13,614</u>
Number of positions with a gross unrealized loss						
	330		137		467	
Fair value as a percentage of total fixed maturities securities fair value						
	8.3%		8.2%		16.5%	
December 31, 2018						
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	<u>\$2,497,440</u>	<u>\$ 63,640</u>	<u>\$ 889,418</u>	<u>\$ 44,038</u>	<u>\$3,386,858</u>	<u>\$ 107,678</u>
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%	

Fixed maturity securities with an investment grade rating represented 93.9% of the gross unrealized losses as of December 31, 2019. 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.

NOTE 3 - Investments (continued)

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, 2019 and 2018 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 basis, for which the non-credit portions of OTTI losses were recognized in OCI:

(\$ in thousands)	Year Ended December 31,	
	2019	2018
Cumulative credit loss ⁽¹⁾		
Beginning of period	\$ 1,529	\$ 3,825
New credit losses	—	—
Increases to previously recognized credit losses	—	246
Losses related to securities sold or paid down during the period	—	(2,542)
End of period	<u>\$ 1,529</u>	<u>\$ 1,529</u>

⁽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.

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, 2019		
	Amortized Cost	Fair Value	Percent of Total Fair Value
Estimated expected maturity:			
Due in 1 year or less	\$ 205,798	\$ 211,420	3.6%
Due after 1 year through 5 years	1,541,749	1,587,300	27.4%
Due after 5 years through 10 years	1,613,539	1,712,236	29.6%
Due after 10 years through 20 years	1,393,503	1,512,769	26.1%
Due after 20 years	702,391	767,951	13.3%
Total	<u>\$ 5,456,980</u>	<u>\$ 5,791,676</u>	<u>100.0%</u>
Average option-adjusted duration, in years		6.0	

NOTE 3 - Investments (continued)

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,		
	2019 ⁽¹⁾	2018	2017
Fixed maturity securities			
Proceeds received	\$ 805,887	\$ 625,527	\$ 500,760
Gross gains realized	150,852	10,536	13,570
Gross losses realized	(7,807)	(14,932)	(11,842)
Equity securities			
Proceeds received	\$ 29,863	\$ 25,498	\$ 50,113
Gross gains realized	9,193	8,592	7,753
Gross losses realized	(788)	(917)	(1,972)

⁽¹⁾ Gross gains realized presented above include a \$135.3 million realized investment gain associated with a transfer of investments to a reinsurer as consideration paid during the second quarter of 2019 in connection with the reinsurance of a \$2.9 billion block of in force fixed and variable annuity business. See Notes 6 and 17 for further information.

Net Unrealized Investment Gains (Losses) on Fixed Maturity 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,		
	2019	2018	2017
Net unrealized investment gains (losses) on fixed maturity securities, net of tax			
Beginning of period	\$ 111,712	\$ 286,176	\$ 202,941
Change in unrealized investment gains (losses) on fixed maturity securities	277,062	(172,350)	80,073
Reclassification of net investment (gains) losses on securities to net income	(124,364)	12,927	3,162
Cumulative effect of change in accounting principle ⁽¹⁾	—	(15,041)	—
End of period	<u>\$ 264,410</u>	<u>\$ 111,712</u>	<u>\$ 286,176</u>

⁽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.

Limited Partnership Interests

As of December 31, 2019 and 2018, the carrying value of equity method limited partnerships totaled \$383.7 million and \$328.5 million, 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.

Investment in Entities Exceeding 10% of Shareholders' Equity

At December 31, 2019 and 2018, 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.

NOTE 3 - Investments (continued)

Offsetting of Assets and Liabilities

The Company's derivatives (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 Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets		Net Amount
				Financial Instruments	Cash Collateral Received	
December 31, 2019						
Asset derivatives						
Free-standing derivatives	\$ 13,239	\$ —	\$ 13,239	\$ 7,687	\$ 6,640	\$ (1,088)
December 31, 2018						
Asset derivatives						
Free-standing derivatives	2,647	—	2,647	—	1,868	779

Deposits

At December 31, 2019 and 2018, fixed maturity securities with a fair value of \$26.0 million and \$17.7 million, respectively, were on deposit with governmental agencies as required by law in various states in which the insurance subsidiaries of the Company conduct business. In addition, at December 31, 2019 and 2018, fixed maturity securities with a fair value of \$594.2 million and \$740.0 million, respectively, were on deposit with FHLB as collateral for amounts subject to funding agreements, advances and borrowings that were equal to \$545.0 million and \$675.0 million at the respective dates. The deposited securities are included in Fixed maturity securities on the Company's Consolidated Balance Sheets.

NOTE 4 - 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.

NOTE 4 - Fair Value of Financial Instruments (continued)

- 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, derivatives 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.

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 fair value of a fixed maturity security is the estimated amount at which the security could be exchanged in an orderly transaction between knowledgeable, unrelated and willing parties. 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, bids, offers, benchmark yield curves, benchmarking of like securities, rating designations, sector groupings, issuer spreads, and/or estimated cash flows, prepayment and default speeds, among others. 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 94.1% and 90.7% of the portfolio, based on fair value, was priced through pricing services or index priced as of December 31, 2019 and 2018, 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 2019.

NOTE 4 - Fair Value of Financial Instruments (continued)

The valuation of hard-to-value fixed maturity securities (generally 100 -150 securities) is more subjective because the markets are less liquid and there is a lack of observable market-based inputs. This may increase the potential that the estimated fair value of an investment is not reflective of the price at which an actual transaction would occur. When the pricing sources cannot provide fair value determinations, the investment managers and custodian bank obtain non-binding price quotes from broker-dealers. 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 selection of the market inputs and assumptions used to estimate the fair value of hard-to-value fixed maturity securities require judgment and include: benchmark yield, liquidity premium, estimated cash flows, prepayment and default speeds, spreads, weighted average life, and credit rating. The extent of the use of each market input depends on the market sector and 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 gains assurance that its portfolio of fixed maturity securities and hard-to-value fixed maturity securities 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.

To determine the fair value of equity securities, the Company utilizes its investment managers and its custodian bank to obtain fair value prices from independent third-party valuation service providers. 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 equity securities.

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.
- Derivatives, all call options — Fair values are based on the amount of cash expected to be received to settle each derivative 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 4 - 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, 2019, Level 3 investments comprised approximately 4.8% 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, 2019					
Financial Assets					
Investments					
Fixed maturity securities					
U.S. Government and federally sponsored agency obligations:					
Mortgage-backed securities	\$ 724,319	\$ 724,319	\$ —	\$ 711,004	\$ 13,315
Other, including U.S. Treasury securities	458,868	458,868	17,699	441,169	—
Municipal bonds	1,686,203	1,686,203	—	1,641,912	44,291
Foreign government bonds	45,370	45,370	—	45,370	—
Corporate bonds	1,581,424	1,581,424	14,470	1,463,002	103,952
Other mortgage-backed securities	1,295,492	1,295,492	—	1,161,979	133,513
Total fixed maturity securities	5,791,676	5,791,676	32,169	5,464,436	295,071
Equity securities	101,864	101,864	49,834	51,923	107
Short-term investments	172,667	172,667	172,667	—	—
Other investments	25,997	25,997	—	25,997	—
Totals	\$ 6,092,204	\$ 6,092,204	\$ 254,670	\$ 5,542,356	\$ 295,178
Separate Account (variable annuity) assets ⁽¹⁾	\$ 2,490,469	\$ 2,490,469	\$ 2,490,469	\$ —	\$ —
Financial Liabilities					
Investment contract and life policy reserves, embedded derivatives	\$ 1,314	\$ 1,314	\$ —	\$ 1,314	\$ —
Other policyholder funds, embedded derivatives	\$ 93,733	\$ 93,733	\$ —	\$ —	\$ 93,733
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
Separate Account (variable annuity) assets ⁽¹⁾	\$ 2,001,128	\$ 2,001,128	\$ 2,001,128	\$ —	\$ —
Financial Liabilities					
Investment contract and life policy reserves, embedded derivatives	\$ 248	\$ 248	\$ —	\$ 248	\$ —
Other policyholder funds, embedded derivatives	\$ 78,700	\$ 78,700	\$ —	\$ —	\$ 78,700

⁽¹⁾ Separate Account (variable annuity) assets represent contractholder funds invested in various actively traded mutual funds that have daily quoted net asset values that are readily determinable for identical assets that the Company can access. Separate Account (variable annuity) liabilities are equal to the estimated fair value of Separate Account (variable annuity) assets.

NOTE 4 - Fair Value of Financial Instruments (continued)

The Company did not have any transfers between Levels 1 and 2 during 2019 and 2018. 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	Total	
Beginning balance, January 1, 2019	\$ 47,531	\$ 80,742	\$ 120,211	\$ 248,484	\$ 5	\$ 248,489	\$ 78,700
Transfers into Level 3 ⁽³⁾	—	33,475	56,766	90,241	65	90,306	—
Transfers out of Level 3 ⁽³⁾	—	(7,698)	(2,568)	(10,266)	—	(10,266)	—
Total gains or losses							
Net investment gains (losses) included in net income related to financial assets	—	—	(1,105)	(1,105)	38	(1,067)	—
Net realized (gains) losses included in net income related to financial liabilities	—	—	—	—	—	—	12,636
Net unrealized investment gains (losses) included in OCI	474	4,461	6,100	11,035	—	11,035	—
Purchases	—	2,483	—	2,483	—	2,483	—
Issuances	—	—	—	—	—	—	10,039
Sales	—	—	(607)	(607)	(1)	(608)	—
Settlements	—	—	—	—	—	—	—
Paydowns, maturities and distributions	(3,714)	(9,511)	(31,969)	(45,194)	—	(45,194)	(7,642)
Ending balance, December 31, 2019	\$ 44,291	\$ 103,952	\$ 146,828	\$ 295,071	\$ 107	\$ 295,178	\$ 93,733
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

⁽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, 2019 and 2018 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.

NOTE 4 - Fair Value of Financial Instruments (continued)

At December 31, 2019, the Company realized a loss of \$1.1 million on Level 3 securities. At December 31, 2018 the Company realized a loss of \$0.5 million on Level 3 securities. For the years ended December 31, 2019 and 2018, a realized loss of \$12.6 million and a realized gain of \$7.5 million, respectively, were included in earnings that were attributable to the changes in the fair value of Level 3 liabilities (embedded derivatives) still held.

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 Amount	Fair Value	Fair Value Measurements at Reporting Date Using		
			Level 1	Level 2	Level 3
December 31, 2019					
Financial Assets					
Investments					
Other investments	\$ 163,312	\$ 167,185	\$ —	\$ —	\$ 167,185
Deposit asset on reinsurance	2,346,166	2,634,012	—	—	2,634,012
Financial Liabilities					
Investment contract and policy reserves, fixed annuity contracts	4,675,774	4,609,880	—	—	4,609,880
Investment contract and life policy reserves, account values on life contracts	93,465	98,332	—	—	98,332
Other policyholder funds	553,550	553,550	—	495,812	57,738
Short-term debt	135,000	135,000	—	—	135,000
Long-term debt	298,025	322,678	—	322,678	—
December 31, 2018					
Financial Assets					
Investments					
Other investments	\$ 156,725	\$ 161,449	\$ —	\$ —	\$ 161,449
Financial Liabilities					
Investment contract and 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	—

NOTE 4 - 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.

Deposit Asset on Reinsurance

The fair value of the deposit asset on reinsurance is estimated by discounting the future cash flows that are expected to arise out of the annuity reinsurance transaction. The treasury yield curve, plus an assumed credit spread, is used to determine the appropriate discount rate.

Investment Contract and 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 policy reserves are embedded derivatives related to the Company's IUL products which are carried at fair value. See Note 5 for further information.

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.

Short-term Debt

The Company carries short-term debt at amortized cost which approximates fair value.

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 5 - Derivatives

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.

NOTE 5 - Derivatives (continued)

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 that 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 derivatives 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 derivatives, including derivatives embedded in FIA and IUL contracts, are presented in the Consolidated Balance Sheets as follows:

(\$ in thousands)	December 31,	
	2019	2018
Assets		
Derivatives, included in Short-term and other investments	\$ 13,239	\$ 2,647
Liabilities		
Fixed indexed annuities - embedded derivatives, included in Other policyholder funds	93,733	78,700
Indexed universal life - embedded derivatives, included in Investment contract and policy reserves	1,314	248

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,		
	2019	2018	2017
Change in fair value of derivatives: ⁽¹⁾			
Revenues			
Net investment gains (losses)	\$ 9,493	\$ (4,112)	\$ 14,867
Change in fair value of embedded derivatives:			
Revenues			
Net investment gains (losses)	(13,576)	7,931	(13,410)

⁽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.

NOTE 5 - Derivatives (continued)

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 S&P/Moody's Investors Service, Inc. (Moody's) long-term credit rating of "BBB+/A3" 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, 2019				December 31, 2018	
	Credit Rating		Notional	Fair	Notional	Fair
	S&P	Moody's	Amount	Value	Amount	Value
Bank of America, N.A.	A+	Aa2	\$ 174,900	\$ 8,523	\$ 144,500	\$ 870
Barclays Bank PLC	A	A2	115,300	3,348	28,500	247
Citigroup Inc.	BBB+	A3	—	—	—	—
Credit Suisse International	A+	A1	—	—	16,100	55
Societe Generale	A	A1	27,800	1,369	89,100	1,475
Total			<u>\$ 318,000</u>	<u>\$ 13,240</u>	<u>\$ 278,200</u>	<u>\$ 2,647</u>

As of December 31, 2019 and 2018, the Company held \$14.3 million and \$1.9 million, respectively, of cash and securities 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 \$0.3 million per counterparty.

NOTE 6 - Deposit Asset on Reinsurance

The Company reinsured a \$2.9 billion block of in force fixed and variable annuity business with a minimum crediting rate of 4.5%. This represented approximately 50% of the Company's in force fixed annuity account balances. The arrangement contains investment guidelines and a trust to help meet the Company's risk management objectives.

The annuity reinsurance transaction was effective April 1, 2019. Under the agreement, approximately \$2.2 billion of fixed annuity reserves were reinsured on a coinsurance basis for consideration of approximately \$2.3 billion which resulted in recognition of an after tax realized investment gain of \$106.9 million. The separate account assets and liabilities of approximately \$0.7 billion were reinsured on a modified coinsurance basis and thus, remain on the Company's consolidated financial statements, but the related results of operations are fully reinsured.

The Company determined that the reinsurance agreement does not expose the reinsurer to a reasonable possibility of a significant loss from insurance risk. Therefore, the Company recognizes the reinsurance agreement using the deposit method of accounting. The assets transferred to the reinsurer as consideration paid is reported as a Deposit asset on reinsurance on the Company's Consolidated Balance Sheet. As amounts are received or paid, consistent with the underlying reinsured contracts, the Deposit asset on reinsurance is adjusted. The Deposit asset on reinsurance is accreted to the estimated ultimate cash flows using the interest method and the adjustment is reported as Net investment income.

NOTE 7 - Goodwill and Intangible Assets, net

The Company conducts impairment testing for goodwill at least annually, or more often if events, changes or circumstances indicate that the carrying amount may not be recoverable. See Note 1 for further description of impairment testing.

The annuity reinsurance transaction described in Note 6 triggered a requirement to evaluate the goodwill associated with the annuity business of the Retirement reporting unit. For the evaluation, the fair value of the Retirement reporting unit was measured using a discounted cash flow method. The carrying value exceeded the fair value, resulting in a \$28.0 million non-cash goodwill impairment charge during the second quarter of 2019. In the second quarter of 2019, the Company adopted guidance to eliminate Step 2 of the goodwill impairment test and as such, the goodwill impairment charge represented the entire balance of the goodwill associated with the annuity business of the Retirement reporting unit. The goodwill impairment charge was reported as Other expense - goodwill impairment in the Consolidated Statement of Operations.

The changes in the carrying amount of goodwill by reportable segment for the year ended December 31, 2019 were as follows:

(\$ in thousands)	December 31, 2018	Impairment	Acquisitions	December 31, 2019
Property and Casualty	\$ 9,460	\$ —	\$ —	\$ 9,460
Supplemental	—	—	19,621	19,621
Retirement	28,025	(28,025)	10,087	10,087
Life	9,911	—	—	9,911
Total	\$ 47,396	\$ (28,025)	\$ 29,708	\$ 49,079

As of December 31, 2019, the outstanding amounts of definite-lived intangible assets subject to amortization are attributable to the acquisitions of BCG and NTA during 2019. The acquisition of BCG resulted in initial recognition of definite-lived intangible assets subject to amortization in the amount of \$14.1 million and the acquisition of NTA resulted in initial recognition of definite-lived intangible assets subject to amortization in the amount of \$160.4 million. As of December 31, 2019 the outstanding amounts of definite-lived intangible assets subject to amortization were as follows:

(\$ in thousands)	Weighted Average Useful Life (in Years)	
At inception:		
Value of business acquired	30	\$ 94,419
Value of distribution acquired	17	53,996
Value of agency relationships	14	16,981
Value of customer relationships	10	9,080
Total	23	174,476
Accumulated amortization:		
Value of business acquired		(3,697)
Value of distribution acquired		(1,871)
Value of agency relationships		(1,489)
Value of customer relationships		(1,733)
Total		(8,790)
Net intangible assets subject to amortization:		\$ 165,686

NOTE 7 - Goodwill and Intangible Assets, net (continued)

In regard to the definite-lived intangible assets in the table above, the VOBA intangible asset represents the difference between the fair value of insurance contracts and insurance policy reserves measured in accordance with the Company's accounting policies for insurance contracts acquired. VOBA was based on an actuarial estimate of the present value of future distributable earnings for insurance in force as of the acquisition date. The VODA intangible asset represents the present value of future business to be written by the existing distribution channel. The value of agency relationships intangible asset represents the present value of the commission overrides retained by NTA. The value of customer relationships intangible asset represents the present value of the expected profits from existing BCG customers in force at the date of acquisition. All of the aforementioned definite-lived intangible assets were valued using the income approach.

Estimated future amortization of the Company's definite-lived intangible assets were as follows:

(\$ in thousands)	
Year Ending December 31,	
2020	\$ 14,488
2021	13,411
2022	12,433
2023	11,577
2024	10,805
Thereafter	102,972
Total	<u>\$ 165,686</u>

The VOBA intangible asset is being amortized by product based on the present value of future premiums to be received. The VODA intangible asset in respect to the acquisition of NTA is being amortized on a straight-line basis. The VODA intangible asset in respect to the acquisition of BCG is being amortized based on the present value of future profits to be received. The value of agency relationships intangible asset is being amortized based on the present value of future premiums to be received. The value of customer relationships intangible asset is being amortized based on the present value of future profits to be received.

Indefinite-lived intangible assets (not subject to amortization) as of December 31, 2019 were as follows:

(\$ in thousands)	
Trade names	\$ 8,645
State licenses	2,886
Total	<u>\$ 11,531</u>

The trade names intangible asset represents the present value of future savings accruing NTA and BCG by virtue of not having to pay royalties for the use of the trade names, valued using the relief from royalty method. The state licenses intangible asset represents the regulatory licenses held by NTA that were valued using the cost approach.

NOTE 8 - 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) basis. 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.

NOTE 8 - Property and Casualty Unpaid Claims and Claim Expenses (continued)

(\$ in thousands)	Years Ended December 31,		
	2019	2018	2017
Property and Casualty segment			
Gross reserves, beginning of year ⁽¹⁾	\$ 367,180	\$ 319,182	\$ 307,757
Less: reinsurance recoverables	89,725	57,409	61,199
Net reserves, beginning of year ⁽²⁾	277,455	261,773	246,558
Incurred claims and claim expenses:			
Claims occurring in the current year	483,062	547,959	498,989
Decrease in estimated reserves for claims occurring in prior years ⁽³⁾	(7,500)	(300)	(2,700)
Total claims and claim expenses incurred ⁽⁴⁾	475,562	547,659	496,289
Claims and claim expense payments for claims occurring during:			
Current year	329,475	369,194	333,385
Prior years	157,072	162,783	147,689
Total claims and claim expense payments	486,547	531,977	481,074
Net reserves, end of year ⁽²⁾	266,470	277,455	261,773
Plus: reinsurance recoverables	120,506	89,725	57,409
Gross reserves, end of year ⁽¹⁾	\$ 386,976	\$ 367,180	\$ 319,182

- ⁽¹⁾ Unpaid claims and claim expenses as reported in the Consolidated Balance Sheets also include reserves for Supplemental, Retirement and Life of \$55.9 million, \$29.5 million and \$28.6 million as of December 31, 2019, 2018 and 2017, respectively, in addition to Property and Casualty reserves.
- ⁽²⁾ Reserves are 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 2019, 2018 and 2017.
- ⁽⁴⁾ Benefits, claims and settlement expenses as reported in the Consolidated Statements of Operations also include amounts for Supplemental, Retirement and Life of \$109.5 million, \$89.9 million, and \$86.0 million for the years ended December 31, 2019, 2018 and 2017, 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

NOTE 8 - Property and Casualty Unpaid Claims and Claim Expenses (continued)

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, 2019) 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, 2019, 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, 2019, 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 8 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 2019.

NOTE 8 - Property and Casualty Unpaid Claims and Claim Expenses (continued)

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.

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 million of net income as of December 31, 2019. 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 \$7.5 million in 2019, \$0.3 million in 2018 and \$2.7 million in 2017. In 2019, the favorable development was predominantly the result of favorable severity trends in Auto for accident year 2018. 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.

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, 2019 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	79.5%	16.6%	2.2%	1.0%	0.4%	0.3%	—	—	—	—
Auto liability	40.8%	34.9%	13.8%	6.1%	3.0%	1.0%	0.3%	0.1%	—	—
Auto physical damage	95.6%	4.4%	—	—	—	—	—	—	—	—

NOTE 8 - 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, 2010 to 2018 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, 2019	
Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	Unaudited 2017	Unaudited 2018	Unaudited 2019	Total of Incurred-But-Not-Reported Liabilities Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
2010	\$ 140,994	\$ 136,907	\$ 133,358	\$ 133,235	\$ 133,216	\$ 133,136	\$ 132,859	\$ 132,905	\$ 132,627	\$ 132,627	\$ —	25,150
2011		150,141	150,334	150,791	148,860	148,755	148,414	148,370	148,079	148,067	—	29,531
2012			108,754	109,156	109,360	106,486	106,308	106,348	106,000	106,028	—	21,578
2013				105,584	107,489	103,982	102,407	102,345	101,769	101,709	—	19,221
2014					111,647	113,505	109,059	106,844	106,554	106,458	59	20,084
2015						111,706	115,134	114,404	114,053	115,050	276	18,714
2016							115,931	118,604	117,009	117,933	280	19,853
2017								126,285	129,818	132,666	2,285	19,827
2018									166,793	157,404	4,170	20,954
2019										130,391	16,842	16,155
										Total	<u>\$ 1,248,333</u>	

(\$ in thousands)													
Homeowners													
Cumulative Paid Claims and Allocated Claim Adjustment Expense, Net of Reinsurance													
Years Ended December 31,													
Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	Unaudited 2017	Unaudited 2018	Unaudited 2019			
2010	\$ 98,190	\$ 124,326	\$ 129,790	\$ 132,246	\$ 132,523	\$ 132,604	\$ 132,599	\$ 132,602	\$ 132,602	\$ 132,602			
2011		123,046	142,846	145,852	146,908	147,451	148,026	148,014	148,069	148,067			
2012			84,260	101,566	104,203	105,156	105,561	105,909	105,993	106,021			
2013				76,890	96,599	99,361	100,968	101,527	101,677	101,709			
2014					83,314	103,030	105,704	106,081	106,258	106,388			
2015						90,704	109,303	111,882	113,321	114,648			
2016							95,772	113,186	115,053	117,537			
2017								106,800	128,518	129,767			
2018									130,548	152,356			
2019										103,790			
										Total	1,212,885		
											Outstanding prior to 2010	32	
												Prior years paid	668
												Liabilities for claims and claim adjustment expenses, net of reinsurance	<u>\$ 35,480</u>

NOTE 8 - Property and Casualty Unpaid Claims and Claim Expenses (continued)

(\$ in thousands)											As of December 31, 2019	
Auto Liability												
Incurred Claims and Allocated Claim Adjustment Expense, Net of Reinsurance												
Years Ended December 31,												
Accident	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Total of Incurred-But-Not-Reported Liabilities Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019		
2010	\$ 157,712	\$ 160,058	\$ 156,369	\$ 154,222	\$ 152,483	\$ 151,653	\$ 149,818	\$ 149,425	\$ 149,542	\$ 149,481	\$ —	48,942
2011		150,803	146,713	145,735	143,133	142,488	139,840	138,891	138,949	138,849	94	45,976
2012			156,448	153,815	150,336	149,346	147,594	145,847	145,620	145,515	204	45,984
2013				153,860	152,858	150,720	150,657	148,111	147,993	148,135	575	47,369
2014					155,105	157,249	158,470	159,937	159,794	159,355	665	49,386
2015						165,517	172,553	177,021	178,325	178,654	1,850	50,618
2016							180,380	184,440	184,567	186,568	2,649	51,995
2017								187,983	188,756	188,625	8,025	48,906
2018									200,314	195,284	26,931	47,078
2019										181,141	64,778	42,587
										Total	\$ 1,671,607	

(\$ in thousands)										
Auto Liability										
Cumulative Paid Claims and Allocated Claim Adjustment Expense, Net of Reinsurance										
Years Ended December 31,										
Accident	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
2010	\$ 63,416	\$ 118,345	\$ 137,012	\$ 144,255	\$ 147,337	\$ 148,751	\$ 149,247	\$ 149,364	\$ 149,439	\$ 149,474
2011		61,070	108,837	126,812	133,931	136,906	138,151	138,358	138,689	138,692
2012			61,279	109,574	127,185	138,641	142,916	144,622	145,121	145,184
2013				62,224	108,856	131,214	139,954	145,291	146,770	147,409
2014					61,329	117,468	139,463	149,059	155,758	157,596
2015						70,836	134,473	157,980	170,088	174,495
2016							73,073	140,901	166,815	177,834
2017								70,682	139,531	166,614
2018									77,528	141,537
2019										69,665
								Total		1,468,500
								Outstanding prior to 2010		73
								Prior years paid		(219)
								Liabilities for claims and claim adjustment expenses, net of reinsurance		\$ 203,180

NOTE 8 - Property and Casualty Unpaid Claims and Claim Expenses (continued)

Auto Physical Damage Incurred Claims and Allocated Claim Adjustment Expense, Net of Reinsurance Years Ended December 31,											As of December 31, 2019	
Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	Unaudited 2017	Unaudited 2018	Unaudited 2019	Total of Incurred-But-Not-Reported Liabilities Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
2010	\$ 84,112	\$ 83,420	\$ 83,103	\$ 83,046	\$ 83,052	\$ 83,050	\$ 83,036	\$ 83,028	\$ 83,018	\$ 83,011	\$ —	81,581
2011		86,205	85,507	86,023	85,120	85,143	85,116	85,108	85,102	85,090	—	80,804
2012			83,770	82,337	83,402	83,431	83,354	83,342	83,334	83,322	—	78,165
2013				91,448	88,856	88,672	88,627	88,455	88,525	88,457	—	80,920
2014					95,572	95,634	95,422	95,239	95,232	95,241	—	87,901
2015						99,291	97,994	97,624	97,455	97,612	(18)	87,497
2016							112,430	109,515	109,348	109,603	(17)	93,225
2017								115,483	111,798	110,520	(161)	91,270
2018									109,040	108,886	(326)	94,388
2019										111,577	(6,829)	89,207
										Total	\$ 973,319	

Auto Physical Damage Cumulative Paid Claims and Allocated Claim Adjustment Expense, Net of Reinsurance Years Ended December 31,											
Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	Unaudited 2017	Unaudited 2018	Unaudited 2019	
2010	\$ 79,329	\$ 83,120	\$ 83,103	\$ 83,087	\$ 83,067	\$ 83,051	\$ 83,036	\$ 83,028	\$ 83,015	\$ 83,009	
2011		83,227	85,254	85,181	85,148	85,127	85,116	85,108	85,095	85,090	
2012			80,519	83,418	83,372	83,355	83,347	83,342	83,326	83,322	
2013				85,110	88,688	88,580	88,532	88,484	88,471	88,452	
2014					88,939	95,444	95,266	95,256	95,258	95,243	
2015						92,138	97,850	97,685	97,638	97,625	
2016							106,459	109,686	109,536	109,611	
2017								105,156	110,817	110,674	
2018									103,559	109,103	
2019										106,243	
										Total	968,372
										Outstanding prior to 2010	—
										Prior years paid	—
										Liabilities for claims and claim adjustment expenses, net of reinsurance	\$ 4,947

NOTE 8 - 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, 2019
Property and Casualty segment	
Net reserves	
Homeowners	\$ 35,480
Auto liability	203,180
Auto physical damage	4,947
Other short duration lines	2,892
Total net reserves for unpaid claims and claim adjustment expense, net of reinsurance	246,499
Reinsurance recoverable on unpaid claims	
Homeowners	12,394
Auto liability	100,866
Other short duration lines	7,246
Total reinsurance recoverable on unpaid claims	120,506
Insurance lines other than short duration ⁽¹⁾	55,878
Unallocated claims adjustment expenses	19,971
Total other than short duration and unallocated claims adjustment expenses	75,849
Gross reserves, end of year ⁽¹⁾	\$ 442,854

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

NOTE 9 - 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 \$52.0 million, \$107.3 million and \$61.8 million for the years ended December 31, 2019, 2018 and 2017, respectively. For 2019, catastrophe losses were impacted by winter storm events in the first part of the year, wind/hail/tornado events in spring and summer months as well as losses from several storms in the latter part of the year.

NOTE 9 - 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,	
	2019	2018
Reinsurance recoverables on reserves and unpaid claims		
Property and Casualty		
Reinsurance companies	\$ 19,640	\$ 33,754
State insurance facilities	100,866	55,971
Life and health	8,707	9,785
Total	\$ 129,213	\$ 99,510

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 ⁽¹⁾	Assumed from Other Companies	Net Amount
Year Ended December 31, 2019				
Premiums written and contract deposits ⁽²⁾	\$ 1,337,847	\$ 23,872	\$ 10,567	\$ 1,324,542
Premiums and contract charges earned	917,610	30,412	10,756	897,954
Benefits, claims and settlement expenses	633,874	56,325	7,519	585,068
Year Ended December 31, 2018				
Premiums written and contract deposits ⁽²⁾	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 ⁽²⁾	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

⁽¹⁾ Excludes the annuity reinsurance agreement accounted for under the deposit method that is discussed in Note 6.

⁽²⁾ 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, 2019. Past due reinsurance recoverables as of December 31, 2019 were not material.

The Company maintains catastrophe excess of loss reinsurance coverage. For 2019, 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 \$25.0 million per occurrence up to \$175.0 million per occurrence. This contract consisted of three layers, each of which provided for one mandatory reinstatement. The layers were \$25.0 million excess of \$25.0 million, \$40.0 million excess of \$50.0 million and \$85.0 million excess of \$90.0 million.

For liability coverages, in 2019, the Company reinsured each loss above a retention of \$1.0 million with coverage up to \$5.0 million on a per occurrence basis and \$20.0 million 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 2019, the Company

NOTE 9 - Reinsurance and Catastrophes (continued)

reinsured each loss above a retention of \$1.0 million up to \$5.0 million 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 \$8.0 million of property recovery in any one event.

The maximum individual life insurance risk retained by the Company is \$0.5 million on any individual life, while either \$0.1 million or \$0.125 million 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 2019, the Company reinsured 100% of the catastrophe risk in excess of \$1.0 million up to \$35.0 million 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.

The Company retains all of the risk on its supplemental health product lines, including accidental death risk embedded within certain products. However, the Company's other accidental death and dismemberment risk issued through all other policies and riders are ceded 100%. The maximum risk retained on any individual life by the Company is \$0.1 million.

NOTE 10 - Debt

Indebtedness and scheduled maturities consisted of the following:

(\$ in thousands)	Effective Interest Rates	Final Maturity	December 31,	
			2019	2018
Short-term debt				
Bank Credit Facility	Variable	2024	\$ 135,000	\$ —
Long-term debt ⁽¹⁾				
4.50% Senior Notes, Aggregate principal amount of \$250,000 less unaccrued discount of \$426 and \$488 and unamortized debt issuance costs of \$1,549 and \$1,772	4.50%	2025	248,025	247,740
Federal Home Loan Bank borrowing	1.99%	2022	50,000	50,000
Total			<u>\$ 433,025</u>	<u>\$ 297,740</u>

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

Credit Agreement with Financial Institutions (Bank Credit Facility)

On June 21, 2019, the Company, as borrower, replaced its current line of credit with a new five-year Credit Agreement (Bank Credit Facility). The new Bank Credit Facility increased the amount available on this senior revolving credit facility to \$225.0 million from \$150.0 million. PNC Capital Markets, LLC and JPMorgan Chase Bank, N.A. served as joint leads on the new agreement, with The Northern Trust Company, U.S. Bank National Association, KeyBank National Association, Comerica Bank and Illinois National Bank participating in the syndicate. Terms and conditions of the new Bank Credit Facility are substantially consistent with the prior agreement, with an interest rate based on LIBOR plus 115 basis points.

On July 1, 2019, the Company utilized the senior revolving credit facility to partially fund the acquisition of NTA. As of December 31, 2019, the amount outstanding on the senior revolving credit facility was \$135.0 million. 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, 2019.

Senior Notes

On November 23, 2015, the Company issued \$250.0 million 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 4.53% (Senior Notes). Interest on the Senior Notes is payable semi-annually at a rate of 4.50%. The Senior Notes 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.

NOTE 10 - Debt (continued)

Federal Home Loan Bank Borrowings

In 2017, Horace Mann Insurance Company (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. In 2019, the Board authorized a maximum amount equal to 15% of net aggregate admitted assets less separate account assets of the insurance subsidiaries for FHLB borrowings. During the fourth quarter of 2017, the Company received \$50.0 million in executed borrowings for HMIC. Of the total \$50.0 million received, \$25.0 million matures on October 5, 2022 and \$25.0 million matures on December 2, 2022. Interest on the borrowings accrues at an annual weighted average rate of 1.99% as of December 31, 2019. HMIC's FHLB borrowings of \$50.0 million 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 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 11 - Income Taxes

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,	
	2019	2018
Income tax (asset) liability		
Current	\$ (12,184)	\$ (20,793)
Deferred	160,624	103,686

NOTE 11 - Income Taxes (continued)

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,	
	2019	2018
Deferred tax assets		
Unearned premium reserve reduction	\$ 12,103	\$ 12,112
Compensation accruals	8,866	6,866
Reinsurance commissions	6,804	—
Impaired securities	1,245	1,295
Other comprehensive income - net funded status of benefit plans	2,875	3,254
Discounting of unpaid claims and claim expense tax reserves	2,530	2,772
Postretirement benefits other than pensions	285	302
Charitable contributions carryforwards	—	89
Net operating loss carryforwards	3,803	10,969
Total gross deferred tax assets	38,511	37,659
Deferred tax liabilities		
Other comprehensive income - net unrealized gains on securities	74,645	32,897
Deferred policy acquisition costs	49,326	60,330
Life insurance future policy benefit reserve	38,210	9,304
Life insurance future policy benefit reserve (transitional rule)	12,786	14,910
Discounting of unpaid claims and claim expense tax reserves (transitional rule)	947	1,203
Investment related adjustments	15,718	17,531
Intangibles	2,021	2,557
Other, net	5,482	2,613
Total gross deferred tax liabilities	199,135	141,345
Net deferred tax liability	\$ 160,624	\$ 103,686

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, 2019 and 2018.

At December 31, 2019, the Company had available the following carryforwards or credits.

(\$ in thousands)	Pretax Amount	Expiration Year
Operating loss carryforwards	\$ 12,711	2038
Operating loss carryforwards	5,397	Indefinite

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

(\$ in thousands)	Years Ended December 31,		
	2019	2018	2017
Current	\$ 31,518	\$ 4,152	\$ 3,813
Deferred	20,488	(2,958)	(84,585)
Total income tax expense (benefit)	\$ 52,006	\$ 1,194	\$ (80,772)

NOTE 11 - Income Taxes (continued)

Income tax expense for the following periods differed from the expected tax computed by applying the federal corporate tax rate of 21% for 2019 and 2018 and 35% for 2017 to income before income taxes as follows:

(\$ in thousands)	Years Ended December 31,		
	2019	2018	2017
Expected federal tax on income	\$ 49,654	\$ 4,103	\$ 31,041
Add (deduct) tax effects of:			
Tax-exempt interest	(4,159)	(3,726)	(5,335)
Dividend received deduction	(1,392)	(412)	(4,810)
Goodwill impairment	5,885	—	—
Tax Act DTL re-measurement	—	—	(98,988)
Employee share-based compensation	272	(1,134)	(3,258)
Compensation deduction limitation	680	1,754	326
Prior year adjustments	(716)	300	(293)
Other, net	1,782	309	545
Income tax expense (benefit) provided on income	<u>\$ 52,006</u>	<u>\$ 1,194</u>	<u>\$ (80,772)</u>

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.

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. National Teachers Associates Life Insurance Company and NTA Life Insurance Company of New York are not included in the consolidated federal income tax return and will file separate federal income tax returns until they are eligible to participate in the consolidated federal income tax return. This is expected to occur in 2025.

NOTE 11 - Income Taxes (continued)

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,		
	2019	2018	2017
Balance as of the beginning of the year	\$ 1,734	\$ 1,790	\$ 1,594
Increases related to prior year tax positions	109	—	101
Decreases related to prior year tax positions	—	(152)	—
Increases related to current year tax positions	123	96	422
Settlements	—	—	—
Lapse of statute	—	—	(327)
Balance as of the end of the year	\$ 1,966	\$ 1,734	\$ 1,790

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, 2019, 2018 and 2017.

NOTE 12 - Operating Leases

The Company has various operating lease agreements, primarily for real estate offices. Such leases have remaining lease terms of 1 year to 6 years, some of which may include options to extend certain leases for up to an additional 25 years.

The components of lease expense were as follows:

(\$ in thousands)	Year Ended December 31, 2019
Operating lease cost	\$ 3,841
Short-term lease cost	208
Total lease cost	\$ 4,049

Supplemental cash flow information related to operating leases was as follows:

(\$ in thousands)	Year Ended December 31, 2019
Cash paid for amounts included in the measurement of lease liabilities	\$ 3,447

Supplemental balance sheet information related to operating leases were as follows:

(\$ in thousands, except lease term and discount rate)	December 31, 2019
Assets	
Right of use assets, included in Other assets	\$ 16,483
Liabilities	
Operating lease liabilities, included in Other liabilities	\$ 17,499
Weighted average remaining lease term	4.51
Weighted average discount rate	3.78%

NOTE 12 - Operating Leases (continued)

Future minimum lease payments under non-cancellable operating leases as of December 31, 2019 are as follows:

(\$ in thousands)	
Year Ending December 31,	
2020	\$ 4,440
2021	4,285
2022	4,156
2023	3,459
2024	1,929
Thereafter	787
Total future minimum lease payments	19,056
Less imputed interest	(1,557)
Total	\$ 17,499

As of December 31, 2019, the Company has no additional operating leases that have not yet commenced.

Note 13 - Shareholders' Equity and Common Stock Equivalents

Share Repurchase Program and Treasury Shares

On September 30, 2015, the Board authorized a share repurchase program allowing repurchases of up to \$50.0 million of HMEC's common stock, par value \$0.001 (Program). The Program authorizes the repurchase of common shares in open market or privately negotiated transactions, from time to time, depending on market conditions. The Program does not have an expiration date and may be limited or terminated at any time without notice.

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 \$1.7 million, or an average price of \$34.28 per share. 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 \$5.1 million, or an average price of \$39.41 per share. During 2019, the Company did not repurchase any shares of its common stock. In total and through December 31, 2019, 2,977,162 shares were repurchased under the Program at an average price of \$25.94 per share. The repurchase of shares was funded through use of cash. As of December 31, 2019, \$22.8 million remained authorized for future share repurchases under the Program.

At December 31, 2019, the Company held 24,850,484 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 issued or outstanding at December 31, 2019 and 2018.

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

NOTE 13 - Shareholders' Equity and Common Stock Equivalents (continued)

Comprehensive Plan which included an increase of 3,250,000 in the number of shares of common stock reserved for issuance under the Comprehensive Plan. As of December 31, 2019, approximately 1,187,200 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,		
	2019	2018	2017
CSUs related to deferred compensation for Directors	28,526	32,288	61,677
CSUs related to deferred compensation for employees	25,194	24,498	24,903
Stock options	908,557	774,821	719,015
RSUs related to incentive compensation	889,438	1,008,249	1,149,679
Total	<u>1,851,715</u>	<u>1,839,856</u>	<u>1,955,274</u>

Director Common Stock Units

Deferred compensation for 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. These dividends are reinvested into additional CSUs.

Employee Common Stock Units

Deferred compensation for 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, 2019, 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, 2018	\$36.65	\$17.32-\$44.75	774,821	271,116
Granted	\$39.22	\$38.99-\$42.73	282,040	—
Vested	\$34.46	\$20.60-\$44.75	—	161,679
Exercised	\$26.98	\$17.32-\$42.95	(64,095)	(64,095)
Forfeited	\$39.97	\$31.01-\$44.75	(84,209)	—
Expired	—	—	—	—
December 31, 2019	<u>\$37.82</u>	<u>\$20.60-\$44.75</u>	<u>908,557</u>	<u>368,700</u>

NOTE 13 - Shareholders' Equity and Common Stock Equivalents (continued)

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

December 31, 2019						
Range of Option Prices per Share	Total Outstanding Options			Vested and Exercisable Options		
	Options	Weighted Average Option Price per Share	Weighted Average Remaining Term	Options	Weighted Average Option Price per Share	Weighted Average Remaining Term
\$20.60-\$22.69	11,100	\$22.34	0.36	11,100	\$22.34	0.36 years
\$28.88-\$32.35	271,579	\$30.94	5.65	222,499	\$30.92	5.53 years
\$38.05-\$41.95	415,356	\$40.14	8.36	85,766	\$41.80	7.19 years
\$42.95-\$44.75	210,522	\$42.94	8.30	49,335	\$43.00	8.19 years
Total	908,557	\$37.82	7.44	368,700	\$34.81	6.11 years

The weighted average exercise prices of vested and exercisable options as of December 31, 2018 and 2017 were \$31.42 and \$27.12, respectively.

As of December 31, 2019, based on a closing stock price of \$43.66 per share, the aggregate intrinsic (in-the-money) values of vested options and all options outstanding were \$3.3 million and \$5.3 million, respectively.

Restricted 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, 2018	1,008,249	\$35.64	417,179	\$20.22
Granted ⁽¹⁾	210,712	\$41.52	—	—
Adjustment for performance achievement	(3,789)	\$32.16	—	—
Vested	—	—	417,454	\$33.93
Forfeited	(34,895)	\$43.08	—	—
Distributed ⁽²⁾	(290,839)	\$31.39	(290,839)	\$31.39
December 31, 2019	889,438	\$31.94	543,794	\$24.77

⁽¹⁾ Includes dividends reinvested into additional RSUs.

⁽²⁾ Includes distributed units which were utilized to satisfy withholding taxes due on the distribution.

NOTE 14 - 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,	
	2019	2018
Statutory capital and surplus of insurance subsidiaries	\$ 868,839	\$ 903,564
Increase (decrease) due to:		
Deferred policy acquisition costs	276,668	298,742
Deposit asset on reinsurance	2,346,166	—
Annuity reserves ceded	(2,239,717)	—
Difference in policyholder reserves	209,127	142,601
Goodwill	49,079	47,396
Intangible assets, net	177,217	—
Investment fair value adjustments on fixed maturity securities	397,762	142,512
Difference in investment reserves	102,380	105,430
Federal income tax liability	(178,026)	(115,667)
Net funded status of benefit plans	(13,690)	(15,495)
Non-admitted assets and other, net	(53,801)	20,412
Shareholders' equity of parent company and non-insurance subsidiaries	8,306	8,795
Parent company short-term and long-term debt	(383,025)	(247,740)
Shareholders' equity as reported herein	\$ 1,567,285	\$ 1,290,550

(\$ in thousands)	Years Ended December 31,		
	2019	2018	2017
Statutory net income of insurance subsidiaries	\$ 62,316	\$ 45,977	\$ 82,587
Net loss of non-insurance companies	(9,537)	(9,755)	(4,496)
Interest expense	(14,272)	(11,892)	(11,836)
Tax benefit of interest expense and other parent company current tax adjustments	8,993	121	5,654
Combined net income	47,500	24,451	71,909
Increase (decrease) due to:			
Deferred policy acquisition costs	2,101	1,015	9,385
Intangible asset amortization expense	(8,790)	—	—
Policyholder benefits	117,369	26,318	30,609
Federal income tax (expense) benefit	(23,492)	3,020	84,198
Investment reserves	88,627	(31,529)	(20,966)
Other adjustments, net	(38,872)	(4,932)	(5,676)
Net income as reported herein	\$ 184,443	\$ 18,343	\$ 169,459

The Company has principal insurance subsidiaries domiciled in Illinois, New York 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, the New York 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 14 - 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, 2019 and 2018, the minimum statutory-basis capital and surplus required to be maintained by HMEC's insurance subsidiaries was \$108.1 million and \$108.5 million, respectively. At December 31, 2019 and 2018, 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 \$26.0 million and \$17.7 million as of December 31, 2019 and 2018, 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 maximum amount of dividends that may be paid in 2020 from all of HMEC's insurance subsidiaries without prior regulatory approval is \$105.3 million, excluding the impact and timing of prior year dividends.

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 \$868.8 million as of December 31, 2019, which is subject to regulatory restrictions.

NOTE 15 - 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.

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.

NOTE 15 - Retirement Plans and Other Postretirement Benefits (continued)

Total Expense and Contribution Plans' Information

Total expense recorded for the non-qualified defined contribution, 401(k), defined benefit and supplemental retirement plans was \$9.3 million, \$8.9 million and \$9.1 million for the years ended December 31, 2019, 2018 and 2017, 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,		
	2019	2018	2017
401(k) plan			
Contributions to employees' accounts	\$ 8,233	\$ 7,655	\$ 7,637
Total assets at the end of the year	206,247	167,767	180,514
Non-qualified defined contribution plan			
Contributions to employees' accounts	58	70	84
Total assets at the end of the year	—	—	—

NOTE 15 - 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, 2019, 2018 and 2017 (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,		
	2019	2018	2017	2019	2018	2017
Change in benefit obligation:						
Projected benefit obligation at beginning of year	\$ 25,075	\$ 28,432	\$ 29,407	\$ 15,404	\$ 16,832	\$ 16,847
Service cost	650	650	650	—	—	—
Interest cost	997	947	1,091	620	566	631
Plan amendments	—	—	—	—	—	—
Actuarial loss (gain)	101	(2,208)	(721)	516	(789)	805
Benefits paid	(2,003)	(2,746)	(1,995)	(1,312)	(1,205)	(1,451)
Settlements	—	—	—	—	—	—
Projected benefit obligation at end of year	<u>\$ 24,820</u>	<u>\$ 25,075</u>	<u>\$ 28,432</u>	<u>\$ 15,228</u>	<u>\$ 15,404</u>	<u>\$ 16,832</u>
Change in plan assets:						
Fair value of plan assets at beginning of year	\$ 22,090	\$ 25,843	\$ 25,446	\$ —	\$ —	\$ —
Actual return on plan assets	3,471	(640)	2,909	—	—	—
Employer contributions	—	—	—	1,312	1,205	1,451
Benefits paid	(2,003)	(2,746)	(1,995)	(1,312)	(1,205)	(1,451)
Expenses paid	(394)	(367)	(517)	—	—	—
Settlements	—	—	—	—	—	—
Fair value of plan assets at end of year	<u>\$ 23,164</u>	<u>\$ 22,090</u>	<u>\$ 25,843</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Funded status	<u>\$ (1,656)</u>	<u>\$ (2,985)</u>	<u>\$ (2,589)</u>	<u>\$ (15,228)</u>	<u>\$ (15,404)</u>	<u>\$ (16,832)</u>
Prepaid (accrued) benefit expense	\$ 6,690	\$ 7,425	\$ 8,016	\$ (9,884)	\$ (10,320)	\$ (10,648)
Total amount recognized in Consolidated Balance Sheets, all in Other liabilities	<u>\$ (1,656)</u>	<u>\$ (2,985)</u>	<u>\$ (2,589)</u>	<u>\$ (15,228)</u>	<u>\$ (15,404)</u>	<u>\$ (16,832)</u>
Amounts recognized in accumulated other comprehensive income (loss) (AOCI):						
Prior service cost	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Net actuarial loss	(8,345)	10,410	10,605	(5,345)	5,084	6,184
Total amount recognized in AOCI	<u>\$ (8,345)</u>	<u>\$ 10,410</u>	<u>\$ 10,605</u>	<u>\$ (5,345)</u>	<u>\$ 5,084</u>	<u>\$ 6,184</u>
Information for pension plans with an accumulated benefit obligation greater than plan assets:						
Projected benefit obligation	\$ 24,820	\$ 25,075	\$ 28,432	\$ 15,228	\$ 15,404	\$ 16,832
Accumulated benefit obligation	24,820	25,075	28,432	15,228	15,404	16,832
Fair value of plan assets	23,164	22,090	25,843	—	—	—

NOTE 15 - 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, 2019 was primarily attributable to better than expected asset returns, updates to mortality assumptions and updated census dates 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, 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.

(\$ in thousands)	Defined Benefit Plan			Supplemental Defined Benefit Plans		
	Year Ended December 31,			Year Ended December 31,		
	2019	2018	2017	2019	2018	2017
Components of net periodic pension (income) expense:						
Service cost:						
Benefit accrual	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Other expenses	650	650	650	—	—	—
Interest cost	997	947	1,091	620	566	631
Expected return on plan assets	(1,222)	(1,377)	(1,493)	—	—	—
Settlement loss	—	—	—	—	—	—
Amortization of:						
Prior service cost	—	—	—	—	—	—
Actuarial loss	310	371	389	256	310	258
Net periodic pension expense	<u>\$ 735</u>	<u>\$ 591</u>	<u>\$ 637</u>	<u>\$ 876</u>	<u>\$ 876</u>	<u>\$ 889</u>
Changes in plan assets and benefit obligations included in other comprehensive income (loss):						
Prior service cost	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Net actuarial loss (gain)	(1,755)	177	(1,619)	516	(789)	805
Amortization of:						
Prior service cost	—	—	—	—	—	—
Actuarial loss	(310)	(371)	(389)	(256)	(310)	(258)
Total recognized in other comprehensive income (loss)	<u>\$ (2,065)</u>	<u>\$ (194)</u>	<u>\$ (2,008)</u>	<u>\$ 260</u>	<u>\$ (1,099)</u>	<u>\$ 547</u>
Weighted average assumptions used to determine expense:						
Discount rate	4.20%	3.50%	3.90%	4.20%	3.50%	3.90%
Expected return on plan assets	5.75%	5.90%	6.25%	*	*	*
Annual rate of salary increase	*	*	*	*	*	*
Weighted average assumptions used to determine benefit obligations as of December 31:						
Discount rate	3.10%	4.20%	3.50%	3.10%	4.20%	3.50%
Expected return on plan assets	5.75%	5.90%	6.25%	*	*	*
Annual rate of salary increase	*	*	*	*	*	*

* Not applicable.

NOTE 15 - Retirement Plans and Other Postretirement Benefits (continued)

The discount rates at December 31, 2019 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, 2019				
Asset category				
Equity security funds ⁽¹⁾				
United States	\$ 8,883	\$ —	\$ 8,883	\$ —
International	2,214	—	2,214	—
Fixed income funds	11,116	—	11,116	—
Short-term investment funds	951	951	—	—
Total	<u>\$ 23,164</u>	<u>\$ 951</u>	<u>\$ 22,213</u>	<u>\$ —</u>
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 investments funds	800	800	—	—
Total	<u>\$ 22,090</u>	<u>\$ 800</u>	<u>\$ 21,290</u>	<u>\$ —</u>

⁽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, 2019 and 2018.

In 2020, the Company expects amortization of net losses of \$0.3 million and \$0.3 million 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.

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 \$7.3 million. As of December 31, 2019, the balance of the previously established HRAs was \$1.4 million. Funding of HRAs was \$0.1 million, \$0.1 million and \$0.1 million for the years ended December 31, 2019, 2018 and 2017, respectively.

NOTE 15 - Retirement Plans and Other Postretirement Benefits (continued)

2020 Contributions

In 2020, 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 2019	\$	—	N/A
Expected contributions (approximations) for the year ended December 31, 2020 as of the time of this Form 10-K ⁽¹⁾	\$	—	\$ 1,282

N/A - Not applicable.

⁽¹⁾ HMEC's Annual Report on Form 10-K for the year ended December 31, 2019.

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, 2019 were as follows:

(\$ in thousands)	2020	2021	2022	2023	2024	2025-2029
Pension plans						
Defined benefit plan	\$ 2,478	\$ 2,277	\$ 2,219	\$ 1,987	\$ 2,099	\$ 7,927
Supplemental retirement plans	1,282	1,265	1,245	1,222	1,195	5,407

NOTE 16 - 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 issuance 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.

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.

Investment Commitments

From time to time, the Company has outstanding commitments to fund investments in limited partnership interests, commercial mortgage loans and bank loans. Such unfunded commitments were \$306.2 million and \$145.4 million for the years ended December 31, 2019 and 2018, respectively.

NOTE 17 - Supplemental Disclosure of Consolidated Cash Flow Information

(\$ in thousands)	Years Ended December 31,		
	2019	2018	2017
Cash	\$ 25,206	\$ 11,906	\$ 7,627
Restricted cash	302	—	—
Total cash and restricted cash shown in the Consolidated Statements of Cash Flows	<u>\$ 25,508</u>	<u>\$ 11,906</u>	<u>\$ 7,627</u>
Cash paid during the year for:			
Interest	\$ 14,104	\$ 12,532	\$ 11,555
Income taxes	22,946	8,679	16,259

Non-cash investing activities include \$2.1 billion of investments transferred to a reinsurer as consideration paid during the second quarter of 2019 in connection with the Company's reinsurance of a \$2.9 billion block of in force fixed and variable annuity business. See Note 6 for further information.

Non-cash investing activities in respect to modifications or exchanges of fixed maturity securities as well as paid-in-kind activity for policy loans were insignificant for the years ended December 31, 2019, 2018 and 2017, respectively.

NOTE 18 - Segment Information

The Company conducts and manages its business through five segments. See Note 1 for a description of the Company's reporting segments that changed effective in the third quarter of 2019. The four operating segments, representing the major lines of insurance business, are Property and Casualty (primarily personal lines of automobile and property insurance products), the newly created Supplemental (primarily heart, cancer, accident and limited short-term supplemental disability coverages), 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 fifth 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. The Company accounts for intersegment transactions, primarily the allocation of operating and agency costs from Corporate and Other to Property and Casualty, Supplemental, Retirement and Life, on a direct cost basis.

NOTE 18 - Segment Information (continued)

Summarized financial information for these segments is as follows:

(\$ in thousands)	Years Ended December 31,		
	2019	2018	2017
Insurance premiums and contract charges earned			
Property and Casualty	\$ 683,454	\$ 665,734	\$ 648,263
Supplemental	65,815	N/A	N/A
Retirement	29,083	31,269	28,003
Life	119,602	120,330	118,437
Total	<u>\$ 897,954</u>	<u>\$ 817,333</u>	<u>\$ 794,703</u>
Net investment income			
Property and Casualty	\$ 41,740	\$ 40,104	\$ 36,178
Supplemental	7,480	N/A	N/A
Retirement	245,475	262,634	261,994
Life	71,957	74,399	76,195
Corporate and Other	(85)	142	78
Intersegment eliminations	(1,503)	(772)	(815)
Total	<u>\$ 365,064</u>	<u>\$ 376,507</u>	<u>\$ 373,630</u>
Net income (loss)			
Property and Casualty	\$ 54,359	\$ (14,243)	\$ 17,790
Supplemental	17,989	N/A	N/A
Retirement	(4,867)	41,736	88,473
Life	17,574	18,754	77,595
Corporate and Other	99,388	(27,904)	(14,399)
Total	<u>\$ 184,443</u>	<u>\$ 18,343</u>	<u>\$ 169,459</u>

(\$ in thousands)	December 31,		
	2019	2018	2017
Assets			
Property and Casualty	\$ 1,327,099	\$ 1,236,362	\$ 1,217,394
Supplemental	747,602	N/A	N/A
Retirement	8,330,127	7,866,969	8,063,912
Life	1,964,993	1,821,351	1,815,732
Corporate and Other	172,955	149,014	143,784
Intersegment eliminations	(64,072)	(41,800)	(42,482)
Total	<u>\$ 12,478,704</u>	<u>\$ 11,031,896</u>	<u>\$ 11,198,340</u>

NOTE 18 - Segment Information (continued)

Additional significant financial information for these segments is as follows:

(\$ in thousands)	Years Ended December 31,		
	2019	2018	2017
DAC amortization expense			
Property and Casualty	\$ 79,453	\$ 79,073	\$ 76,967
Supplemental	438	N/A	N/A
Retirement	21,446	23,186	17,759
Life	7,844	7,630	7,459
Total	<u>\$ 109,181</u>	<u>\$ 109,889</u>	<u>\$ 102,185</u>
Income tax expense (benefit)			
Property and Casualty	\$ 13,954	\$ (6,622)	\$ (3,279)
Supplemental	5,105	N/A	N/A
Retirement	33,772	10,000	(19,498)
Life	4,907	4,979	(51,876)
Corporate and Other	(5,732)	(7,163)	(6,119)
Total	<u>\$ 52,006</u>	<u>\$ 1,194</u>	<u>\$ (80,772)</u>

NOTE 19 - 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,
2019				
Insurance premiums and contract charges earned ⁽¹⁾	\$ 240,392	\$ 239,681	\$ 208,096	\$ 209,785
Insurance premiums written and contract deposits ⁽¹⁾⁽²⁾⁽³⁾	346,242	371,216	311,691	295,394
Total revenues ⁽¹⁾	331,376	334,418	451,478	313,213
Net income ⁽¹⁾	33,001	25,454	93,822	32,166
Per share information				
Basic				
Net income ⁽¹⁾	\$ 0.79	\$ 0.61	\$ 2.25	\$ 0.77
Shares of common stock - weighted average ⁽⁴⁾	41,814	41,785	41,762	41,610
Diluted				
Net income ⁽¹⁾	\$ 0.78	\$ 0.60	\$ 2.24	\$ 0.77
Shares of common stock and equivalent shares - weighted average ⁽⁴⁾	42,093	42,030	41,921	41,785
2018				
Insurance premiums and contract charges earned	\$ 201,905	\$ 206,820	\$ 205,610	\$ 202,998
Insurance premiums written and contract deposits ⁽²⁾	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 ⁽⁴⁾	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 ⁽⁴⁾	41,911	41,850	41,735	41,653
2017				
Insurance premiums and contract charges earned	\$ 204,328	\$ 198,935	\$ 195,718	\$ 195,722
Insurance premiums written and contract deposits ⁽²⁾	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 ⁽⁵⁾	\$ 3.03	\$ 0.64	\$ 0.05	\$ 0.37
Shares of common stock - weighted average ⁽⁴⁾	41,419	41,433	41,368	41,135
Diluted				
Net income ⁽⁵⁾	\$ 3.00	\$ 0.64	\$ 0.05	\$ 0.37
Shares of common stock and equivalent shares - weighted average ⁽⁴⁾	41,718	41,575	41,493	41,342

⁽¹⁾ See Note 2 for more information regarding the acquisition of NTA on July 1, 2019.

⁽²⁾ 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.

⁽³⁾ Excludes the annuity reinsurance agreement accounted for under the deposit method that is discussed in Note 6.

⁽⁴⁾ Rounded to thousands.

⁽⁵⁾ 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 TCJA.