HORACE MANN EDUCATORS CORP /DE/
Form 10-K
March 16, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 1-10890

HORACE MANN EDUCATORS CORPORATION

(Exact name of registrant as specified in its charter)

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

1 Horace Mann Plaza, Springfield, Illinois 62715-0001

(Address of principal executive offices, including Zip Code)

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

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.001 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of the registrant s voting Common Stock held by non-affiliates of the registrant based on the closing price of the registrant s Common Stock on the New York Stock Exchange and the shares outstanding on June 30, 2005, was $807.3 million.

As of February 28, 2006, 42,989,389 shares of the registrant s Common Stock, par value $0.001 per share, were outstanding, net of 17,503,371 shares of treasury stock.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant s Proxy Statement for the 2006 Annual Meeting of Shareholders are incorporated by reference into Part II Item 5 and Part III Items 10, 11, 12, 13 and 14 of Form 10-K as specified in those Items and will be filed with the Securities and Exchange Commission within 120 days after December 31, 2005.

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HORACE MANN EDUCATORS CORPORATION

FORM 10-K

YEAR ENDED DECEMBER 31, 2005

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PART I

ITEM 1. Business

Forward-looking Information

It is important to note that the Company s actual results could differ materially from those projected in forward-looking statements. Additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements is contained in Management s Discussion and Analysis of Financial Condition and Results of Operations .

Overview and Available Information

Horace Mann Educators Corporation (HMEC ; and together with its subsidiaries, the Company or Horace Mann) is an insurance holding company incorporated in Delaware. Through its subsidiaries, HMEC markets and underwrites personal lines of property and casualty and life insurance and retirement annuities in the United States of America (U.S.). HMEC s principal insurance subsidiaries are Horace Mann Insurance Company (HMIC), Teachers Insurance Company (TIC) and Horace Mann Life Insurance Company (HMLIC), each of which is an Illinois corporation; Horace Mann Property & Casualty Insurance Company (HMPCIC), a California corporation; and Horace Mann Lloyds (HM Lloyds), an insurance company domiciled in Texas.

The Company markets its products primarily to educators and other employees of public schools and their families. The Company s nearly one million customers typically have moderate annual incomes, with many belonging to two-income households. Their financial planning tends to focus on retirement, security, savings and primary insurance needs. Management believes that Horace Mann is the largest national multiline insurance company focused on the nation s educators as its primary market.

The Company markets and services its products primarily through an exclusive sales force of full-time agents employed by the Company and trained to sell multiline products. The Company s agents sell Horace Mann s products and limited additional third-party vendor products authorized by the Company. Many of the Company s agents are former educators or individuals with close ties to the educational community who utilize their contacts within, and knowledge of, the target market. Compensation for agents includes an incentive element based upon the profitability of the business they write. This employee agent sales force is supplemented by an independent agent distribution channel for the Company s annuity products.

The Company s insurance premiums written and contract deposits for the year ended December 31, 2005 were $972.6 million and net income was $77.3 million. The Company s total assets were $5.8 billion at December 31, 2005. The property and casualty segment, whose primary products are private passenger automobile and homeowners insurance, accounted for 56% of the Company s insurance premiums written and contract deposits for the year ended December 31, 2005; the annuity and life insurance segments together accounted for 44% of insurance premiums written and contract deposits for the year ended December 31, 2005 (33% and 11%, respectively).

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The Company is one of the largest participants in the 403(b) tax-qualified annuity market, measured by 403(b) net written premium on a statutory accounting basis. The Company s 403(b) tax-qualified annuities are annuities purchased voluntarily by individuals employed by public school systems or other tax-exempt organizations. The Company has approved 403(b) payroll reduction capabilities in approximately one-third of the 14,000 public school districts in the U.S.

The Company s investment portfolio had an aggregate fair value of $4.0 billion at December 31, 2005. Investments consist principally of investment grade, publicly traded fixed income securities.

The Company s annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, and all amendments to those reports are available free of charge through the Investor Relations section of the Company s Internet website, www.horacemann.com, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission (SEC). The EDGAR filings of such reports are also available at the SEC s website, www.sec.gov.

Also available in the Investor Relations section of the Company s Internet website are its corporate governance principles, code of conduct and code of ethics as well as the charters of the Board s Audit Committee, Compensation Committee, Executive Committee, Investment and Finance Committee, and Nominating and Governance Committee.

Louis G. Lower II, CEO of HMEC, timely submitted the Annual Section 12(a) CEO Certification to the New York Stock Exchange (NYSE) on June 17, 2005 without any qualifications. The Company filed with the SEC, as exhibits to the Annual Report on Form 10-K for the year ended December 31, 2004, the CEO and CFO certifications required under Section 302 of the Sarbanes-Oxley Act.

History

The Company s business was founded in Springfield, Illinois in 1945 by two school teachers to sell automobile insurance to other teachers within the State of Illinois. The Company expanded its business to other states and broadened its product line to include life insurance in 1949, 403(b) tax-qualified retirement annuities in 1961 and homeowners insurance in 1965. In November 1991, HMEC completed an initial public offering of its common stock (the IPO). The common stock is traded on the New York Stock Exchange under the symbol HMN .

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SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA

The following consolidated statement of operations and balance sheet data have been derived from the consolidated financial statements of the Company. The consolidated financial statements of the Company for each of the years in the five-year period ended December 31, 2005 have been audited by KPMG LLP, an independent registered public accounting firm. The following selected historical consolidated financial data should be read in conjunction with the consolidated financial statements of HMEC and its subsidiaries and Management s Discussion and Analysis of Financial Condition and Results of Operations.

	Year Ended December 31,				
	2005	2004	2003	2002	2001
	(Dollars in millions, except per share data)				
Statement of Operations Data:					
Insurance premiums written and contract deposits	$ 972.6	$ 998.4	$ 955.5	$ 899.3	$ 875.6
Insurance premiums and contract charges earned	664.9	674.7	643.5	625.2	615.2
Net investment income	194.6	191.4	184.7	196.0	199.3
Realized investment gains (losses)	9.8	12.2	25.5	(49.4)	(10.0)
Total revenues	869.3	878.3	853.7	771.8	804.5
Amortization of intangible assets (1)	5.1	6.0	5.0	5.7	5.8
Interest expense	8.9	6.8	6.3	8.5	9.3
Income before income taxes	94.0	69.7	19.2	7.7	28.3
Net income (2)	77.3	56.3	19.0	11.3	25.6
Ratio of earnings to fixed charges (3)	1.8x	1.6x	1.2x	1.1x	1.3x
Per Share Data (4):					
Net income:					
Basic	$ 1.80	$ 1.32	$ 0.44	$ 0.28	$ 0.63
Diluted	$ 1.67	$ 1.25	$ 0.44	$ 0.28	$ 0.63
Shares of Common Stock - weighted average:					
Basic	42.9	42.8	42.7	40.9	40.6
Diluted	47.9	47.3	42.9	41.2	40.9
Shares of Common Stock - ending outstanding	43.0	42.8	42.7	42.7	40.7
Cash dividends	$ 0.42	$ 0.42	$ 0.42	$ 0.42	$ 0.42
Book value per share	$ 13.51	$ 13.45	$ 12.42	$ 12.39	$ 11.27
Balance Sheet Data, at Year End:					
Total investments	$ 3,996.5	$ 3,657.2	$ 3,385.7	$ 3,130.6	$ 2,975.7
Total assets	5,840.6	5,371.9	4,953.2	4,453.6	4,455.1
Total policy liabilities	3,172.1	3,010.6	2,787.0	2,585.2	2,445.2
Short-term debt		25.0	25.0		53.0
Long-term debt	190.9	144.7	144.7	144.7	99.8
Total shareholders equity	580.6	576.2	530.5	528.8	459.2
Segment Information (5):					
Insurance premiums written and contract deposits					
Property and casualty	$ 546.9	$ 562.3	$ 546.5	$ 524.9	$ 519.3
Annuity	320.1	327.0	296.6	261.5	239.1
Life	105.6	109.1	112.4	112.9	117.2
Total	972.6	998.4	955.5	899.3	875.6
Net income (loss)					
Property and casualty	$ 45.0	$ 27.6	$ (17.8)	$ 19.9	$ 5.2
Annuity	15.1	12.6	14.4	17.0	20.6
Life	13.4	14.8	13.4	18.9	18.7
Corporate and other (2) (6)	3.8	1.3	9.0	(44.5)	(18.9)
Total	77.3	56.3	19.0	11.3	25.6

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(1) Amortization of intangible assets is comprised of amortization of goodwill and amortization of acquired value of insurance in force and is the result of purchase accounting adjustments related to the 1989 acquisition of the Company and the 1994 acquisition of HMPCIC. Effective January 1, 2002, the Company adopted Financial Accounting Standard (FAS) No. 142, Goodwill and Other Intangible Assets . Under FAS No. 142, goodwill amortization ceases and the goodwill is annually tested for impairment. Goodwill amortization was $1.6 million for the year ended December 31, 2001.

(2) In 2005, the Company s federal income tax expense reflected a reduction of $9.1 million from the closing of tax years 1996 through 2001 with favorable resolution of the contingent tax liabilities related to those prior tax years. In 1999, the Company recorded a charge of $20.0 million for an additional federal income tax provision representing the Company s maximum exposure for disputed prior years taxes (for tax years 1994 through 1997). Resolution of the portion of this dispute related to the 1997 tax year resulted in a $1.3 million benefit in 2001.

(3) For the purpose of determining the ratio of earnings to fixed charges, earnings consist of income before income taxes and fixed charges, and fixed charges consist of interest expense (including amortization of debt issuance cost) and interest credited to policyholders on interest-sensitive contracts.

(4) Basic earnings per share is computed based on the weighted average number of shares outstanding. Diluted earnings per share is computed based on the weighted average number of shares and common stock equivalents outstanding. The Company s common stock equivalents relate to outstanding common stock options, Director Stock Plan units, Employee Stock Plan units and restricted stock units. The Company s Senior Convertible Notes, which were issued in May 2002, are considered potentially dilutive securities and are included in the calculation of diluted earnings per share, to the extent dilutive, per Emerging Issues Task Force (EITF) issue 04-8, The Effect of Contingently Convertible Instruments on Diluted Earnings per Share .

(5) Information regarding assets by segment at December 31, 2005, 2004 and 2003 is contained in Notes to Consolidated Financial Statements Note 13 Segment Information listed on page F-1 of this report.

(6) The corporate and other segment primarily includes interest expense on debt and the impact of realized investment gains and losses, restructuring charges, debt retirement costs, litigation charges, provision for/resolution of prior years taxes and certain public company expenses.

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Corporate Strategy and Marketing

The Horace Mann Value Proposition

The Horace Mann Value Proposition articulates the Company s overarching strategy and business purpose: Provide lifelong financial well-being for educators and their families through personalized service, advice, and a full range of tailored insurance and financial products.

Target Market

Management believes that Horace Mann is the largest national multiline insurance company focused on the nation s educators as its primary market. The Company s target market consists of educators and other employees of public schools and their families located throughout the U.S. The U.S. Department of Education estimates that there are approximately 3.5 million elementary and secondary teachers in public and private schools in the U.S. The Company also markets its products to other education-related customers, including school administrators, education support personnel, private school teachers, community college personnel and customer referrals.

Exclusive Agency Force

A cornerstone of the Company s marketing strategy is its exclusive sales force of full-time employee agents trained to sell multiline products. As of December 31, 2005, the Company employed 855 full-time agents, approximately 80% of which are licensed by the National Association of Securities Dealers, Inc. (NASD) to sell variable annuities. Many of the Company s agents were previously teachers, other members of the education profession or persons with close ties to the educational community. The Company s agents are under contract to market only the Company s products and limited additional third-party vendor products authorized by the Company. Collectively, the Company s principal insurance subsidiaries are licensed to write business in 49 states and the District of Columbia.

Broadening Distribution Options

Management has begun to broaden the Company s distribution options to complement and extend the reach of the Company s agency force. This initiative initially focuses on more fully utilizing its approved payroll deduction slots in school systems across the country which are assigned to Horace Mann. In 2001, the Company began building a network of independent agents who comprise a second distribution channel for the Company s 403(b) tax-qualified annuity products. In addition to serving educators in areas where the Company does not have agents, the independent agents will complement and extend the annuity capabilities of the Company s agents in under-penetrated areas.

As an example of the potential for this initiative, in January 2002 the Company announced that it had been selected as one of four providers of fixed and variable annuity options to Chicago, Illinois public school employees. At the time of this Report on Form 10-K, there are six annuity providers serving the Chicago Public Schools. The Chicago Public Schools is the third-largest school district in the U.S. Beginning in April 2002, the Company is partnering with a firm, which has been providing retirement planning services to Chicago Public School employees for more than two decades, to pursue this opportunity to bolster growth in its annuity business. At December 31, 2005, there were 759 independent agents approved to market the Company s annuity products throughout the U.S. During 2005, collected contract deposits from this distribution channel were approximately $41 million.

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Geographic Composition of Business

The Company s business is geographically diversified. For the year ended December 31, 2005, based on direct insurance premiums and contract deposits for all product lines, the top five states and their portion of total premiums were North Carolina, 7.1%; Illinois, 6.6%; Florida, 6.3%; Minnesota, 5.5%; and California, 5.5%.

HMEC s property and casualty subsidiaries write business in 48 states and the District of Columbia. The following table sets forth the Company s top ten property and casualty states based on total direct premiums in 2005:

Property and Casualty Segment Top Ten States

(Dollars in millions)

	Property and Casualty Segment	
	Direct Premiums (1)	**Percent of Total**
State		
Florida	$ 47.5	8.4%
California	46.7	8.3
North Carolina	42.0	7.4
Minnesota	40.4	7.1
Louisiana	25.6	4.5
Pennsylvania	25.4	4.5
Texas	24.8	4.4
South Carolina	23.8	4.2
Michigan	19.5	3.5
Maine	18.8	3.3
Total of top ten states	314.5	55.6
All other areas	251.1	44.4
Total direct premiums	$ 565.6	100.0%

(1) Defined as earned premiums before reinsurance and is determined under statutory accounting principles.

HMEC s principal life insurance subsidiary writes business in 48 states and the District of Columbia. The following table sets forth the Company s top ten combined life and annuity states based on total direct premiums and contract deposits in 2005:

Combined Life and Annuity Segments Top Ten States

(Dollars in millions)

State	Direct Premiums and Contract Deposits (1)	Percent of Total
Illinois	$ 52.3	12.1%
North Carolina	29.1	6.7
Virginia	27.2	6.3
South Carolina	23.9	5.5
Texas	18.0	4.2
Tennessee	16.9	3.9
Pennsylvania	16.6	3.8
Indiana	16.3	3.8
Florida	15.9	3.7
Minnesota	14.8	3.4
Total of top ten states	231.0	53.4
All other areas	201.8	46.6
Total direct premiums	$ 432.8	100.0%

(1) Defined as collected premiums before reinsurance and is determined under statutory accounting principles.

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National, State and Local Education Associations

The Company has had a long relationship with the National Education Association (NEA), the nation s largest confederation of state and local teachers associations, and many of the state and local education associations affiliated with the NEA. The NEA has approximately 2.7 million members. The Company maintains a special advisory board, primarily composed of leaders of state education associations, that meets with Company management on a regular basis. The NEA and its affiliated state and local associations sponsor various insurance products and services of the Company and its competitors.

From 1984 to September 1993 and beginning again in September 1996, the NEA purchased from the Company educator excess professional liability insurance for all of its members. The NEA has entered into a contract to purchase this insurance from the Company through August 2007. Premiums from this product represent less than 1% of all insurance premiums written and contract deposits of the Company.

Property and Casualty Segment

The property and casualty segment represented 56% of the Company s total insurance premiums written and contract deposits.

The primary property and casualty product offered by the Company is private passenger automobile insurance, which in 2005 represented 39% of the Company s total insurance premiums written and contract deposits and 70% of property and casualty net written premiums. As of December 31, 2005, the Company had approximately 531,000 voluntary automobile policies in force with annual premiums of approximately $391 million. The Company s automobile business is primarily preferred risk, defined as a household whose drivers have had no recent accidents and no more than one recent moving violation.

In 2005, homeowners insurance represented 16% of the Company s total insurance premiums written and contract deposits and 28% of property and casualty net written premiums. The Company insures primarily residential homes. As of December 31, 2005, the Company had approximately 266,000 homeowners policies in force with annual premiums of approximately $176 million. As expected, the number of homeowners policies in force decreased in 2005, reflecting initiatives to improve profitability in this product line.

Educator excess professional liability insurance represented less than 1% of the Company s 2005 property and casualty premiums. See Corporate Strategy and Marketing National, State and Local Education Associations .

The Company has programs in a majority of states to provide higher-risk automobile and homeowners coverages, with third-party vendors underwriting and bearing the risk of such insurance and the Company receiving commissions on the sales.

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Selected Historical Financial Information For Property and Casualty Segment

The following table sets forth certain financial information with respect to the property and casualty segment for the periods indicated.

Property and Casualty Segment

Selected Historical Financial Information

(Dollars in millions)

	Year Ended December 31,		
	2005	**2004**	**2003**
Statement of Operations Data:			
Insurance premiums written (1) (2)	$ 546.9	$ 562.3	$ 546.5
Insurance premiums earned (1)	549.6	561.3	533.8
Net investment income	33.2	33.8	31.9
Income (loss) before income taxes	58.0	29.5	(35.2)
Net income (loss)	45.0	27.6	(17.8)
Catastrophe costs, pretax (3)	69.2	75.5	33.2
Operating Statistics:			
Loss and loss adjustment expense ratio	72.4%	78.3%	88.6%
Expense ratio	23.2%	22.2%	23.7%
Combined loss and expense ratio (including policyholder dividends)	95.6%	100.5%	112.3%
Effect of catastrophe costs on the combined ratio (3)	12.3%	13.4%	6.2%
Automobile and Homeowners (Voluntary):			
Insurance premiums written (1) (2)	$ 535.2	$ 552.5	$ 549.2
Insurance premiums earned (1)	538.8	552.0	534.8
Policies in force (in thousands)	797	818	850

(1) As a result of catastrophes in the third quarter of both 2005 and 2004, the Company incurred additional ceded written and earned premiums to reinstate its property and casualty catastrophe reinsurance coverage of $9.9 million and $5.0 million for the years ended December 31, 2005 and 2004, respectively.

(2) Reflecting resolution of the challenge to automobile rates in North Carolina, in 2004 the Company returned to policyholders $4.0 million of previously escrowed premiums, resulting in a reduction to written premiums.

(3) These measures are used by the Company s management to evaluate performance against historical results and establish targets on a consolidated basis. These measures are components of net income but are considered non-GAAP financial measures under applicable SEC rules because they are not displayed as separate line items in the Consolidated Statement of Operations and require inclusion or exclusion of certain items not ordinarily included or excluded in a GAAP financial measure. In the opinion of the Company s management, a discussion of these measures is meaningful to provide investors with an understanding of the significant factors that comprise the Company s periodic results of operations.

Catastrophe costs The sum of catastrophe losses and property and casualty catastrophe reinsurance reinstatement premiums.

Catastrophe losses   In categorizing property and casualty claims as being from a catastrophe, the Company utilizes the designations of the Insurance Services Office, Inc. (ISO   ) and reports loss and loss adjustment expense amounts net of reinsurance recoverables. A catastrophe is a severe loss resulting from natural and man-made events within a particular territory, including risks such as hurricane, fire, earthquake, windstorm, explosion, terrorism and other similar events, that causes $25 million or more in insured property and casualty losses for the industry and affects a significant number of property and casualty insurers and policyholders. Each catastrophe has unique characteristics. Catastrophes are not predictable as to timing or amount in advance, and therefore their effects are not included in earnings or claim and claim adjustment expense reserves prior to occurrence. In the opinion of the Company   s management, a discussion of the impact of catastrophes is meaningful for investors to understand the variability in periodic earnings.

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Catastrophe Costs

The level of catastrophe costs can fluctuate significantly from year to year. Catastrophe costs before federal income tax benefits for the Company and the property and casualty industry for the ten years ended December 31, 2005 were as follows:

Catastrophe Costs

(Dollars in millions)

	The Company (1)	Property and Casualty Industry (2)
Year Ended December 31,		
2005	$ 69.2	$ 56,800.0
2004	75.5	27,300.0
2003	33.2	12,900.0
2002	11.9	5,900.0
2001	11.2	26,500.0
2000	16.2	4,600.0
1999	19.6	8,300.0
1998	28.4	10,100.0
1997	6.2	2,600.0
1996	20.9	7,400.0

(1) Net of reinsurance and before federal income tax benefits. Includes allocated loss adjustment expenses and reinsurance reinstatement premiums. The Company s individually significant catastrophe losses net of reinsurance were as follows:

2005 - $23.7 million, Hurricane Katrina; $15.0 million, Hurricane Wilma; $10.8 million, Hurricane Rita; $6.5 million, September Minnesota tornadoes; $5.0 million, Hurricane Dennis.
2004 - $19.9 million, Hurricane Charley; $11.9 million, Hurricane Frances; $19.2 million, Hurricane Ivan; $18.2 million, Hurricane Jeanne.
2003 - $12.0 million, California wildfires; $9.6 million, May hail/tornadoes/wind; $5.0 million, Hurricane Isabel; $2.7 million, early April winter storms.
2002 - $4.2 million, Hurricane Lili; $1.7 million, April Eastern states hail, tornadoes, wind and heavy rain; $1.2 million, Eastern states winter storms.
2001 - $3.7 million, June Midwest wind/hail/tornadoes; $2.3 million, April tornadoes; $2.2 million, Tropical Storm Allison.
2000 - $5.0 million, May tornadoes; $2.7 million, December winter storms.
1999 - $5.4 million, Hurricane Floyd; $3.1 million, May tornadoes primarily in Oklahoma.
1998 - $7.9 million, May Minnesota hailstorm; $2.9 million, May Upper Midwest hailstorm; $2.0 million, June Midwest wind/hail; $1.6 million, Hurricane Georges.
1997 - $1.4 million, July wind/hail/tornadoes; $1.1 million, Denver, Colorado hailstorm.
1996 - $8.2 million, Hurricane Fran.

(2) Source: Insurance Services Office, Inc. news release dated January 26, 2006. These amounts represent anticipated insured losses from catastrophes for personal and commercial property items, business interruption and additional living expenses and are net of reinsurance,

before federal income tax benefits, and exclude all loss adjustment expenses.

Fluctuations from year to year in the level of catastrophe losses impact a property and casualty insurance company s loss and loss adjustment expenses incurred and paid. For comparison purposes, the following table provides amounts for the Company excluding catastrophe losses:

Impact of Catastrophe Losses (1)

(Dollars in millions)

	Year Ended December 31,		
	2005	**2004**	**2003**
Claims and claim expense incurred (2)	$ 398.0	$ 439.3	$ 472.9
Amount attributable to catastrophes	59.3	70.5	33.2
Excluding catastrophes (2)	$ 338.7	$ 368.8	$ 439.7
Claims and claim expense payments	$ 396.2	$ 413.7	$ 420.2
Amount attributable to catastrophes	50.9	42.8	21.4
Excluding catastrophes	$ 345.3	$ 370.9	$ 398.8

(1) Net of reinsurance and before federal income tax benefits. Includes allocated loss adjustment expenses.

(2) Includes the impact of development of prior years reserves as quantified in Property and Casualty Reserves .

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Property and Casualty Reserves

Property and casualty unpaid claims and claim settlement expenses (loss reserves) represent management s estimate of ultimate unpaid costs of losses and settlement expenses for claims that have been reported and claims that have been incurred but not yet reported. The process for estimating these liabilities begins with the collection and analysis of claim data. Data on individual reported claims, both current and historical, including paid amounts and individual claim adjuster estimates, are grouped by common characteristics and evaluated by actuaries in their analyses of ultimate claim liabilities by product line. Such data is supplemented with external data as available and when appropriate. The process of analyzing loss reserves for all product lines is undertaken on a quarterly basis.

Multiple estimation methods are available for the analysis of ultimate claim liabilities. Some of the techniques used include development of paid loss dollars, development of reported loss dollars, methods based on the expected loss ratio and methods utilizing frequency and severity of losses. These methods tend to converge over time, with the broadest range of results observed initially. The short-tailed coverages, such as property coverages, tend to converge more quickly than the long-tailed liability lines. Each estimation method has its own set of assumption variables and its own advantages and disadvantages, with no single estimation method being better than the others in all situations and no one set of assumption variables being meaningful for all product lines. The relative strengths and weaknesses of the particular estimation methods when applied to a particular group of claims can also change over time. Therefore, the actual choice of estimation method(s) can change with each evaluation. The estimation method(s) chosen are those that are believed to produce the most reliable indication at that particular evaluation date for the claim liabilities being evaluated.

In most cases, multiple estimation methods will be valid for the particular facts and circumstances of the claim liabilities being evaluated. This will result in a range of reasonable estimates for any particular claim liability. The Company uses such range analyses to back test whether previously established estimates for reserves are reasonable, given subsequent information. Reported values found to be closer to the endpoints of a range of reasonable estimates are subject to further detailed reviews. These reviews may substantiate the validity of management s recorded estimate or lead to a change in the reported estimate.

The exact boundary points of these ranges are more qualitative than quantitative in nature, as no clear line of demarcation exists to determine when the set of underlying assumptions for an estimation method switches from being reasonable to unreasonable. As a result, the Company does not believe that the endpoints of these ranges are or would be comparable across companies. In addition, potential interactions among the different estimation assumptions for different product lines make the aggregation of individual ranges a highly judgmental and inexact process.

A key assumption in most actuarial analyses is that past patterns demonstrated in the data will repeat themselves in the future, absent a significant change in the associated risk factors discussed below. To the extent a significant change affecting the ultimate claim liability is known, such change is quantified to the extent possible through an analysis of internal Company and, if available and when appropriate, external data. Such a measurement is specific to the facts and circumstances of the particular claim portfolio and the known change being evaluated.

Informed management judgment is applied throughout the reserving process. This includes the application, on a consistent basis over time, of various individual experiences and expertise to multiple sets of data and analyses. In addition to actuaries, individuals involved with the reserving process also include underwriting and claims personnel as well as other Company management. Therefore, it is quite possible and generally likely that management must consider varying individual viewpoints as part of its estimation of loss reserves.

The variables discussed above in this general discussion have different impacts on reserve estimation uncertainty for a given product line, depending on the length of the claim tail (described below), the reporting lag, the impact of individual claims and the complexity of the claim process for a given product line.

Product lines are generally classified as either long-tail or short-tail, based on the average length of time between the event triggering claims under a policy and the final resolution of those claims. Short-tail claims are reported and settled quickly, resulting in less estimation variability. The longer the time before final claim resolution, the greater the exposure to estimation risks and hence the greater the estimation uncertainty.

A major component of the claim tail is the reporting lag. The reporting lag, which is the time between the event triggering a claim and the reporting of the claim to the insurer, makes estimating incurred but not reported (IBNR) reserves inherently more uncertain. In addition, the greater the reporting lag, the greater the proportion of IBNR claims to the total claim liability for the product line.

For some lines, the impact of large individual claims can be material to the analysis. These lines are generally referred to as being low frequency/high severity, while lines without this large claim sensitivity are referred to as high frequency/low severity. Estimates of claim liabilities for low frequency/high severity lines can be sensitive to a few key assumptions. As a result, the role of judgment is much greater for these reserve estimates. In contrast, high frequency/low severity lines tend to have a lower level of volatility, such that the range of reasonable reserve estimates is narrower and more stable.

Claim complexity can also greatly affect the estimation process by impacting the number of assumptions needed to produce the estimate, the potential stability of the underlying data and claim process and the ability to gain an understanding of the data. Product lines with greater claim complexity have inherently greater estimation uncertainty.

Actuaries have to exercise a considerable degree of judgment in the evaluation of all these factors in their analysis of reserves. The human element in the application of actuarial judgment is unavoidable when faced with material uncertainty. Different actuaries will choose different assumptions when faced with such uncertainty, based on their individual backgrounds, professional experiences and areas of focus. Hence, the estimate selected by the various actuaries may differ materially from each other.

The major causes of significant uncertainty (risk factors) generally will vary for each product line, as well as for each separately analyzed coverage of the product line. In some cases, such risk factors are explicit assumptions of the estimation method, and in others, they are implicit. For example, a method may explicitly assume a certain claim reporting pattern, but implicitly assume that the Company s claim handling process is consistent over time. Actual results will likely vary from expectations for each of these assumptions, resulting in an ultimate claim liability that is different from that being estimated currently.

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At December 31, 2005, all of the Company s reserves for unpaid claims and claim expenses were carried at the full value of estimated liabilities and were not discounted for interest expected to be earned on reserves. Due to the nature of the Company s personal lines business, the Company has no exposure to claims for toxic waste cleanup, other environmental remediation or asbestos-related illnesses other than claims under homeowners insurance policies for environmentally related items such as mold.

The following table is a summary reconciliation of the beginning and ending property and casualty insurance claims and claim expense reserves, displayed individually for each of the last three years. The table presents reserves on a 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 listed on page F-1 of this report. The end of the year gross reserve (before reinsurance) balances are reflected in the Consolidated Balance Sheets also listed on page F-1 of this report.

Reconciliation of Property and Casualty Claims and Claim Expense Reserves

(Dollars in millions)

	Year Ended December 31,		
	2005	**2004**	**2003**
Gross reserves, beginning of year	$ 335.0	$ 304.3	$ 275.7
Less reinsurance recoverables	25.7	20.6	44.7
Net reserves, beginning of year (1)	309.3	283.7	231.0
Incurred claims and claim expenses:			
Claims occurring in the current year	411.1	435.5	416.5
Increase (decrease) in estimated reserves for claims occurring in prior years (2):			
Policies written by the Company	(13.1)	3.8	58.3
Business assumed from state reinsurance facilities			(1.9)
Total increase (decrease)	(13.1)	3.8	56.4
Total claims and claim expenses incurred (3)	398.0	439.3	472.9
Claims and claim expense payments for claims occurring during:			
Current year	252.3	268.5	259.8
Prior years	143.9	145.2	160.4
Total claims and claim expense payments	396.2	413.7	420.2
Net reserves, end of year (1)	311.1	309.3	283.7
Plus reinsurance recoverables	31.6	25.7	20.6
Reported gross reserves, end of year (4)	$ 342.7	$ 335.0	$ 304.3

(1) Reserves net of anticipated reinsurance recoverables.

(2) Shows the amounts by which the Company increased or 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. For discussion of the reserve development recorded by the Company in 2005, 2004 and 2003, see Notes to Consolidated Financial Statements Note 3 Property and Casualty Unpaid Claims and Claim Expenses listed on page F-1 of this report.

(3) Benefits, claims and settlement expenses as reported in the Consolidated Statements of Operations, listed on page F-1 of this report, also include life, annuity, group accident and health and corporate amounts of $44.7 million, $45.1 million and $46.1 million for the years ended December 31, 2005, 2004 and 2003, respectively, in addition to the property and casualty amounts.

(4) Unpaid claims and claim expenses as reported in the Consolidated Balance Sheets, listed on page F-1 of this report, also include life, annuity, and group accident and health reserves of $8.1 million, $7.4 million and $9.0 million at December 31, 2005, 2004 and 2003, respectively, in addition to property and casualty reserves.

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The claim reserve development table below illustrates the change over time in the Net Reserves (defined in footnote 1 to the table above) established for property and casualty insurance claims and claim expenses at the end of various calendar years. The first section shows the reserves as originally reported at the end of the stated year. The second section, reading down, shows the cumulative amounts of claims for which settlements have been made in cash as of the end of successive years with respect to that reserve liability. The third section, reading down, shows retroactive reestimates of the original recorded reserve as of the end of each successive year which is the result of the Company s learning additional facts that pertain to the unsettled claims. The fourth section compares the latest reestimated reserve to the reserve originally established, and indicates whether or not the original reserve was adequate or inadequate to cover the estimated costs of unsettled claims. The table also presents the gross reestimated liability as of the end of the latest reestimation period, with separate disclosure of the related reestimated reinsurance recoverable. The claim reserve development table is cumulative and, therefore, ending balances should not be added since the amount at the end of each calendar year includes activity for both the current and prior years.

In evaluating the information in the table below, it should be noted that each amount includes the effects of all changes in amounts of prior periods. For example, if a claim determined in 2004 to be $150 thousand was first reserved in 1995 at $100 thousand, the $50 thousand deficiency (actual claim minus original estimate) would be included in the cumulative deficiency in each of the years 1995 - 2003 shown below. This table presents development data by calendar year and does not relate the data to the year in which the accident actually occurred. Conditions and trends that have affected the development of these reserves in the past will not necessarily recur in the future. It may not be appropriate to use this cumulative history in the projection of future performance.

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Property and Casualty

Claims and Claims Expense Reserve Development

(Dollars in millions)

	December 31,										
	1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Gross reserves for property and casualty claims and claim expenses	$ 349.1	$ 318.7	$ 289.1	$ 275.6	$ 271.2	$ 272.1	$ 275.7	$ 275.7	$ 304.3	$ 335.0	$ 342.7
Deduct: Reinsurance recoverables	23.8	34.1	41.3	55.9	64.4	49.1	34.1	44.7	20.6	25.7	31.6
Net Reserves for property and casualty claims and claim expenses (1)	325.3	284.6	247.8	219.7	206.8	223.0	241.6	231.0	283.7	309.3	311.1
Paid cumulative as of:											
One year later	125.1	133.4	127.0	129.3	135.9	139.0	153.4	160.4	145.2	143.9	
Two years later	178.7	184.3	174.9	185.7	191.6	202.6	226.0	222.3	209.5		
Three years later	205.1	206.5	205.0	215.4	225.4	243.3	258.4	258.6			
Four years later	215.1	220.8	219.5	232.1	246.9	256.1	276.3				
Five years later	222.1	226.6	227.7	243.3	252.7	264.1					
Six years later	224.7	230.9	234.2	245.1	257.6						
Seven years later	227.5	234.9	235.0	249.0							
Eight years later	230.0	235.0	237.3								
Nine years later	229.9	237.2									
Ten years later	231.5										
Net Reserves reestimated as of (1):											
End of year	325.3	284.6	247.8	219.7	206.8	223.0	241.6	231.0	283.7	309.3	311.1
One year later	262.8	239.5	222.9	215.1	229.5	239.5	265.6	287.3	287.5	296.2	
Two years later	229.0	228.5	217.8	237.9	248.3	260.5	294.7	297.1	283.1		
Three years later	225.2	226.1	233.4	245.4	256.0	277.0	301.3	297.9			
Four years later	223.2	235.4	235.5	248.0	266.9	280.2	298.5				
Five years later	230.3	234.7	237.2	254.7	269.3	277.9					
Six years later	229.5	237.1	241.2	257.8	268.1						
Seven years later	231.6	239.5	245.1	257.1							
Eight years later	233.7	244.2	245.0								
Nine years later	238.1	244.4									
Ten years later	238.6										
Net Reserve redundancy (deficiency) initial net reserves in excess of (less than) reestimated reserves:											
Amount (2)	$ 86.7	$ 40.2	$ 2.8	$ (37.4)	$ (61.3)	$ (54.9)	$ (56.9)	$ (66.9)	$ 0.6	$ 13.1	
Percent	26.7%	14.1%	1.1%	-17.0%	-29.6%	-24.6%	-23.6%	-29.0%	0.2%	4.2%	
Gross reestimated liability - latest	$ 267.5	$ 278.3	$ 278.1	$ 300.2	$ 311.1	$ 321.8	$ 345.4	$ 347.4	$ 313.0	$ 328.9	

Reestimated reinsurance recoverables - latest	28.9	33.9	33.1	43.1	43.0	43.9	46.9	49.5	29.9	32.7
Net Reserve reestimated - latest (1)	$ 238.6	$ 244.4	$ 245.0	$ 257.1	$ 268.1	$ 277.9	$ 298.5	$ 297.9	$ 283.1	$ 296.2
Gross cumulative excess (deficiency) (2)	$ 81.6	$ 40.4	$ 11.0	$ (24.6)	$ (39.9)	$ (49.7)	$ (69.7)	$ (71.7)	$ (8.7)	$ 6.1

(1) Reserves net of anticipated reinsurance recoverables (Net Reserves). Net Reserves is a measure used by the Company s management to evaluate the overall adequacy of the property and casualty loss reserves and management believes it provides an alternative view of the Company s anticipated liabilities after reflecting expected recoveries from its reinsurers. This is considered a non-GAAP financial measure under applicable SEC rules because it is not displayed as a separate item in the Consolidated Balance Sheets. For balance sheet reporting, GAAP does not permit the Company to offset expected reinsurance recoveries against liabilities, yet management believes it is useful to investors to take these expected recoveries into account. These adjustments only affect the classification of these items in the Consolidated Balance Sheets and the Consolidated Statements of Cash Flows and there is no impact on the Company s benefits, claims and settlement expenses incurred as reported in the Consolidated Statements of Operations.

(2) For discussion of the reserve development, see Notes to Consolidated Financial Statements Note 3 Property and Casualty Unpaid Claims and Claim Expenses listed on page F-1 of this report.

Property and Casualty Reinsurance

All reinsurance is obtained through contracts which generally are renewed each calendar year. Although reinsurance does not legally discharge the Company from primary liability for the full amount of its policies, it does make the assuming reinsurer liable to the extent of the reinsurance ceded. Historically, the Company s losses from uncollectible reinsurance recoverables have been insignificant due to the Company s emphasis on the credit worthiness of its reinsurers. Past due reinsurance recoverables as of December 31, 2005 were insignificant.

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Through 2005, the Company maintained an excess and catastrophe treaty reinsurance program. Effective January 1, 2005, the Company reinsured 95% of catastrophe losses above a retention of $10.0 million per occurrence up to $80.0 million per occurrence. The catastrophe treaty coverage consisted of four layers, each of which provided for one mandatory reinstatement. The four layers were $5.0 million excess of $10.0 million, $10.0 million excess of $15.0 million, $15.0 million excess of $25.0 million and $40.0 million excess of $40.0 million. In addition, the Company s predominant insurance subsidiary for property and casualty business written in Florida reinsures 90% of hurricane losses in that state above an estimated retention of $13.2 million up to $60.9 million with the Florida Hurricane Catastrophe Fund (FHCF), based on the FHCF s financial resources. The FHCF contract is a one-year contract, effective June 1. Through May 7, 2005, these catastrophe reinsurance programs were augmented by a $75.0 million equity put and reinsurance agreement, as further discussed below.

During 2005, the Company experienced significant losses from four hurricanes, two of which Katrina and Rita resulted in substantial catastrophe treaty reinsurance recoveries. As a result of reinsurance claims from these two hurricanes, the first layer of the catastrophe treaty was exhausted and the second layer had $2.5 million of remaining coverage.

Effective January 1, 2006, the Company purchased both catastrophe excess of loss and catastrophe aggregate reinsurance coverage. The excess of loss coverage consists of two contracts in addition to the FHCF. The primary contract provides 95% coverage of catastrophe losses above a retention of $15.0 million per occurrence up to $110.0 million per occurrence. This contract consists of four layers, each of which provide for one mandatory reinstatement. The four layers are $10.0 million excess of $15.0 million, $20.0 million excess of $25.0 million, $30.0 million excess of $45.0 million, and $35.0 million excess of $75.0 million. The other excess of loss contract provides 95% coverage of catastrophe losses above a retention of $10.0 million per occurrence up to $15.0 million per occurrence, after the Company retains $5.0 million of losses above $10.0 million for the first occurrence. This contract also provides for one mandatory reinstatement. The FHCF limits described above continue through June 1, 2006, at which time a new annual contract begins. The catastrophe aggregate contract provides 95% coverage of the Company s 2006 catastrophe losses, capped at $10.0 million per occurrence, above an annual retention of $20.0 million, up to an annual limit of $40.0 million.

Effective May 7, 2002, the Company entered into a 36-month equity put and reinsurance agreement with a subsidiary of Swiss Reinsurance Company, which provided a source of up to $75 million of contingent capital for catastrophe losses above the Company s reinsurance coverage limits. Due to relatively unfavorable pricing and terms, the Company elected not to renew this agreement on the May 7, 2005 expiration date. Management believes that the Company s current catastrophe protection as well as other potential sources of capital would be sufficient in the event of excessive catastrophe losses.

The Company has not joined the California Earthquake Authority (CEA). The Company s exposure to losses from earthquakes is managed through its underwriting standards, its earthquake policy coverage limits and deductible levels, and the geographic distribution of its business, as well as its reinsurance program. After reviewing the exposure to earthquake losses from its own policies and from participation in the CEA, management believes it is in the Company s best economic interest to offer earthquake coverage directly to its homeowners policyholders.

For liability coverages, including the educator excess professional liability policy, the Company reinsures each loss above a retention of $500,000 up to $20 million. For property coverages, the Company reinsures each loss above a retention of $500,000 up to $2.5 million, including catastrophe losses that in the aggregate are less than the retention levels above.

The following table identifies the Company s most significant reinsurers under the traditional catastrophe reinsurance program, their percentage participation in the Company s aggregate reinsured catastrophe coverage and their rating by A.M. Best Company (A.M. Best) and Standard & Poor s Corporation (S&P or Standard & Poor s) as of January 1, 2006. No other single reinsurer s percentage participation in 2006 or 2005 exceeds 5%.

Property Catastrophe Reinsurance Participants In Excess of 5%

A.M. Best Rating	S&P Rating	Reinsurer	Parent	Participation 2006	Participation 2005
A+	AA	Swiss Re Underwriters Agency	Swiss Reinsurance Company	13%	0%
A-	AA-	AXA Re	AXA Group	10%	7%
A-	NR	New Castle Reinsurance Company, Ltd.	Citadel Investment Group, L.L.C.	9%	0%
A++	AA	Harbor Point Re	The Chubb Corporation	7%	0%
A+	AA-	Tokio Millennium Re Ltd.	Millea Holdings Inc.	7%	0%
A	A	Liberty Syndicate Management Limited	Liberty Mutual Holding Company, Inc.	5%	8%
A+	A+	IPCRe, Ltd.	IPC Holdings, Ltd.	*	17%
A	AA-	Mapfre Reinsurance Corporation	Sistema MAPFRE	*	12%
A	A-	Montpelier Reinsurance Ltd.	Montpelier Re Holdings, Ltd.	0%	9%
A-	NR	Rosemont Reinsurance Limited	GoshawK Insurance Holdings plc	0%	8%
A+	AA	Transatlantic Reinsurance Company	American International Group, Inc.	*	7%
A	A	Axis Specialty Limited	Axis Capital Holdings Limited	0%	6%
A+	NR	Allied World Assurance Company, Ltd.	Allied World Assurance Holdings, Ltd.	0%	6%

* Less than 5%
NR Not rated.

For 2006, property catastrophe reinsurers representing 100% of the Company s aggregate reinsured catastrophe coverage were rated A- (Excellent) or above by A.M. Best.

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Annuity Segment

Educators in the Company s target market benefit from the provisions of Section 403(b) of the Internal Revenue Code. This section of the Code allows public school employees and employees of other tax-exempt organizations, such as not-for-profit private schools, to reduce their pretax income by making periodic contributions to an individual qualified retirement plan. The Company is one of the largest participants in the 403(b) tax-qualified annuity market, measured by 403(b) net written premium on a statutory accounting basis. The Company has approved 403(b) payroll reduction capabilities in approximately one-third of the 14,000 public school districts in the U.S. Approximately 65% of the Company s new annuity contract deposits in 2005 were for 403(b) tax-qualified annuities; approximately 75% of accumulated annuity value on deposit is 403(b) tax-qualified. In 2005, annuities represented 33% of the Company s total insurance premiums written and contract deposits.

The Company markets tax-qualified annuities primarily under a contract which allows the contractholder to allocate funds to both fixed and variable alternatives. The features of the Company s annuity contract contribute to business retention. Under the fixed account option, both the principal and a rate of return are guaranteed. Contractholders can change at any time their allocation of deposits between the guaranteed interest rate fixed account and available variable investment options.

The Company s 48 variable account options include funds managed by some of the best-known names in the mutual fund industry, such as Wilshire, Fidelity, JP Morgan, T. Rowe Price, Neuberger Berman, AllianceBernstein, Ranier, Davis, Credit Suisse, BlackRock, Goldman Sachs, Dreyfus, Templeton, Ariel, Wells Fargo, Royce, Lord Abbett and Delaware, offering the Company s customers multiple investment options, regardless of their personal investment objectives and risk tolerance. Total accumulated fixed and variable annuity cash value on deposit at December 31, 2005 was $3.3 billion.

In 2003, to assist agents in delivering the Value Proposition, the Company entered into a third-party vendor agreement with American Funds Distributors, Inc. (AFD) to market their retail mutual funds. In addition to retail mutual funds accounts, the Company s agents can also offer a 529 college savings program and Coverdell Education Savings Accounts through this marketing alliance. In 2005, the Company further expanded its product offerings to include equity indexed annuities and single premium immediate annuities through additional marketing alliances. These third-party vendors underwrite these accounts and the Company receives commissions on the sales of these products.

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Selected Historical Financial Information For Annuity Segment

The following table sets forth certain information with respect to the Company s annuity products for the periods indicated.

Annuity Segment

Selected Historical Financial Information

(Dollars in millions, unless otherwise indicated)

	Year Ended December 31,		
	2005	**2004**	**2003**
Statement of Operations Data:			
Contract deposits:			
Variable	$ 137.8	$ 132.0	$ 115.3
Fixed	182.3	195.0	181.3
Total	320.1	327.0	296.6
Contract charges earned	17.9	16.7	14.6
Net investment income	112.9	109.4	104.4
Net interest margin (without realized gains)	31.4	33.7	33.1
Income before income taxes	16.3	16.3	19.8
Net income	15.1	12.6	14.4
Operating Statistics:			
Fixed:			
Accumulated value	$ 1,961.7	$ 1,826.2	$ 1,650.6
Accumulated value persistency	94.5%	95.5%	95.1%
Variable:			
Accumulated value	$ 1,333.7	$ 1,254.8	$ 1,119.2
Accumulated value persistency	91.5%	92.9%	92.8%
Number of contracts in force	162,417	158,703	$ 152,515
Average accumulated cash value (in dollars)	$ 20,290	$ 19,414	$ 18,161
Average annual deposit by contractholders (in dollars)	$ 2,436	$ 2,391	$ 2,303
Annuity contracts terminated due to surrender, death, maturity or other:			
Number of contracts	7,938	6,918	7,019
Amount	$ 243.6	$ 200.5	$ 171.3
Fixed accumulated cash value grouped by applicable surrender charge:			
0%	$ 530.8	$ 510.7	$ 478.3
Greater than 0% but less than 5%	78.3	69.1	50.3
5% and greater but less than 10%	1,226.7	1,106.4	968.3
10% and greater	18.8	35.2	54.3
Supplementary contracts with life contingencies not subject to discretionary withdrawal	107.1	104.8	99.4
Total	$ 1,961.7	$ 1,826.2	$ 1,650.6

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Life Segment

The Company entered the individual life insurance business in 1949 with traditional term and whole life insurance products. The Company s traditional term, whole life and group life business in force consists of approximately 157,000 policies, representing approximately $7.8 billion of life insurance in force with annual insurance premiums and contract deposits of approximately $42.6 million as of December 31, 2005. The Company also underwrites Experience Life , a flexible, adjustable-premium life insurance contract which allows the customer to combine elements of term life insurance, interest-sensitive whole life insurance and an interest-bearing account. At December 31, 2005, the Company had in force approximately 80,000 Experience Life policies representing approximately $5.3 billion of life insurance in force with annual insurance premiums and contract deposits of approximately $62.7 million.

In 2005, the life segment represented 11% of the Company s total insurance premiums written and contract deposits, including approximately 1 percentage point attributable to the Company s group life and group disability income business.

During 2005, the average face amount of ordinary life insurance policies issued by the Company was $159,825 and the average face amount of all ordinary life insurance policies in force at December 31, 2005 was $65,550.

The maximum individual life insurance risk retained by the Company is $200,000 on any individual life and $100,000 or $125,000 is retained on each group life policy depending on the type of coverage. The excess of the amounts retained are reinsured with life reinsurers that are all rated A- (Excellent) or above by A.M. Best. The Company also maintains a life catastrophe reinsurance program. The Company reinsures 100% of the catastrophe risk in excess of $1 million up to $15 million per occurrence. This program covers acts of terrorism but excludes nuclear, biological and chemical explosions as well as other acts of war.

In 2000, the Company instituted a program to offer long-term care and variable universal life policies with two third-party vendors underwriting such insurance. In 2003, the Company expanded its third-party vendor offerings with the addition of fixed interest rate universal life insurance underwritten by Jefferson Pilot Financial. Under these programs, the third-party vendors underwrite and bear the risk of these insurance policies and the Company receives a commission on the sale of that business.

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Selected Historical Financial Information For Life Segment

The following table sets forth certain information with respect to the Company s life products for the periods indicated.

Life Segment

Selected Historical Financial Information

(Dollars in millions, unless otherwise indicated)

	Year Ended December 31,		
	2005	**2004**	**2003**
Statement of Operations Data:			
Insurance premiums and contract deposits	$ 105.6	$ 109.1	$ 112.4
Insurance premiums and contract charges earned	97.4	96.7	95.1
Net investment income	49.3	49.5	49.6
Income before income taxes	22.3	22.0	20.8
Net income	13.4	14.8	13.4
Operating Statistics:			
Life insurance in force:			
Ordinary life	$ 11,588	$ 11,509	$ 11,527
Group life	1,554	1,714	1,736
Total	$ 13,142	$ 13,223	$ 13,263
Number of policies in force:			
Ordinary life	176,780	182,022	187,533
Group life	60,674	69,621	70,725
Total	237,454	251,643	258,258
Average face amount in force (in dollars):			
Ordinary life	$ 65,550	$ 63,229	$ 61,467
Group life	25,612	24,619	24,546
Total	55,345	52,547	51,356
Lapse ratio (ordinary life insurance in force)	6.5%	7.2%	7.7%
Ordinary life insurance terminated due to death, surrender, lapse or other:			
Face amount of insurance surrendered or lapsed	$ 733.4	$ 842.5	$ 932.6
Number of policies	6,941	8,078	7,466
Amount of death claims opened	$ 33.7	$ 31.1	$ 32.0
Number of death claims opened	1,310	1,273	1,292

Investments

The Company s investments are selected to balance the objectives of protecting principal, minimizing exposure to interest rate risk and providing a high current yield. These objectives are implemented through a portfolio that emphasizes investment grade, publicly traded fixed income securities. When impairment of the value of an investment is considered other than temporary, the decrease in value is recorded as a charge to the results of operations and a new cost basis is established. At December 31, 2005, investments in non-investment grade securities represented 5.1% of total investments. At December 31, 2005, fixed income securities represented 97.4% of investments excluding securities lending collateral. Of the fixed income investment portfolio, 94.4% was investment grade and 99.9% was publicly traded. At December 31, 2005, the average quality and average option adjusted duration of the total fixed income portfolio were A+ and 5.5 years, respectively. There are no significant investments in mortgage loans, real estate, foreign securities, privately placed securities, or common or preferred stocks.

The Company has separate investment strategies and guidelines for its property and casualty assets and for its life and annuity assets, which recognize different characteristics of the associated insurance liabilities, as well as different tax and regulatory environments. The Company manages interest rate exposure for its portfolios through asset/liability management techniques which attempt to coordinate the duration of the assets with the duration of the insurance policy liabilities. Duration of assets and liabilities will generally differ only because of

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opportunities to significantly increase yields or because policy values are not interest-sensitive, as is the case in the property and casualty segment.

The investments of each insurance subsidiary must comply with the insurance laws of such insurance subsidiary s domiciliary state. These laws prescribe the type and amount of investments that may be purchased and held by insurance companies. In general, these laws permit investments, within specified limits and subject to certain qualifications, in federal, state and municipal obligations, corporate bonds, mortgage-backed bonds, other asset-backed bonds, preferred stocks, common stocks, real estate mortgages and real estate.

The following table sets forth the carrying values and amortized cost of the Company s investment portfolio as of December 31, 2005:

Investment Portfolio

(Dollars in millions)

	Percentage of Total Carrying Value	Carrying Value Total	Carrying Value Life and Annuity	Carrying Value Property and Casualty	Amortized Cost
Publicly Traded Fixed Maturity Securities and Cash Equivalents:					
U.S. government and agency obligations (1):					
Mortgage-backed securities	17.3%	$ 690.2	$ 660.9	$ 29.3	$ 700.1
Other	6.8	272.2	235.1	37.1	273.6
Investment grade corporate and public utility bonds	44.8	1,789.3	1,734.2	55.1	1,738.6
Municipal bonds	14.4	576.8	49.6	527.2	571.2
Other mortgage-backed securities	3.5	138.0	118.9	19.1	138.0
Non-investment grade corporate and public utility bonds (2)	5.1	203.2	136.8	66.4	201.7
Foreign government bonds	0.8	31.3	29.4	1.9	29.8
Short-term investments (3)	0.2	8.6	7.1	1.5	8.6
Short-term investments, loaned securities collateral (3)	4.8	193.0	184.7	8.3	193.0
Total publicly traded securities	97.7	3,902.6	3,156.7	745.9	3,854.6
Other Investments:					
Private placements, investment grade (4)		2.2	2.2		2.2
Private placements, non- investment grade (2) (4)		0.1	0.1		0.1
Mortgage loans (5)	0.1	3.6	3.6		3.6
Policy loans and other	2.2	88.0	85.1	2.9	87.9
Total other investments	2.3	93.9	91.0	2.9	93.8
Total investments (6)	100.0%	$ 3,996.5	$ 3,247.7	$ 748.8	$ 3,948.4

(1)

Includes $206.0 million fair value of investments guaranteed by the full faith and credit of the U.S. government and $756.4 million fair value of federally sponsored agency securities.

(2) A non-investment grade rating is assigned to a security when it is acquired, primarily on the basis of the Standard & Poor s Corporation (Standard & Poor s or S&P) rating for such security, or if there is no S&P rating, the Moody s Investors Service, Inc. (Moody s) rating for such security, or if there is no S&P or Moody s rating, the National Association of Insurance Commissioners (the NAIC) rating for such security. The rating agencies monitor securities, and their issuers, regularly and make changes to the ratings as necessary. The Company incorporates rating changes on a monthly basis.

(3) Short-term investments mature within one year of being acquired and are carried at cost, which approximates fair value. Short-term investments represent $9.1 million in money market funds rated AAA and $192.5 million in repurchase agreements and commercial paper maturing on January 3, 2006. The Company loans fixed income securities to third parties, primarily major brokerage firms. The Company separately maintains a minimum of 100% of the market value of the loaned securities as collateral for each loan.

(4) Fair values for private placements are estimated by the Company with the assistance of its investment advisors.

(5) Mortgage loans are carried at amortized cost or unpaid principal balance.

(6) Approximately 9% of the Company s investment portfolio, having a carrying value of $358.2 million as of December 31, 2005, consisted of securities with some form of credit support, such as insurance. All of these securities with credit support have the highest investment grade rating.

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Fixed Maturity Securities

The following table sets forth the composition of the Company s fixed maturity securities portfolio by rating as of December 31, 2005:

Rating of Fixed Maturity Securities (1)

(Dollars in millions)

	Percent of Total Carrying Value	Carrying Value	Amortized Cost
AAA	43.3%	$ 1,603.2	$ 1,609.0
AA	7.5	278.1	277.5
A	24.1	893.8	864.0
BBB	19.5	722.6	700.8
BB	2.0	75.8	75.0
B	3.4	124.6	125.0
CCC or lower	0.1	2.9	1.7
Not rated (2)	0.1	2.3	2.3
Total	100.0%	$ 3,703.3	$ 3,655.3

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

(2) This category includes $2.3 million of private placement securities not rated by either S&P or Moody s. The NAIC has rated 99.2% of these private placement securities as investment grade.

At December 31, 2005, 34.7% of the Company s fixed maturity securities portfolio was expected to mature within the next 5 years. Mortgage-backed securities, including mortgage-backed securities of U.S. governmental agencies, represented 20.7% of the total investment portfolio at December 31, 2005. These securities typically have average lives shorter than their stated maturities due to unscheduled prepayments on the underlying mortgages. Mortgages are prepaid for a variety of reasons, including sales of existing homes, interest rate changes over time that encourage homeowners to refinance their mortgages and defaults by homeowners on mortgages that are then paid by guarantors.

For financial reporting purposes, the Company has classified the entire fixed maturity portfolio as available for sale . Fixed maturities to be held for indefinite periods of time and not intended to be held to maturity are classified as available for sale and carried at fair value. The net adjustment for unrealized gains and losses on securities available for sale is recorded as a separate component of shareholders equity, net of applicable deferred tax asset or liability and the related impact on deferred policy acquisition costs and value of acquired insurance in force associated with interest-sensitive life and annuity contracts. Fixed maturities held for indefinite periods of time include securities that management intends to use as part of its asset/liability management strategy and that may be sold in response to changes in interest rates, resultant prepayment risk and other related factors.

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Cash Flow

As a holding company, HMEC conducts its principal operations through its subsidiaries. Payment by HMEC of principal and interest with respect to HMEC s indebtedness, and payment by HMEC of dividends to its shareholders, are dependent upon the ability of its insurance subsidiaries to pay cash dividends or make other cash payments to HMEC, including tax payments pursuant to tax sharing agreements. Restrictions on the subsidiaries ability to pay dividends or to make other cash payments to HMEC may materially affect HMEC s ability to pay principal and interest on its indebtedness and dividends on its common stock.

The ability of the insurance subsidiaries to pay cash dividends to HMEC is subject to state insurance department regulations which generally permit dividends to be paid for any 12 month period in amounts equal to the greater of (i) net income for the preceding calendar year or (ii) 10% of surplus as of the preceding December 31st. Any dividend in excess of these levels requires the prior approval of the Director or Commissioner of the state insurance department of the state in which the dividend paying insurance subsidiary is domiciled. The aggregate amount of dividends that may be paid in 2006 from all of HMEC s insurance subsidiaries without prior regulatory approval is approximately $74 million.

Notwithstanding the foregoing, if insurance regulators otherwise determine that payment of a dividend or any other payment to an affiliate would be detrimental to an insurance subsidiary s policyholders or creditors, because of the financial condition of the insurance subsidiary or otherwise, the regulators may block dividends or other payments to affiliates that would otherwise be permitted without prior approval.

Competition

The Company operates in a highly competitive environment. The insurance industry consists of a large number of insurance companies, some of which have substantially greater financial resources, more diversified product lines, and lower cost marketing approaches compared to the Company, such as direct marketing, mail, Internet and telemarketing.

The Company competes in its target market with a number of national providers of personal automobile, homeowners and life insurance such as State Farm, Allstate, Farmers and Nationwide as well as several regional companies. The Company also competes for automobile business with other companies such as American International Group (AIG), GEICO, Progressive and USAA, many of which feature direct marketing distribution.

The market for tax-deferred annuity products has seen heightened competition from entrants such as mutual funds and banks. Among the major national providers of annuities to educators, Variable Annuity Life Insurance Company (VALIC), a subsidiary of AIG, is one of the Company s major tax-qualified annuity competitors. ING US Financial Services, MetLife and Security Benefit are also significant national providers of 403(b) annuities and competitors of the Company. Mutual fund families, independent agent companies and financial planners also compete in this marketplace.

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Regulation

General Regulation at State Level

As an insurance holding company, HMEC is subject to extensive regulation by the states in which its insurance subsidiaries are domiciled or transact business. In addition, the laws of the various states establish regulatory agencies with broad administrative powers to grant and revoke licenses to transact business, regulate trade practices, license agents, require statutory financial statements, and prescribe the type and amount of investments permitted.

The NAIC has adopted risk-based capital guidelines to evaluate the adequacy of statutory capital and surplus in relation to an insurance company s risks. State insurance regulations prohibit insurance companies from making any public statements or representations with regard to their risk-based capital levels. Based on current guidelines, the risk-based capital statutory requirements are not expected to have a negative regulatory impact on the Company s insurance subsidiaries.

Assessments Against Insurers

Under insurance insolvency or guaranty laws in most states in which the Company operates, insurers doing business therein can be assessed for policyholder losses related to insolvencies of other insurance companies. The amount and timing of any future assessments on the Company under these laws cannot be reasonably estimated and are beyond the control of the Company. Most of these laws do provide, however, that an assessment may be excused or deferred if it would threaten an insurer s financial strength, and many assessments paid by the Company pursuant to these laws may be used as credits for a portion of the Company s premium taxes in certain states. For the three years ended December 31, 2005, the Company s assessments, net of the related premium tax credits, were not significant.

Mandatory Insurance Facilities

The Company is required to participate in various mandatory insurance facilities in proportion to the amount of the Company s direct writings in the applicable state. In 2005, the Company reflected a net loss from participation in such mandatory pools and underwriting associations of $2.4 million before federal income taxes, primarily as a result of assessments following hurricanes in 2005 and 2004.

In 2005 the Company paid $3.1 million in additional assessments related to hurricanes which occurred in 2005 and 2004 and these payments are reflected in the $2.4 million net loss reported above. The Citizens Property Insurance Corporation of Florida assessed the Company $1.8 million and the Louisiana Citizens Fair and Coastal Plan assessed the Company $1.3 million. The Company will in turn assess its policyholders in the respective states to recoup these amounts. See also Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations for the Three Years Ended December 31, 2005 Insurance Premiums and Contract Charges .

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Regulation at Federal Level

Although the federal government generally does not directly regulate the insurance industry, federal initiatives often impact the insurance business. Current and proposed federal measures which may significantly affect insurance and annuity business include employee benefits regulation, controls on the costs of medical care, medical entitlement programs such as Medicare, structure of retirement plans and accounts, changes to the insurance industry anti-trust exemption, and minimum solvency requirements. Other federal regulation such as the Fair Credit Reporting Act, Gramm-Leach-Bliley Act, Privacy Act and USA PATRIOT Act, including its anti-money laundering regulations, also impact the Company s business.

The variable annuities underwritten by HMLIC are regulated by the SEC. Horace Mann Investors, Inc., the broker-dealer subsidiary of HMEC, also is regulated by the SEC, the NASD, the Municipal Securities Rule-making Board (MSRB) and various state securities regulators.

Federal income taxation of the build-up of cash value within a life insurance policy or an annuity contract could have a materially adverse impact on the Company s ability to market and sell such products. Various legislation to this effect has been proposed in the past, but has not been enacted. Although no such legislative proposals are known to exist at this time beyond the proposal described below, such proposals may be made again in the future.

Changes in other federal and state laws and regulations could also affect the relative tax and other advantages of the Company s life and annuity products to customers. For instance, in late 2004, the Internal Revenue Service (IRS) issued proposed regulations regarding Section 403(b) arrangements, including annuities. The proposed regulations would alter the nature of 403(b) arrangements to an employer-sponsored plan, compared to the historical view of 403(b) arrangements being individual plans funded by salary reduction. If adopted, the Company, and many other providers of 403(b) arrangements, would need to adapt its product and services offered to better meet the changing needs of the school district sponsors of those arrangements and modify its administrative systems to support these changes. The issuance of final regulations had been expected in 2005 with an effective date of January 1, 2006. Both the timing and the nature of the proposed regulations have come under heavy criticism from school administrators, teachers, and providers of 403(b) arrangements and final regulations were not issued in 2005. It is now anticipated that the IRS will issue final regulations in 2006 with an effective date no earlier than January 1, 2007. At the time of this Annual Report on Form 10-K, the final form of any changes, their timing or their impact on the 403(b) market is unknown.

In recent years, the state insurance regulatory framework has come under public scrutiny and members of Congress have discussed proposals to provide for optional federal chartering of insurance companies. Although no such legislative proposals are known to exist at the time of this Annual Report on Form 10-K, proposals of this nature may be made in the future.

Employees

At December 31, 2005, the Company had approximately 2,400 employees, including 855 full-time agents. The Company has no collective bargaining agreement with any employees.

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ITEM 1A. Risk Factors

The following are certain risk factors that could affect the Company s business, financial results and results of operations. In addition, refer to the risk factors disclosed in Management s Discussion and Analysis of Financial Condition and Results of Operations Forward-looking Information , listed on page F-1 of this report for certain important factors that may cause our financial condition and results of operations to differ materially from current expectations. The risks that the Company has highlighted in these two sections of this report are not the only ones that the Company faces. In this discussion, the Company is also referred to as our , we and us .

Our markets are highly competitive and our financial condition and results of operations may be adversely affected if we do not remain competitive.

We operate in a highly competitive environment and compete with numerous insurance companies, as well as mutual fund families, independent agent companies and financial planners. In some instances and geographic locations, competitors have specifically targeted the educator marketplace with specialized products and programs. We compete in our target market with a number of national providers of personal automobile and homeowners insurance and life insurance and annuities.

The insurance industry consists of a large number of insurance companies, some of which have substantially greater financial resources, more diversified product lines and lower cost marketing approaches, such as direct marketing, mail, Internet and telemarketing, compared to us. In our target market, we believe that the principal competitive factors in the sale of property and casualty insurance products are price, service, name recognition and education association sponsorships. We believe that the principal competitive factors in the sale of life insurance and annuity products are product features, perceived stability of the insurer, service, name recognition, education association sponsorships and price.

Particularly in the property and casualty business, our insurance subsidiaries have experienced, and expect to experience in the future, periods of intense competition during which they are unable to increase prices sufficiently to cover costs. The inability of an insurance subsidiary to compete successfully in the property and casualty business would adversely affect its financial condition and results of operations and its resulting ability to distribute cash to us.

For our annuity business, in addition to insurance companies, mutual funds and banks are increasingly strong competitors in the 403(b) and tax deferred annuity products markets. The inability of an insurance subsidiary to compete successfully in these markets would adversely affect its financial condition and results of operations and its resulting ability to distribute cash to us.

Our financial condition and results of operations may be adversely affected by declining market conditions.

Conditions in the U.S. and international financial markets affect the sale and profitability of our variable annuities. In general, sales of variable annuities decrease when financial markets are declining over an extended period of time. Therefore, weak financial market performance may adversely affect sales of our variable annuity products to potential customers and may cause current customers to withdraw or reduce the amounts invested in our variable annuity products, in

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turn reducing the amount of variable annuity fee revenues generated as well. In addition, some of our variable annuity contracts offer guaranteed minimum death benefits features, which provide for a benefit if the annuitant dies and the contract value is less than a specified amount. A decline in the financial markets could cause the contract value to fall below this specified amount, increasing our exposure to losses from variable annuity products featuring guaranteed minimum death benefits.

If we are not able to effectively develop and expand our agent force and independent agent distribution systems, as well as maintain and secure product sponsorships by local, state and national education associations, our financial condition and results of operations could be adversely affected.

Our success in marketing and selling our products is largely dependent upon the efforts of our exclusive sales force of full-time employee agents and, to a lesser degree, our independent agents. As we expand our business, we may need to expand our network of agents to market our products. If we are unable to hire additional agents or if we fail to retain our current agents, sales of our products would likely decline and our financial condition and results of operations would be adversely affected.

In addition, one of the keys to the successful sale of our 403(b) tax-qualified annuity products is our ability to obtain payroll reduction authorization from school districts and product sponsorships from local, state and national education associations. In late 2004, the IRS issued proposed regulations regarding Section 403(b) arrangements, including annuities. The proposed regulations would alter the nature of 403(b) arrangements to an employer-sponsored plan. This would be a potentially significant change from the historical view of 403(b) arrangements being individual plans funded by salary reduction. This could prompt school district sponsors of 403(b) arrangements to reconsider the companies permitted to offer products to fund such arrangements within their district, and potentially reduce the number of authorized providers. Such actions present the threat of losing certain current payroll reduction authorizations and sponsorships, and the potential for lost sales and resulting revenues in those school districts, as well as the opportunity to increase penetration in school districts where the Company remains as one of a reduced number of approved providers. If these proposed regulations are adopted, our ability to maintain and grow our share of the 403(b) market will depend on our ability to successfully adapt our products, services offered, and administrative systems, which could potentially increase the Company s cost of doing business in this market. At the time of this Annual Report on Form 10-K, we anticipate that the proposed changes would not occur prior to January 1, 2007. Also, the final form of any changes, their timing or their impact on the 403(b) market is unknown.

Certain changes in accounting or financial reporting standards issued by the Financial Accounting Standards Board, the Securities and Exchange Commission or other standard-setting bodies may have an adverse affect on our financial condition, results of operations and/or cost of doing business.

Our consolidated financial statements are subject to the application of U.S. generally accepted accounting principles, or GAAP, which is periodically revised and/or expanded. Accordingly, we are required to adopt new or revised accounting standards issued by recognized authoritative bodies, including the Financial Accounting Standards Board and the Securities and Exchange Commission. It is possible that future changes in accounting standards may impact the current accounting treatment applied in our consolidated financial statements and that such changes could have a material adverse effect on our financial condition and results of operations. For a description of potential changes in accounting standards that could affect us currently, see

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Management s Discussion and Analysis of Financial Condition and Results of Operations Recent Accounting Changes listed on page F-1 of this report.

Our property and casualty loss reserves may not be adequate.

Our property and casualty insurance subsidiaries maintain loss reserves to provide for their estimated ultimate liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred as of the end of each accounting period. If these loss reserves prove inadequate, we will record a loss measured by the amount of the shortfall and, as a result, the financial condition and results of operations of our insurance subsidiaries will be adversely affected, potentially affecting their ability to distribute cash to us.

Reserves do not represent an exact calculation of liability. Reserves represent estimates, generally involving actuarial projections at a given time, of what our insurance subsidiaries expect the ultimate settlement and adjustment of claims will cost, net of salvage and subrogation. Estimates are based on assessments of known facts and circumstances, assumptions related to the ultimate cost to settle such claims, estimates of future trends in claims severity and frequency, changing judicial theories of liability and other factors. These variables are affected by both internal and external events, including changes in claims handling procedures, economic inflation, unpredictability of court decisions, plaintiffs expanded theories of liability, risks inherent in major litigation and legislative changes. Many of these items are not directly quantifiable, particularly on a prospective basis. Significant reporting lags may exist between the occurrence of an insured event and the time it is actually reported. Our insurance subsidiaries adjust their reserve estimates regularly as experience develops and further claims are reported and settled.

Due to inherent uncertainty in estimating reserves for losses and loss adjustment expenses, we cannot be certain that the ultimate liability will not exceed amounts reserved, with a resulting adverse effect on our financial condition and results of operations.

Inaccuracies in assumptions regarding future persistency, mortality, morbidity and interest rates used in calculating life and annuity reserve and deferred policy acquisition expense amounts could have a material adverse impact on our net income.

The process of calculating reserve and deferred policy acquisition expense amounts for our life and annuity businesses involve the use of a number of assumptions, including those related to persistency (how long a contract stays with the company), mortality (the relative incidence of death over a given period of time), morbidity (the relative incidence of disability resulting from disease or physical impairment) and interest rates (the rates expected to be paid or received on financial instruments, including insurance or investment contracts). We periodically review the adequacy of these reserves and deferred policy acquisition expenses on an aggregate basis and, if future experience differs significantly from assumptions, adjustments to reserves and deferred policy acquisition expenses may be required which could have a material adverse effect on our financial condition and results of operations.

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Catastrophic events can have a material adverse effect on our financial condition and results of operations.

Results of property and casualty insurers are subject to weather and other conditions prevailing in an accident year. While one year may be relatively free of major weather or other disasters, another year may have numerous such events causing results for such a year to be materially worse than for other years.

Our insurance subsidiaries have experienced, and we anticipate that in the future they will continue to experience, catastrophe losses. A catastrophic event or a series of multiple catastrophic events could have a material adverse effect on the financial condition and results of operations of our insurance subsidiaries.

Various events can cause catastrophes, including hurricanes, windstorms, earthquakes, hail, terrorism, explosions, severe winter weather and fires. The frequency and severity of these catastrophes are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposures in the area affected by the event and the severity of the event. Although catastrophes can cause losses in a variety of property and casualty lines, most of the catastrophe-related claims of our insurance subsidiaries are related to homeowners coverages. Our ability to provide accurate estimates of ultimate catastrophe costs is based on several factors, including:

- the proximity of the catastrophe occurrence date to the date of our estimate;
- potential inflation of property repair costs in the affected area; and
- the occurrence of multiple catastrophes in a geographic area over a relatively short period of time.

As of December 31, 2005, approximately 56% of the total annual premiums for the property and casualty business conducted by our insurance subsidiaries were for policies issued in the ten largest states in which our insurance subsidiaries write property and casualty coverage, including certain states in which catastrophe occurrences are relatively common: California, Florida, North Carolina, South Carolina, Louisiana and Texas.

Our insurance subsidiaries seek to reduce their exposure to catastrophe losses through their underwriting strategies and the purchase of catastrophe reinsurance. Nevertheless, reinsurance may prove inadequate if:

- a major catastrophic loss exceeds the reinsurance limit, or
- a series of major catastrophic events in a single year exhaust the existing reinsurance coverage, or
- an insurance subsidiary pays a number of smaller catastrophic loss claims which, individually, fall below the subsidiary s loss retention level.

Our catastrophe management strategy may adversely affect premium and policy growth.

As an ongoing practice, but particularly following the significant catastrophic claims from hurricanes in 2005 and 2004, we attempt to manage our exposure to catastrophes. Reductions in property and casualty business written in catastrophe-prone areas may have a negative impact on near-term business growth and earnings.

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Reduction of the statutory surplus of our insurance subsidiaries could adversely affect their ability to write insurance business.

Insurance companies write business based, in part, upon guidelines including a ratio of premiums to surplus for property and casualty insurance companies and a ratio of reserves to surplus for life insurance companies. If our insurance subsidiaries cannot maintain profitability in the future, they may be required to draw on their surplus in order to pay dividends to us to enable us to meet our financial obligations. As their surplus is reduced by the payment of dividends, continuing losses or both, our insurance subsidiaries ability to write business and maintain acceptable financial strength ratings could also be reduced. This could have a material adverse effect upon the business volume and profitability of our insurance subsidiaries.

Any downgrade in the ratings of our insurance subsidiaries could adversely affect our business.

Claims-paying and financial strength ratings have become an increasingly important factor in establishing the competitive position of insurance companies. Each rating agency reviews its ratings periodically and from time to time may modify its rating criteria including, among other factors, its expectations regarding capital adequacy. A downgrade in the ratings of any of our insurance subsidiaries by a recognized rating agency could result in a substantial loss of business for that subsidiary if policyholders or independent agents move to other companies with higher claims-paying and financial strength ratings. This loss of business could have a material adverse effect on the financial condition and results of operations of that subsidiary.

Uncollectible reinsurance can have a material adverse effect upon our business volume and profitability.

Reinsurance is a contract by which one insurer, called a reinsurer, agrees to cover a portion of the losses incurred by a second insurer in the event a claim is made under a policy issued by the second insurer. Our insurance subsidiaries obtain reinsurance to help manage their exposure to property, casualty and life insurance risks. Although a reinsurer is liable to our insurance subsidiaries according to the terms of its reinsurance policy, the insurance subsidiaries remain primarily liable as the direct insurers on all risks reinsured. As a result, reinsurance does not eliminate the obligation of our insurance subsidiaries to pay all claims, and each insurance subsidiary is subject to the risk that one or more of its reinsurers will be unable or unwilling to honor its obligations.

Our insurance subsidiaries cannot guarantee that their reinsurers will pay in a timely fashion, if at all. Reinsurers may become financially unsound by the time that they are called upon to pay amounts due, which may not occur for many years. Additionally, the availability and cost of reinsurance are subject to prevailing market conditions beyond our control. For example, the significant level of losses from hurricanes in 2005 and 2004 and the terrorist attacks of September 11, 2001 have had a significant adverse affect on the reinsurance market.

If one of our insurance subsidiaries is unable to obtain adequate reinsurance at reasonable rates, that insurance subsidiary would have to increase its risk exposure and/or reduce the level of its underwriting commitments, which could have a material adverse effect upon the business volume and profitability of the subsidiary.

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A reduction or elimination of the tax advantages of life and annuity products would adversely affect our operating results.

A significant part of our annuity business involves fixed and variable 403(b) tax-qualified annuities, which are annuities purchased voluntarily by individuals employed by public school systems or other tax-exempt organizations. Our financial condition and results of operations could be adversely affected by changes in federal and state laws and regulations that affect the relative tax and other advantages of our life and annuity products to customers, including adverse changes in IRS regulations governing 403(b) plans such as those currently being proposed.

Current federal income tax laws generally permit the tax-deferred accumulation of earnings on the premiums paid by the holders of annuities and life insurance products. Taxes, if any, are payable on income attributable to a distribution under the contract for the year in which the distribution is made. From time to time, Congress has considered legislation that would reduce or eliminate the benefit of such deferral of taxation on the accretion of value with life insurance and non-qualified annuity contracts. Enactment of this legislation, including a simplified flat tax income structure with an exemption from taxation for investment income, could result in fewer sales of our life insurance and annuity products.

Losses due to defaults by others could reduce our profitability or negatively affect the value of our investments.

Third parties that owe us money, securities or other assets may not pay or perform their obligations. These parties may include the issuers whose securities we hold, borrowers under mortgage loans, customers, trading counterparties, counterparties under swaps and other derivative contracts, reinsurers, clearing agents, exchanges, clearing houses and other financial intermediaries. These parties may default on their obligations to us due to bankruptcy, lack of liquidity, downturns in the economy or real estate values, operational failure or other reasons.

The default of a major market participant could disrupt the securities markets or clearance and settlement systems in the U.S. or abroad. A failure of a major market participant could cause some clearance and settlement systems to assess members of that system, including our broker-dealer subsidiary, or could lead to a chain of defaults that could adversely affect us. A default of a major market participant could disrupt various markets, which could in turn cause market declines or volatility and negatively impact our financial condition and results of operations.

If our investment strategy is not successful, we could suffer unexpected losses.

The success of our investment strategy is crucial to the success of our business. Specifically, we are subject to:

- *market value risk*, which is the risk that our invested assets will decrease in value due to a change in the yields realized on our assets and prevailing market yields for similar assets, an unfavorable change in the liquidity of the investment or an unfavorable change in the financial prospects or a downgrade in the credit rating of the issuer of the investment;

- *reinvestment risk*, which is the risk that interest rates will decline and funds reinvested will earn less than expected; and *liquidity risk*, which is the risk that liabilities are surrendered or mature sooner than anticipated requiring us to sell assets at an undesirable time to provide for policyholder surrenders or withdrawals.

We attempt to control these risks through product pricing, product features and the establishment of policy reserves, but we cannot provide assurance that assets will be properly matched to meet anticipated liabilities or that our investments will provide sufficient returns to enable us to satisfy our guaranteed fixed benefit obligations.

From time to time, we may also enter into foreign currency, interest rate and credit derivatives and other hedging transactions in an effort to manage risks. We cannot provide assurance that we will successfully structure those derivatives and hedges so as to effectively manage these risks. If our calculations are incorrect, or if we do not properly structure our derivatives or hedges, we may have unexpected losses and our assets may not be adequate to meet our needed reserves, which could adversely affect our financial condition and results of operations.

The result of any investment activity is determined to a significant degree by general economic conditions, which may adversely affect the markets for interest rate sensitive securities, including the level and volatility of interest rates and the extent and timing of investor participation in these markets. Unexpected volatility or illiquidity in the markets in which we hold positions could adversely affect us.

Declining financial markets could also cause the value of the investments in our defined benefit pension plan to decrease, resulting in additional pension expense and an increase in required contributions to the defined benefit pension plan.

If we fail to correct certain material weaknesses in our internal controls or if we fail to maintain an effective system of internal controls once such material weaknesses are corrected, we may not be able to accurately report our financial results.

Effective internal controls are necessary for us to provide accurate, reliable financial reports. If we cannot provide accurate, reliable financial reports, our investors could be unable to accurately assess our performance and could lose confidence in us, and our financial condition and results of operations could be harmed. We have in the past discovered, and may in the future discover, areas of our internal controls that need improvement.

For example, in our Annual Report on Form 10-K for the year ended December 31, 2004, our management reported that we did not maintain effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*, and identified two areas that constituted material weaknesses. The first material weakness related to deficiencies in our policies and procedures with respect to the reconciling of differences between the tax basis and book basis of each component of our deferred tax asset and liability accounts. The second material weakness related to deficiencies in our policies and procedures with respect to the accurate reporting of cash. The deficiencies included our failure to timely reconcile bank accounts and suspense accounts, as well as the improper application of GAAP related to the classification of outstanding checks. As a result of these material weaknesses, misstatements were discovered with respect to our deferred tax assets and liabilities and with respect to various expense accounts. These misstatements and deficiencies were first discovered and brought to the attention of management by KPMG LLP in connection with their 2004 audit of our consolidated financial statements. The misstatements, which were recorded in our December 31, 2004 consolidated financial statements, were immaterial and did not require the restatement of any of our prior consolidated financial statements. However, we cannot provide assurance that any internal control weaknesses we may discover in the future will not require us to restate any of our prior consolidated financial statements.

During 2005, these two material weaknesses were fully remediated. Any failure to maintain the improvements made in our internal control over financial reporting could cause us to fail to produce accurate, reliable financial reports or to meet our reporting obligations and could cause the market to lose confidence in our reported financial information. As a result, our financial condition and results of operations could suffer materially.

Interest rate fluctuations could negatively affect the income we derive from the difference between the interest rates we earn on our investments and the interest we pay under our annuity contracts.

Significant changes in interest rates expose us to the risk of not earning income or experiencing losses based on the differences between the interest rates earned on our investments and the credited interest rates paid on our outstanding annuity contracts. Significant changes in interest rates may affect:

- the unrealized gains and losses in our investment portfolio and the related after-tax effect on our shareholders equity and total capital;
- the book yield of our investment portfolio; and
- the ability of our insurance subsidiaries to maintain appropriate interest rate spreads over the fixed rates guaranteed in their life and annuity products.

Both rising and declining interest rates can negatively affect the income we derive from these interest rate spreads. During periods of falling interest rates, our investment earnings will be lower because new investments in fixed maturity securities will likely bear lower interest rates. We may not be able to fully offset the decline in investment earnings with lower crediting rates on our annuity contracts. During periods of rising interest rates, there may be competitive pressure to increase the crediting rates on our annuity contracts. We may not, however, have the ability immediately to acquire investments with interest rates sufficient to offset an increase in crediting rates under our annuity contracts. Although we develop and maintain asset/liability management programs and procedures designed to reduce the volatility of our income when interest rates are rising or falling, changes in interest rates can affect our interest rate spreads.

Changes in interest rates may also affect our business in other ways. For example, lower interest rates may result in decreased crediting rates on certain of our fixed-rate products which could make those products less attractive, leading to lower sales and/or increases in the level of life insurance and annuity product surrenders and withdrawals.

The insurance industry is highly regulated.

We are subject to extensive regulation and supervision in the jurisdictions in which we do business. Regulation generally is designed to protect the interests of policyholders, as opposed to stockholders and non-policyholder creditors. Such regulations, among other things, impose restrictions on the amount and type of investments our subsidiaries may hold. Certain states also regulate the rates insurers may charge for certain property and casualty products. Legislation and voter initiatives have expanded, in some instances, the states regulation of rates and have increased data reporting requirements. Consumer-related pressures to roll back rates, even if not enacted by legislation or upheld upon judicial appeal, may affect our ability to obtain timely rate increases or operate at desired levels of profitability. Changes in insurance regulations, including those affecting the ability of our insurance subsidiaries to distribute cash to us and those affecting the ability of our insurance subsidiaries to write profitable property and casualty insurance policies in one or more states, may adversely affect the financial condition and results of operations of our insurance subsidiaries.

Examples of governmental regulation that has adversely affected the operations of our insurance subsidiaries include:

- the adoption in several states of legislation and other regulatory action intended to reduce the premiums paid for automobile insurance by residents of those states;
- restrictions on a company s ability to achieve pricing adequacy and/or reduce their volume of business in catastrophe prone areas; and
- requirements that insurance companies:
  - pay assessments to support associations that fund state-sponsored insurance operations, or
  - involuntarily issue policies for high-risk automobile drivers.

Regulation that could adversely affect our insurance subsidiaries also includes statutory surplus and risk-based capital requirements. Maintaining appropriate levels of surplus, as measured by statutory accounting principles, is considered important by state insurance regulatory authorities and the private agencies that rate insurers claims-paying abilities and financial strength. The failure of an insurance subsidiary to maintain levels of statutory surplus that are sufficient for the amount of its insurance written could result in increased regulatory scrutiny, action by state regulatory authorities or a downgrade by rating agencies.

Similarly, the NAIC has adopted a system of assessing minimum capital adequacy that is applicable to our insurance subsidiaries. This system, known as risk-based capital, is used to identify companies that may merit further regulatory action by analyzing the adequacy of the insurer s surplus in relation to statutory requirements.

Because state legislatures remain concerned about the availability and affordability of property and casualty insurance and the protection of policyholders, our insurance subsidiaries expect that they will continue to face efforts by those legislatures to expand regulations to cover these concerns. For example, in the Spring 2005 session, the Florida legislature implemented measures to address the effect of future and past multi-hurricane seasons. Any one of these measures, or similar future measures, could adversely affect the financial condition and results of operations of our insurance subsidiaries.

In the event of the insolvency, liquidation or other reorganization of any of our insurance subsidiaries, our creditors and stockholders would have no right to proceed against any such insurance subsidiary or to cause the liquidation or bankruptcy of any such insurance subsidiary under federal or state bankruptcy laws. The insurance laws of the domiciliary state would govern such proceedings and the relevant insurance commissioner would act as liquidator or rehabilitator for the insurance subsidiary. Creditors and policyholders of any such insurance subsidiary would be entitled to payment in full from the assets of the insurance subsidiary before we, as a stockholder, would be entitled to receive any distribution.

The financial position of our insurance subsidiaries also may be affected by court decisions that expand insurance coverage beyond the intention of the insurer at the time it originally issued an insurance policy.

The insurance industry is highly cyclical.

The results of companies in the insurance industry historically have been subject to significant fluctuations due to competition, economic conditions, interest rates and other factors. In particular, the property and casualty insurance segment of the industry historically have experienced pricing and profitability cycles. With respect to these cycles, the factors having the greatest impact include intense price competition, aggressive marketing by insurers and industry-wide underwriting results, which have resulted in higher combined loss and expense ratios.

Litigation may harm our financial strength or reduce our profitability.

Companies in the insurance industry have been subject to substantial litigation resulting from claims, disputes and other matters. Most recently, 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. The resolution of such claims against any of our insurance subsidiaries, including the potential adverse effect on our reputation and charges against the earnings of our insurance subsidiaries as a result of legal defense costs, a settlement agreement or an adverse finding or findings against our insurance subsidiaries in such a claim, could materially adversely affect the financial condition and results of operations of our insurance subsidiaries.

ITEM 1B. Unresolved Staff Comments

None.

ITEM 2. Properties

HMEC s home office property at 1 Horace Mann Plaza in Springfield, Illinois, consists of an office building totaling approximately 214,000 square feet which is owned by the Company. The Company also owns buildings with an aggregate of approximately 24,000 square feet at other locations in Springfield. The Company leases buildings in Springfield with an aggregate of approximately 92,000 square feet. In addition, the Company leases office space in other states related to claims and agency offices which are smaller in size. These properties, which are utilized by all of the Company s operating segments, are adequate and suitable for the Company s current and anticipated future needs.

ITEM 3. Legal Proceedings

The Company is not currently party to any material pending legal proceedings other than routine litigation incidental to its business.

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

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PART II

ITEM 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

HMEC s common stock began trading on the NYSE in November 1991 under the symbol of HMN at a price of $9 per share. The following table sets forth the high and low sales prices of the common stock on the NYSE Composite Tape and the cash dividends paid per share of common stock during the periods indicated.

Fiscal Period	Market Price High	Market Price Low	Dividend Paid
2005:			
Fourth Quarter	$ 20.04	$ 17.96	$ 0.105
Third Quarter	20.80	18.90	0.105
Second Quarter	19.00	15.86	0.105
First Quarter	19.20	17.31	0.105
2004:			
Fourth Quarter	$ 19.30	$ 16.01	$ 0.105
Third Quarter	17.59	15.83	0.105
Second Quarter	17.48	14.92	0.105
First Quarter	16.10	13.94	0.105

As of February 28, 2006, the approximate number of holders of HMEC s common stock was 5,000.

In March 2006, the Company s Board of Directors announced a regular quarterly dividend of $0.105 per share. The payment of dividends in the future is subject to the discretion of the Board of Directors and will depend upon general business conditions, legal restrictions and other factors the Board of Directors of HMEC may deem to be relevant. See also Business Cash Flow .

During 2005, options were exercised for the issuance of 124,624 shares, 0.3% of the Company s common stock shares outstanding at December 31, 2004. The Company received $2.1 million as a result of these option exercises, including related federal income tax benefits.

The equity compensation plan information required by Item 201(d) of Regulation S-K is incorporated by reference to the Company s Proxy Statement for the 2006 Annual Meeting of Shareholders.

ITEM 6. Selected Financial Data

The information required by Item 301 of Regulation S-K is contained in the table in Item 1 Business Selected Historical Consolidated Financial Data .

ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The information required by Item 303 of Regulation S-K is listed on page F-1 of this report.

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ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

The information required by Item 305 of Regulation S-K is contained in Management s Discussion and Analysis of Financial Condition and Results of Operations listed on page F-1 of this report.

ITEM 8. Consolidated Financial Statements and Supplementary Data

The Company s consolidated financial statements, financial statement schedules, the report of its independent registered public accounting firm and the selected quarterly financial data required by Item 302 of Regulation S-K are listed on page F-1 of this report.

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

ITEM 9A. Controls and Procedures

a.) Management s Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) of the Securities and Exchange Act of 1934 as amended (the Exchange Act). Based on this evaluation, our chief executive officer and our chief financial officer concluded that our disclosure controls and procedures were effective as of December 31, 2005, the end of the period covered by this Annual Report on Form 10-K.

b.) Management s Report on Internal Control Over Financial Reporting

Management of Horace Mann is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is identified in Rule 13a-15(f) of the Exchange Act. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that:

(i) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;

(ii) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

(iii) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Management of Horace Mann conducted an evaluation of the effectiveness of the Company s internal control over financial reporting as of December 31, 2005, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control Integrated Framework (COSO).* Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Based on this evaluation, management determined that, as of December 31, 2005, the Company maintained effective internal control over financial reporting.

c.) Independent Registered Public Accounting Firm s Report on Internal Control Over Financial Reporting

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Horace Mann Educators Corporation:

We have audited management s assessment, included in the accompanying *Management s Report on Internal Control Over Financial Reporting (Item 9A.b.)* that Horace Mann Educators Corporation and subsidiaries (the Company) maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the consolidated financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2005 and 2004, and the related consolidated statements of operations and comprehensive income, change in shareholders equity and cash flows for each of the years in the three-year period ended December 31, 2005, and our report dated March 15, 2006 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP
KPMG LLP

Chicago, Illinois
March 15, 2006

d). Changes in Internal Control Over Financial Reporting

The following changes have been made subsequent to December 31, 2004 to remediate the material weaknesses described in the Company s 2004 Annual Report on Form 10-K and have materially affected the Company s internal control over financial reporting.

Income Tax Financial Reporting

The Company has fully remediated the material weakness in its internal control over income tax deferred assets and liabilities. Management has implemented the following remedial actions:

- Processes to compute and reconcile the book to tax basis differences at an asset and liability transaction level, including documentation and testing of enhanced processes and procedures have been implemented;
- A qualified tax officer was employed by the Company in March 2005 to allow for appropriate segregation of duties and to strengthen processes related to the preparation and review of tax asset and liability documentation and an additional tax accountant was employed by the Company in September 2005 to assist in the reconciliation process; and
- A tax consulting firm was engaged to review the Company s 2005 quarterly federal income tax provisions, along with related reconciliations and supporting documentation, for validity and consistency.

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Reporting of Cash Balances

The Company has fully remediated the material weakness in its internal control over the reporting of cash balances. Management has implemented the following remedial actions:

Bank Account and Suspense Account Reconciliations

- Processes to reconcile and clear all suspense accounts on a timely basis, including a review of staffing levels and proficiencies, training, documentation and testing of enhanced processes and procedures have been implemented;
- Processes for the timely completion, review and testing of bank account reconciliations, including a review of staffing levels, proficiencies and training have been completed; and
- Remediation actions to address controller department staffing and training have been completed, including redeployment and retraining of existing staff, increased utilization of temporary employees and hiring of additional full-time employees.

Accounting Policy for Outstanding Check Amounts

- Documentation of processes and procedures, along with appropriate training, to ensure that the Company s accounting policy, which has been corrected to conform with U.S. generally accepted accounting principles, is consistently applied on a going forward basis has been completed.

Other than the items noted above, there were no changes in the Company s internal control over financial reporting that occurred during the Company s last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

ITEM 9B. Other Information

None.

PART III

ITEM 10. Directors and Executive Officers of the Registrant

The information required by Items 401 and 405 of Regulation S-K is incorporated by reference to the Company s Proxy Statement for the 2006 Annual Meeting of Shareholders.

Horace Mann Educators Corporation has adopted a code of ethics that applies to its principal executive officer, principal financial officer, principal accounting officer and all other employees of the Company. In addition, the Board of Directors of Horace Mann Educators Corporation has adopted the code of ethics for its Board members as it applies to each Board members business conduct on behalf of the Company. The code of ethics is posted on the Company s website, www.horacemann.com, under Investor Relations Corporate Governance .

ITEM 11. Executive Compensation

The information required by Item 402 of Regulation S-K is incorporated by reference to the Company s Proxy Statement for the 2006 Annual Meeting of Shareholders.

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ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by Items 201(d) and 403 of Regulation S-K is incorporated by reference to the Company s Proxy Statement for the 2006 Annual Meeting of Shareholders.

ITEM 13. Certain Relationships and Related Transactions

The information required by Item 404 of Regulation S-K is incorporated by reference to the Company s Proxy Statement for the 2006 Annual Meeting of Shareholders.

ITEM 14. Principal Accounting Fees and Services

The information required by Item 9(e) of Schedule 14A is incorporated by reference to the Company s Proxy Statement for the 2006 Annual Meeting of Shareholders.

PART IV

ITEM 15. Exhibits and Financial Statement Schedules

(a)(1) The following consolidated financial statements of the Company are contained in the Index to Financial Information on Page F-1 of this report:

Consolidated Balance Sheets as of December 31, 2005 and 2004.

Consolidated Statements of Operations and Comprehensive Income for the Years Ended December 31, 2005, 2004 and 2003.

Consolidated Statements of Changes in Shareholders Equity for the Years Ended December 31, 2005, 2004 and 2003.

Consolidated Statements of Cash Flows for the Years Ended December 31, 2005, 2004 and 2003.

(a)(2) The following financial statement schedules of the Company are contained in the Index to Financial Information on page F-1 of this report:

Schedule I Summary of Investments Other than Investments in Related Parties.

Schedule II Condensed Financial Information of Registrant.

Schedules III and VI Combined Supplementary Insurance Information and Supplemental Information Concerning Property and Casualty Insurance Operations.

Schedule IV Reinsurance.

(a)(3) The following items are filed as Exhibits. Management contracts and compensatory plans are indicated by an asterisk (*).

Exhibit No.	Description
(3) Articles of incorporation and bylaws:	
3.1	Restated Certificate of Incorporation of HMEC, filed with the Delaware Secretary of State on June 24, 2003, incorporated by reference to Exhibit 3.1 to HMEC s Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, filed with the Securities and Exchange Commission (the SEC) on August 14, 2003.
3.2	Form of Certificate for shares of Common Stock, $0.001 par value per share, of HMEC, incorporated by reference to Exhibit 4.5 to HMEC s Registration Statement on Form S-3 (Registration No. 33-53118) filed with the SEC on October 9, 1992.
3.3	Bylaws of HMEC, incorporated by reference to Exhibit 3.2 to HMEC s Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, filed with the SEC on August 14, 2003.
(4) Instruments defining the rights of security holders, including indentures:	
4.1	Indenture, dated as of May 14, 2002, between HMEC and JPMorgan Chase Bank as trustee, with regard to HMEC s 1.425% Senior Convertible Notes Due 2032, incorporated by reference to Exhibit 4.1 to HMEC s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the SEC on August 14, 2002.
4.1(a)	Form of 1.425% Senior Convertible Notes Due 2032 (included in Exhibit 4.1).
4.2	Indenture, dated as of June 9, 2005, between HMEC and JPMorgan Chase Bank, N.A., as trustee, with regard to HMEC s 6.05% Senior Notes Due 2015, incorporated by reference to Exhibit 4.1 to HMEC s Current Report on Form 8-K dated June 6, 2005, filed with the SEC on June 9, 2005.
4.2(a)	First Supplemental Indenture, dated as of June 9, 2005, between HMEC and JPMorgan Chase Bank, N.A., as trustee, incorporated by reference to Exhibit 4.2 to HMEC s Current Report on Form 8-K dated June 6, 2005, filed with the SEC on June 9, 2005.
4.2(b)	Form of HMEC 6.05% Senior Notes Due 2015 (included in Exhibit 4.2(a)).
4.3	Certificate of Designations for HMEC Series A Cumulative Convertible Preferred Stock.

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Exhibit No.	Description
(10) Material contracts:	
10.1	Credit Agreement dated as of May 31, 2005 among HMEC, certain financial institutions named therein and Bank of America, N.A., as administrative agent (the Agent), incorporated by reference to Exhibit 10.1 to HMEC s Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, filed with the SEC on August 9, 2005.
10.1(a)	First Amendment to Credit Agreement dated as of August 19, 2005 among HMEC, certain financial institutions named therein and the Agent, incorporated by reference to Exhibit 10.1(a) to HMEC s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005, filed with the SEC on November 9, 2005.
10.2*	Horace Mann Educators Corporation Deferred Equity Compensation Plan for Directors, incorporated by reference to Exhibit 10.1 to HMEC s Quarterly Report on Form 10-Q for the quarter ended September 30, 1996, filed with the SEC on November 14, 1996.
10.3*	Horace Mann Educators Corporation Deferred Compensation Plan for Employees, incorporated by reference to Exhibit 10.4 to HMEC s Annual Report on Form 10-K for the year ended December 31, 1997, filed with the SEC on March 30, 1998.
10.4*	Amended and Restated Horace Mann Educators Corporation 1991 Stock Incentive Plan, incorporated by reference to Exhibit 10.5 to HMEC s Annual Report on Form 10-K for the year ended December 31, 1999, filed with the SEC on March 30, 2000.
10.4(a)*	Amendment to Amended and Restated Horace Mann Educators Corporation 1991 Stock Incentive Plan, incorporated by reference to Exhibit 10.1(a) to HMEC s Quarterly Report on Form 10-Q for the quarter ended June 30, 2000, filed with the SEC on August 11, 2000.
10.4(b)*	Specimen Employee Stock Option Agreement under the Horace Mann Educators Corporation 1991 Stock Incentive Plan, incorporated by reference to Exhibit 10.5(a) to HMEC s Annual Report on Form 10-K for the year ended December 31, 1999, filed with the SEC on March 30, 2000.
10.4(c)*	Specimen Director Stock Option Agreement under the Horace Mann Educators Corporation 1991 Stock Incentive Plan, incorporated by reference to Exhibit 10.5(b) to HMEC s Annual Report on Form 10-K for the year ended December 31, 1999, filed with the SEC on March 30, 2000.
10.5*	Horace Mann Educators Corporation 2001 Stock Incentive Plan, incorporated by reference to Exhibit 10.6 to HMEC s Annual Report on Form 10-K for the year ended December 31, 2001, filed with the SEC on March 29, 2002.

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Exhibit No.	Description
10.5(a)*	Specimen Employee Stock Option Agreement under the Horace Mann Educators Corporation 2001 Stock Incentive Plan, incorporated by reference to Exhibit 10.6(a) to HMEC s Annual Report on Form 10-K for the year ended December 31, 2001, filed with the SEC on March 29, 2002.
10.5(b)*	Specimen Director Stock Option Agreement under the Horace Mann Educators Corporation 2001 Stock Incentive Plan, incorporated by reference to Exhibit 10.6(b) to HMEC s Annual Report on Form 10-K for the year ended December 31, 2001, filed with the SEC on March 29, 2002.
10.6*	Horace Mann Educators Corporation Amended and Restated 2002 Incentive Compensation Plan (2002 Incentive Compensation Plan), incorporated by reference to Exhibit 10.2 to HMEC s Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, filed with the SEC on August 9, 2005.
10.6(a)*	Specimen Employee Stock Option Agreement under the 2002 Incentive Compensation Plan, incorporated by reference to Exhibit 10.2(a) to HMEC s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the SEC on August 14, 2002.
10.6(b)*	Specimen Regular Employee Stock Option Agreement under the 2002 Incentive Compensation Plan, incorporated by reference to Exhibit 10.2(b) to HMEC s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the SEC on August 14, 2002.
10.6(c)*	Specimen Director Stock Option Agreement under the 2002 Incentive Compensation Plan, incorporated by reference to Exhibit 10.2(c) to HMEC s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the SEC on August 14, 2002.
10.6(d)*	Specimen Employee Restricted Stock Unit Agreement under the 2002 Incentive Compensation Plan.
10.6(e)*	Specimen Non-employee Director Restricted Stock Unit Agreement under the 2002 Incentive Compensation Plan.
10.6(f)*	Specimen Restricted Stock Unit Deferral Election Form under the 2002 Incentive Compensation Plan.
10.6(g)*	Specimen Modification to Stock Options outstanding as of June 30, 2004, incorporated by reference to Exhibit 10.2(d) to HMEC s Quarterly Report on Form 10-Q for the quarter ended June 30, 2004, filed with the SEC on August 9, 2004.
10.7*	Horace Mann Supplemental Employee Retirement Plan, 2002 Restatement, incorporated by reference to Exhibit 10.1 to HMEC s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the SEC on May 15, 2002.

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Exhibit No.	Description
10.8*	Horace Mann Executive Supplemental Employee Retirement Plan, 2002 Restatement, incorporated by reference to Exhibit 10.2 to HMEC s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the SEC on May 15, 2002.
10.9*	Horace Mann Nonqualified Supplemental Money Purchase Pension Plan, incorporated by reference to Exhibit 10.3 to HMEC s Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2002, filed with the SEC on May 15, 2002.
10.10*	Summary of HMEC Non-Employee Director Compensation.
10.11*	Summary of HMEC Named Executive Officer Annualized Salary.
10.12*	Severance Agreements between HMEC and certain officers of HMEC, incorporated by reference to Exhibit 10.7 to HMEC s Annual Report on Form 10-K for the year ended December 31, 2001, filed with the SEC on March 29, 2002.
10.12(a)*	Revised Schedule to Severance Agreements between HMEC and certain officers of HMEC, incorporated by reference to Exhibit 10.2(a) to HMEC s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005, filed with the SEC on November 9, 2005.
10.13*	Change in Control Agreement between HMEC, Horace Mann Service Corporation (HMSC) and certain officers of HMEC and/or HMSC, incorporated by reference to Exhibit 10.13 to HMEC s Annual Report on Form 10-K for the year ended December 31, 2004, filed with the SEC on March 31, 2005.
10.13(a)*	Schedule to Change in Control Agreements between HMEC, HMSC and certain officers of HMEC and/or HMSC, incorporated by reference to Exhibit 10.13(a) to HMEC s Annual Report on Form 10-K for the year ended December 31, 2004, filed with the SEC on March 31, 2005.
10.14*	Employment Agreement between HMEC and Louis G. Lower II as of December 31, 1999, incorporated by reference to Exhibit 10.12 to HMEC s Annual Report on Form 10-K for the year ended December 31, 1999, filed with the SEC on March 30, 2000.
10.15*	Letter of Employment between HMSC and Frank D Ambra III effective February 1, 2005, incorporated by reference to Exhibit 10.15 to HMEC s Annual Report on Form 10-K for the year ended December 31, 2004, filed with the SEC on March 31, 2005.

(11) Statement regarding computation of per share earnings.

(12) Statement regarding computation of ratios.

(21) Subsidiaries of HMEC.

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Exhibit No.	Description
(23)	Consent of KPMG LLP.
(31)	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.1	Certification by Louis G. Lower II, Chief Executive Officer of HMEC.
31.2	Certification by Peter H. Heckman, Chief Financial Officer of HMEC.
(32)	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by Louis G. Lower II, Chief Executive Officer of HMEC.
32.2	Certification by Peter H. Heckman, Chief Financial Officer of HMEC.
(99)	Additional exhibits
99.1	Glossary of Selected Terms.

(b) See list of exhibits in this Item 15.

(c) See list of financial statement schedules in this Item 15.

Copies of Exhibits, Horace Mann Educators Corporation s Code of Ethics and charters of the committees of the Board of Directors may be obtained by writing to Investor Relations, Horace Mann Educators Corporation, 1 Horace Mann Plaza, C-120, Springfield, Illinois 62715-0001.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Horace Mann Educators Corporation has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HORACE MANN EDUCATORS CORPORATION

/s/ Louis G. Lower II
Louis G. Lower II
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Horace Mann Educators Corporation and in the capacities and on the date indicated.

Principal Executive Officer:

/s/ Louis G. Lower II
Louis G. Lower II

President,

Chief Executive Officer and a Director

Principal Financial Officer:

/s/ Peter H. Heckman
Peter H. Heckman

Executive Vice President and

Chief Financial Officer

Principal Accounting Officer:

/s/ Bret A. Conklin
Bret A. Conklin

Senior Vice President and Controller

Directors:

/s/ Joseph J. Melone
Joseph J. Melone, Chairman of the

Board of Directors

/s/ William W. Abbott
William W. Abbott, Director

/s/ Mary H. Futrell
Mary H. Futrell, Director

/s/ Stephen J. Hasenmiller
Stephen J. Hasenmiller, Director

Jeffrey L. Morby, Director

/s/ Shaun F. O Malley
Shaun F. O Malley, Director

/s/ Charles A. Parker
Charles A. Parker, Director

Dated: March 15, 2006

HORACE MANN EDUCATORS CORPORATION

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MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-looking Information

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

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

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

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

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

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

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

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

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

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Based on property and casualty direct earned premiums for 2005, the Company s ten largest states represented 56% of the segment total. Included in this top ten group are certain states in which catastrophe occurrences are relatively common: California, Florida, North Carolina, South Carolina, Louisiana and Texas.

Underwriting actions to mitigate the Company s risk exposure to catastrophe-prone areas could have a near-term negative impact on premium, policy and earnings growth.

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

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

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

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

Changes in accounting or financial reporting standards issued by the FASB, SEC or other standard-setting bodies which may have an adverse effect on the Company s financial condition, results of operations and/or cost of doing business.

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

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

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

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

The competitive impact of entrants such as mutual funds and banks into the tax-deferred annuity products markets, and the Company s ability to profitably expand its property and casualty business in highly competitive environments.

The Company s ability to develop and expand its agent force and its independent agent distribution system, as well as the Company s ability to maintain and secure product sponsorships by local, state and national education associations.

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

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

The impact of a disaster or catastrophic event affecting the Company s employees or its home office facilities and the Company s ability to recover and resume its business operations on a timely basis.

Executive Summary

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

For 2005, the Company s net income increased compared to the prior year, primarily reflecting improved property and casualty segment earnings. This improvement was driven by tightened underwriting standards and pricing actions taken in recent years, ongoing improvements in claims processes, cost containment initiatives, and generally low non-catastrophe claim frequencies. For the Company, and for the property and casualty insurance industry, catastrophe costs were significant in both 2005 and 2004. However, the Company s catastrophe costs for 2005 were lower than those for 2004. Net income in 2005 also benefited from favorable development of prior years claim reserves.

Horace Mann received refunds from the Internal Revenue Service (IRS) in April 2005, including amounts related to tax years 1996 and 1997, which were deemed to be closed. In September 2005, tax years 1998 through 2001 were also deemed closed. This resulted in the elimination of the contingent tax liability related to those six years, which reduced federal income tax expense for 2005 by $9.1 million ($2.7 million and $6.4 million in the second and third quarters, respectively). In addition, $1.4 million of interest on the tax refund amounts was received and recorded as pretax income in the second quarter.

Premiums written and contract deposits decreased 3% compared to 2004. Property and casualty premiums written declined as increases in average voluntary automobile and homeowners premium per policy which were moderated to some extent by the improvement in the quality of the books of business were more than offset by the decline in policies in force in these lines. Also, property and casualty catastrophe reinsurance reinstatement premiums were higher in 2005, representing one-half percentage point of the decline. In addition to the decline in property and casualty premiums written, new annuity single premium and rollover deposit receipts declined compared to 2004.

During 2003 and 2004, the Company improved the underlying operating results of its property and casualty segment and substantially increased the new sales volume and retention of business in its annuity segment. However, that underlying operating progress was substantially offset by other factors which suppressed the Company s net income. In 2004, the Company experienced a record level of catastrophe costs. In 2003, the Company recorded adverse development of prior years property and casualty reserves, primarily related to voluntary automobile liability claims. In addition, in both years the Company experienced spread compression in its fixed annuity business, as a result of credit-related investment losses in 2003 and declining investment yields.

Critical Accounting Policies

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

Liabilities for Property and Casualty Claims and Claim Settlement Expenses

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

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 for the period in which the adjustments are made. Detailed discussion of the impact of adjustments recorded during recent years is included in Results of Operations for the Three Years Ended December 31, 2005 Benefits, Claims and Settlement Expenses and in the Notes to Consolidated Financial Statements Note 3 Property and Casualty Unpaid Claims and Claim Expenses listed on page F-1 of this report. Due to the nature of the Company s personal lines business, the Company has no exposure to claims for toxic waste cleanup, other environmental remediation or asbestos-related illnesses other than claims under homeowners insurance policies for environmentally related items such as mold.

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. For 2001 through 2005, the Company engaged an independent property and casualty actuarial consulting firm to prepare an independent study of the Company s property and casualty reserves at June 30 and December 31 of each year. Beginning in 2006, the independent actuarial consulting firm will prepare an independent study of reserves at December 31, supplemented by other analyses throughout the year.

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

	December 31, 2005			December 31, 2004		
	Case Reserves	IBNR Reserves	Total (1)	Case Reserves	IBNR Reserves	Total (1)
Automobile liability	$ 77.3	$ 144.3	$ 221.6	$ 88.8	$ 138.4	$ 227.2
Automobile other	13.9	5.7	19.6	13.7	2.7	16.4
Homeowners	14.4	52.0	66.4	17.0	44.0	61.0
All other	7.6	27.5	35.1	5.0	25.4	30.4
Total	$ 113.2	$ 229.5	$ 342.7	$ 124.5	$ 210.5	$ 335.0

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

Some 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 outside claims 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 (medical costs, labor rates, the cost of materials), the occurrence of unusually large or frequent catastrophic loss events, timeliness of claim reporting, the state in which the claim occurred, and degree of claimant fraud. The extent of the impact of a risk factor will also vary by coverages within a product line. Individual risk factors are also subject to interactions with other risk factors within product line coverages.

While all product lines are exposed to these risks, there are some loss types or product lines for which the financial affect will be more significant. For instance, the use of outside adjusters for large catastrophe losses adds a level of risk to this loss type not present when employee adjusters handle claims. Also, given the relatively large proportion (approximately 60%) of the Company s reserves that are in the longer-tail auto liability coverages, regulatory and court actions and changes in economic conditions and trends could be expected to impact this product line more extensively than others.

As noted above, there are a number of assumptions involved in the determination of the Property and Casualty liability for unpaid claims and claim settlement expense (loss reserves). Amongst the factors affecting recorded loss reserves, claim severity is of particular significance. Management believes that claim severity is reasonably likely to deviate by 1% from the targeted claim severity for the most recent 36-month period. This deviation would have between a $3 million and $5 million impact on net loss reserves on auto liability coverages and between a $1.5 million to $2.0 million impact on net loss reserves on homeowners coverages. These results may change, depending on the magnitude and direction of the deviation.

Information regarding the Company s property and casualty segment claims and claims settlement expense reserve development is located in Business Property and Casualty Segment Property and Casualty Reserves .

Liabilities for Future Policy Benefits

Liabilities for future benefits on life and annuity policies are established in amounts adequate to meet the estimated future obligations on policies in force. Liabilities for future policy benefits on certain life insurance policies are computed using the net level premium method and are based on assumptions as to future investment yield, mortality and withdrawals. Mortality and withdrawal assumptions for all policies have been based on actuarial tables which are consistent with the Company s own experience. 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. In the event actual experience varies from the estimated liability assumptions, adjustments are charged or credited to income for the period in which the adjustments are made.

Deferred Policy Acquisition Costs and Value of Acquired Insurance in Force for Annuity and Interest-Sensitive Life Products

Policy acquisition costs, consisting of commissions, policy issuance and other costs, which vary with and are primarily related to the production of business, are capitalized and amortized on a basis consistent with the type of insurance coverage. For all investment (annuity) contracts, acquisition costs, and also the value of annuity business acquired in the 1989 acquisition of the Company (Annuity VIF), are amortized over 20 years in proportion to estimated gross profits. Capitalized acquisition costs for interest-sensitive life contracts are also amortized over 20 years in proportion to estimated gross profits.

The most significant assumptions that are involved in the estimation of annuity gross profits include future financial market performance, interest rate spreads, business surrender/lapse rates and the impact of realized investment gains and losses. For the variable deposit portion of the annuity segment, the Company amortizes policy acquisition costs and the Annuity VIF utilizing a future financial market performance assumption of a 10% reversion to the mean approach with a 200 basis point corridor around the mean. At December 31, 2005, the ratio of capitalized annuity policy acquisition costs and the Annuity VIF asset to the total annuity accumulated cash value was approximately 4%.

In the event actual experience differs significantly from assumptions or assumptions are significantly revised, the Company may be required to record a material charge or credit to amortization expense for the period in which the adjustment is made. As noted above, there are a number of assumptions involved in the valuation of capitalized policy acquisition costs and the Annuity VIF. As one example of the volatility of this amortization, if all other assumptions are met, a 1% deviation from the targeted financial market performance for the underlying mutual funds of the Company s variable annuities would currently impact amortization between \$0.1 million and \$0.2 million. This result may change depending on the magnitude and direction of the deviation. Detailed discussion of the impact of adjustments to the amortization of capitalized acquisition costs and Annuity VIF is included in Results of Operations for the Three Years Ended December 31, 2005 Amortization of Policy Acquisition Expenses and Intangible Assets .

Valuation of Investments

The Company s methodology of assessing other-than-temporary impairments is based on security-specific facts and circumstances as of the date of the reporting period. Based on these facts, if management believes it is probable that amounts due will not be collected according to the contractual terms of a debt security not impaired at acquisition, or if the Company does not have the ability or intent to hold a security with an unrealized loss until it matures or recovers in value, an other-than-temporary impairment shall be considered to have occurred. As a general rule, if the fair value of a debt security has fallen below 80% of book value for more than six months, this security will be reviewed for an other-than-temporary impairment. Additionally, if events become known that call into question whether the security issuer has the ability to honor its contractual commitments, whether or not such security has been trading above an 80% fair value to book value relationship, such security holding will be evaluated to determine whether or not such security has suffered an other-than-temporary decline in value.

The Company reviews the fair value of all investments in its portfolio on a monthly basis to assess whether an other-than-temporary decline in value has occurred. These reviews, in conjunction with the Company s investment managers monthly credit reports and relevant factors such as (1) the financial condition and near-term prospects of the issuer, (2) the Company s ability or intent to retain the investment long enough to allow for the anticipated recovery in fair value, (3) the stock price trend of the issuer, (4) the market leadership position of the issuer, (5) the debt ratings of the issuer and (6) the cash flows of the issuer, are all considered in the impairment assessment. A write-down of an investment is recorded when a decline in the fair value of that investment is deemed to be other-than-temporary, with a realized investment loss charged to income for the period.

A decline in fair value below amortized cost is not assumed to be other-than-temporary for fixed maturity investments with unrealized losses due to market conditions or industry-related events where there exists a reasonable expectation that fair value will recover versus historical cost and the Company has the intent and ability to hold the investment until maturity or a market recovery is realized. An other-than-temporary impairment loss will be recognized based upon all relevant facts and circumstances for each investment, as appropriate.

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

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

The Company s cost estimates for its defined benefit pension plan are determined annually based on assumptions which include the discount rate, expected return on plan assets, anticipated retirement rate and estimated lump sum distributions. A discount rate of 5.5% was used by the Company for estimating accumulated benefits under the plan at December 31, 2005, which was based on the average yield for long-term, high grade securities having maturities generally consistent with the defined benefit pension payout period. To set its discount rate, the Company looks to leading indicators, including Moody s Aa long-term bond index. The expected annual return on plan assets assumed by the Company at December 31, 2005 was 7.5%. The assumption for the long-term rate of return on plan assets was determined by considering actual investment experience during the lifetime of the plan, balanced with reasonable expectations of future growth considering the various classes of assets and percentage allocation for each asset class. Management believes that it has adopted realistic assumptions for investment returns, discount rates and other key factors used in the estimation of pension costs and asset values.

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To the extent that actual experience differs from the Company s assumptions, subsequent adjustments may be required, with the effects of those adjustments charged or credited to income and/or shareholders equity for the period in which the adjustments are made. Generally, a change of 50 basis points in the discount rate would inversely impact pension expense and accumulated other comprehensive income (AOCI) by approximately $0.2 million and $2 million, respectively. In addition, for every $1 million increase in the value of pension plan assets, there is an equal increase in AOCI.

Results of Operations for the Three Years Ended December 31, 2005

Insurance Premiums and Contract Charges

Insurance Premiums Written and Contract Deposits

	Year Ended December 31,		Growth Over Prior Year		Year Ended December 31,
	2005	2004	Percent	Amount	2003
Property & casualty					
Automobile and property (voluntary) (1)	$ 535.2	$ 552.5	-3.1%	$ (17.3)	$ 549.2
Involuntary and other property & casualty	11.7	9.8		1.9	(2.7)
Total property & casualty (1)	546.9	562.3	-2.7%	(15.4)	546.5
Annuity deposits	320.1	327.0	-2.1%	(6.9)	296.6
Life	105.6	109.1	-3.2%	(3.5)	112.4
Total (1)	$ 972.6	$ 998.4	-2.6%	$ (25.8)	$ 955.5
Effect of property and casualty catastrophe reinsurance reinstatement premiums, included above	$ (9.9)	$ (5.0)		$ (4.9)	$

(1) The amount for the year ended December 31, 2004 was reduced by $4.0 million of previously escrowed premiums returned to North Carolina automobile policyholders. See further discussion of this topic below.

Insurance Premiums and Contract Charges Earned

(Excludes annuity and life contract deposits)

	Year Ended December 31,	Growth Over Prior Year	Year Ended December 31,

	2005	2004	Percent	Amount	2003
Property & casualty					
Automobile and property (voluntary)	$ 538.8	$ 552.0	-2.4%	$ (13.2)	$ 534.8
Involuntary and other property & casualty	10.8	9.3		1.5	(1.0)
Total property & casualty	549.6				