

HORACE MANN EDUCATORS CORP /DE/

Form 10-Q

August 08, 2018

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended **June 30, 2018**

OR

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

For the transition period from _____ to _____

Commission file number 1-10890

HORACE MANN EDUCATORS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

37-0911756

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

1 Horace Mann Plaza, Springfield, Illinois 62715-0001

(Address of principal executive offices, including Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Act.

Yes No

As of July 31, 2018, the registrant had 41,014,552 shares of Common Stock, par value \$0.001 per share, outstanding.

HORACE MANN EDUCATORS CORPORATION
 FORM 10-Q
 FOR THE QUARTER ENDED JUNE 30, 2018
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SIGNATURES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Horace Mann Educators Corporation:

Results of Review of Interim Financial Information

We have reviewed the consolidated balance sheet of Horace Mann Educators Corporation and subsidiaries (the Company) as of June 30, 2018, the related consolidated statements of operations and comprehensive income for the three-month and six-month periods ended June 30, 2018 and 2017, the related consolidated statements of changes in shareholders' equity and cash flows for the six-month periods ended June 30, 2018 and 2017, and the related notes (collectively, the consolidated interim financial information). Based on our reviews, we are not aware of any material modifications that should be made to the consolidated interim financial information for it to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of the Company as of December 31, 2017, and the related consolidated statements of operations and comprehensive income, changes in shareholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated February 28, 2018, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2017, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Basis for Review Results

This consolidated interim financial information is the responsibility of the Company's management. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

/s/ KPMG LLP
KPMG LLP

Chicago, Illinois
August 8, 2018

HORACE MANN EDUCATORS CORPORATION
CONSOLIDATED BALANCE SHEETS
(\$ in thousands, except per share data)

	June 30, 2018	December 31, 2017
	(Unaudited)	
ASSETS		
Investments		
Fixed maturity securities, available for sale, at fair value (amortized cost 2018, \$7,292,023; 2017, \$7,302,950)	\$7,475,565	\$7,724,075
Equity securities, at fair value (cost 2017, \$116,320)	130,780	135,466
Limited partnership interests	273,787	247,266
Short-term and other investments	352,700	245,541
Total investments	8,232,832	8,352,348
Cash	8,247	7,627
Deferred policy acquisition costs	292,608	257,826
Goodwill	47,396	47,396
Other assets	379,266	381,182
Separate Account (variable annuity) assets	2,195,865	2,151,961
Total assets	\$11,156,214	\$11,198,340
LIABILITIES AND SHAREHOLDERS' EQUITY		
Policy liabilities		
Investment contract and life policy reserves	\$5,634,169	\$5,573,735
Unpaid claims and claim expenses	379,833	347,749
Unearned premiums	260,088	260,539
Total policy liabilities	6,274,090	6,182,023
Other policyholder funds	718,510	724,261
Other liabilities	319,705	341,053
Long-term debt	297,603	297,469
Separate Account (variable annuity) liabilities	2,195,865	2,151,961
Total liabilities	9,805,773	9,696,767
Preferred stock, \$0.001 par value, authorized 1,000,000 shares; none issued	—	—
Common stock, \$0.001 par value, authorized 75,000,000 shares; issued, 2018, 65,733,532; 2017, 65,439,245	66	65
Additional paid-in capital	470,652	464,246
Retained earnings	1,248,305	1,231,177
Accumulated other comprehensive income (loss), net of tax:		
Net unrealized investment gains on securities	125,596	300,177
Net funded status of benefit plans	(13,217) (13,217
Treasury stock, at cost, 2018, 24,723,533 shares; 2017, 24,721,372 shares) (480,961) (480,875
Total shareholders' equity	1,350,441	1,501,573
Total liabilities and shareholders' equity	\$11,156,214	\$11,198,340

See Notes to Consolidated Financial Statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues				
Insurance premiums and contract charges earned	\$205,610	\$195,718	\$408,608	\$391,440
Net investment income	97,101	91,994	188,965	182,705
Net investment gains (losses)	735	2,072	(919)	1,830
Other income	2,811	1,652	5,092	2,765
Total revenues	306,257	291,436	601,746	578,740
Benefits, losses and expenses				
Benefits, claims and settlement expenses	168,278	165,879	311,840	309,975
Interest credited	51,071	49,348	101,105	98,122
DAC amortization expense	26,586	24,808	53,291	49,694
Operating expenses	50,218	46,228	98,387	94,984
Interest expense	3,291	2,945	6,464	5,901
Total benefits, losses and expenses	299,444	289,208	571,087	558,676
Income before income taxes	6,813	2,228	30,659	20,064
Income tax expense (benefit)	896	(33)	4,587	2,485
Net income	\$5,917	\$2,261	\$26,072	\$17,579
Net income per share				
Basic	\$0.14	\$0.05	\$0.63	\$0.43
Diluted	\$0.14	\$0.05	\$0.63	\$0.42
Weighted average number of shares and equivalent shares				
Basic	41,600	41,368	41,531	41,268
Diluted	41,735	41,493	41,659	41,416
Net investment gains (losses)				
Total other-than-temporary impairment losses on securities	\$(1,177)	\$(3,564)	\$(1,287)	\$(1,777)
Portion of losses recognized in other comprehensive income	—	—	—	(4,583)
Net other-than-temporary impairment losses on securities recognized in earnings	(1,177)	(3,564)	(1,287)	(6,360)
Sales and other, net	1,789	5,202	3,992	7,685
Change in fair value - equity securities	(1,156)	—	(6,342)	—
Change in fair value and gains (losses) realized	1,279	434	2,718	505

on settlements - derivative instruments

Total	\$735	\$2,072	\$(919)	\$1,830
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See Notes to Consolidated Financial Statements.

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

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Comprehensive income				
Net income	\$5,917	\$2,261	\$26,072	\$17,579
Other comprehensive income, net of tax:				
Change in net unrealized investment gains (losses) on securities	(52,444)	45,239	(159,540)	67,772
Change in net funded status of benefit plans	—	—	—	—
Cumulative effect of change in accounting principle	—	—	(15,041)	—
Other comprehensive income (loss)	(52,444)	45,239	(174,581)	67,772
Total	\$(46,527)	\$47,500	\$(148,509)	\$85,351

See Notes to Consolidated Financial Statements.

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

	Six Months Ended June	
	2018	2017
Common stock, \$0.001 par value		
Beginning balance	\$65	\$65
Options exercised, 2018, 107,148 shares; 2017, 127,774 shares	—	—
Conversion of common stock units, 2018, 30,368 shares; 2017, 15,981 shares	—	—
Conversion of restricted stock units, 2018, 163,835 shares; 2017, 280,341 shares	1	—
Ending balance	66	65
Additional paid-in capital		
Beginning balance	464,246	453,479
Options exercised and conversion of common stock units and restricted stock units	2,259	1,909
Share-based compensation expense	4,147	3,929
Ending balance	470,652	459,317
Retained earnings		
Beginning balance	1,231,177	1,155,732
Net income	26,072	17,579
Dividends, 2018, \$0.57 per share; 2017, \$0.55 per share	(23,985)	(23,041)
Cumulative effect of change in accounting principle	15,041	—
Ending balance	1,248,305	1,150,270
Accumulated other comprehensive income, net of tax:		
Beginning balance	286,960	163,921
Change in net unrealized investment gains on securities	(159,540)	67,772
Change in net funded status of benefit plans	—	—
Cumulative effect of change in accounting principle	(15,041)	—
Ending balance	112,379	231,693
Treasury stock, at cost		
Beginning balance, 2018, 24,721,372 shares; 2017, 24,672,932 shares	(480,875)	(479,215)
Acquisition of shares, 2018, 2,161 shares; 2017, 0 shares	(86)	—
Ending balance, 2018, 24,723,533 shares; 2017, 24,672,932 shares	(480,961)	(479,215)
Shareholders' equity at end of period	\$1,350,441	\$1,362,130

See Notes to Consolidated Financial Statements.

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

	Six Months Ended	
	June 30,	
	2018	2017
Cash flows - operating activities		
Premiums collected	\$ 392,103	\$ 392,715
Policyholder benefits paid	(272,769)	(274,256)
Policy acquisition and other operating expenses paid	(141,620)	(141,913)
Income taxes paid	(7,393)	(8,068)
Investment income collected	184,749	185,546
Interest expense paid	(6,190)	(5,738)
Other	2,429	6,167
Net cash provided by operating activities	151,309	154,453
Cash flows - investing activities		
Fixed maturity securities		
Purchases	(551,984)	(723,354)
Sales	190,023	229,690
Maturities, paydowns, calls and redemptions	383,090	491,739
Equity securities		
Purchases	(6,028)	(24,190)
Sales and repayments	5,783	18,196
Limited partnership interests		
Purchases	(33,031)	(45,284)
Sales	9,457	6,699
Change in short-term and other investments, net	(109,711)	(41,528)
Net cash used in investing activities	(112,401)	(88,032)
Cash flows - financing activities		
Dividends paid to shareholders	(23,320)	(23,041)
Acquisition of treasury stock	(86)	—
Proceeds from exercise of stock options	2,460	3,130
Withholding tax payments on RSUs tendered	(2,155)	(2,604)
Annuity contracts: variable, fixed and FHLB funding agreements		
Deposits	199,074	234,133
Benefits, withdrawals and net transfers to Separate Account (variable annuity) assets	(218,694)	(200,845)
Transfer of Company 401(k) assets to a third-party provider	—	(77,898)
Life policy accounts		
Deposits	3,163	2,240
Withdrawals and surrenders	(2,525)	(2,287)
Change in bank overdrafts	3,795	87
Net cash used in financing activities	(38,288)	(67,085)

Net increase (decrease) in cash	620	(664)
Cash at beginning of period	7,627	16,670
Cash at end of period	\$8,247	\$16,006

See Notes to Consolidated Financial Statements.

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HORACE MANN EDUCATORS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
June 30, 2018 and 2017

(\$ in thousands, except per share data and unless noted otherwise)

Note 1 - Basis of Presentation

The accompanying unaudited consolidated financial statements of Horace Mann Educators Corporation (HMEC; and together with its subsidiaries, the Company or Horace Mann) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and with the rules and regulations of the Securities and Exchange Commission (SEC), specifically Regulation S-X and the instructions to Form 10-Q. Certain information and disclosures normally included in annual financial statements prepared in conformity with GAAP, but are not required for interim reporting purposes, have been omitted. The Company believes that these consolidated financial statements contain all adjustments (consisting of normal recurring accruals) which are, in the opinion of management, necessary to present fairly the Company's consolidated financial position as of June 30, 2018, the consolidated results of operations and comprehensive income for the three and six month periods ended June 30, 2018 and 2017 and the consolidated changes in shareholders' equity and cash flows for the six month periods ended June 30, 2018 and 2017. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect (1) the reported amounts of assets and liabilities, (2) disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and (3) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The subsidiaries of HMEC market and underwrite personal lines of property and casualty insurance products (primarily personal lines of automobile and property insurance), retirement products (primarily tax-qualified annuities) and life insurance, primarily to K-12 teachers, administrators and other employees of public schools and their families. HMEC's principal operating subsidiaries are Horace Mann Life Insurance Company, Horace Mann Insurance Company, Teachers Insurance Company, Horace Mann Property & Casualty Insurance Company and Horace Mann Lloyds.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes to consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

The results of operations for the three and six month period ended June 30, 2018 are not necessarily indicative of the results to be expected for the full year.

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

Investment Contract and Life Policy Reserves

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

(\$ in thousands)	June 30, 2018	December 31, 2017
Investment contract reserves	\$4,498,302	\$ 4,452,972
Life policy reserves	1,135,867	1,120,763
Total	\$5,634,169	\$ 5,573,735

Note 1 - Basis of Presentation (Continued)*Accumulated Other Comprehensive Income (Loss)*

Accumulated other comprehensive income (loss) (AOCI) represents the accumulated change in shareholders' equity from transactions and other events and circumstances from non-shareholder sources. For the Company, AOCI includes the after tax change in net unrealized investment gains and losses on securities and the after tax change in net funded status of defined benefit plans for the periods as shown in the Consolidated Statements of Changes in Shareholders' Equity. The following tables reconcile these components.

(\$ in thousands)	Net Unrealized Investment Gains and Losses on Securities (1)(2)	Defined Benefit Plans (1)	Total (1)
Beginning balance, April 1, 2018	\$ 178,040	\$(13,217)	\$ 164,823
Other comprehensive income (loss) before reclassifications	(52,873)	—	(52,873)
Amounts reclassified from accumulated other comprehensive income (loss)	429	—	429
Cumulative effect of change in accounting principle (3)	—	—	—
Net current period other comprehensive income (loss)	(52,444)	—	(52,444)
Ending balance, June 30, 2018	\$ 125,596	\$(13,217)	\$ 112,379
Beginning balance, January 1, 2018	\$ 300,177	\$(13,217)	\$ 286,960
Other comprehensive income (loss) before reclassifications	(162,412)	—	(162,412)
Amounts reclassified from accumulated other comprehensive income (loss)	2,872	—	2,872
Cumulative effect of change in accounting principle (3)	(15,041)	—	(15,041)
Net current period other comprehensive income (loss)	(174,581)	—	(174,581)
Ending balance, June 30, 2018	\$ 125,596	\$(13,217)	\$ 112,379

(1) All amounts are net of tax.

The pretax amounts reclassified from AOCI, \$(544) thousand and \$(3,636) thousand, are included in Net investment gains (losses) and the (2) related income tax expenses, \$(115) thousand and \$(764) thousand, are included in Income tax expense in the Consolidated Statements of Operations for the three and six month periods ended June 30, 2018, respectively.

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

(\$ in thousands)	Net Unrealized Investment Gains and Losses on Securities (1)(2)	Defined Benefit Plans (1)	Total (1)
Beginning balance, April 1, 2017	\$ 198,271	\$(11,817)	\$ 186,454
Other comprehensive income (loss) before reclassifications	46,303	—	46,303
Amounts reclassified from accumulated other comprehensive income (loss)	(1,064)	—	(1,064)
Net current period other comprehensive income	45,239	—	45,239
Ending balance, June 30, 2017	\$ 243,510	\$(11,817)	\$ 231,693

Beginning balance, January 1, 2017	\$ 175,738	\$(11,817)	\$ 163,921
Other comprehensive income (loss) before reclassifications	68,633	—	68,633
Amounts reclassified from accumulated other comprehensive income (loss)	(861)) —	(861)
Net current period other comprehensive income	67,772	—	67,772
Ending balance, June 30, 2017	\$ 243,510	\$(11,817)	\$ 231,693

(1) All amounts are net of tax.

The pretax amounts reclassified from AOCI, \$1,638 thousand and \$1,325 thousand, are included in Net investment gains (losses) and the (2) related income tax expenses, \$574 thousand and \$464 thousand, are included in Income tax expense (benefit) in the Consolidated Statements of Operations for the three and six month periods ended June 30, 2017, respectively.

Note 1 - Basis of Presentation (Continued)

Comparative information for elements that are not required to be reclassified in their entirety to net income in the same reporting period is located in Note 2 -- Investments -- Net Unrealized Investment Gains and Losses on Securities.

Adopted Accounting Standards

Revenue Recognition

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

Recognition and Measurement of Financial Assets and Liabilities

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

Statement of Cash Flows -- Classification

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

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

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

Note 1 - Basis of Presentation (Continued)

Pending Accounting Standards

Accounting for Leases

In February 2016, the FASB issued accounting and disclosure guidance to improve financial reporting and comparability among organizations about leasing transactions. Under the new guidance, for leases with lease terms of more than 12 months, a lessee will be required to recognize assets and liabilities on the balance sheet for the rights and obligations created by those leases. Consistent with current accounting guidance, the recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or an operating lease. However, while current guidance requires only capital leases to be recognized on the balance sheet, the new guidance will require both operating and capital leases to be recognized on the balance sheet. This new guidance is effective for annual reporting periods beginning December 15, 2018, and interim reporting periods within those annual periods, with early adoption permitted. The Company will adopt this new guidance on January 1, 2019, and the Company expects to use the optional transition method, which allows the Company to recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption (i.e., comparative periods presented in the consolidated financial statements will continue to be in conformity with current GAAP). While the Company is in the process of evaluating the impact of the guidance, it does not expect the guidance to have a material impact on its consolidated financial statements, except for recognizing lease assets and lease liabilities for its operating leases. The Company's lease obligations under various non-cancellable operating lease agreements amounted to approximately \$8,416 thousand at June 30, 2018.

Measurement of Credit Losses on Financial Instruments

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

Simplifying the Test for Goodwill Impairment

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

for impairment.

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Note 2 - Investments

The Company's investment portfolio includes free-standing derivative financial instruments (currently over the counter index call option contracts) to economically hedge risk associated with its fixed indexed annuity (FIA) and indexed universal life (IUL) products' contingent liabilities. The Company's FIA and IUL products include embedded derivative features that are discussed in Note 1 -- Summary of Significant Accounting Policies -- Investment Contract and Life Policy Reserves -- Reserves for Fixed Indexed Annuities and Indexed Universal Life Policies of the Company's Annual Report on Form 10-K for the year ended December 31, 2017. The Company's investment portfolio included no other free-standing derivative financial instruments (futures, forwards, swaps, option contracts or other financial instruments with similar characteristics), and there were no other embedded derivative features related to the Company's investment or insurance products during the six month periods ended June 30, 2018 and 2017.

Fixed Maturity Securities

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

(\$ in thousands)	Amortized Cost/Cost	Unrealized Investment Gains	Unrealized Investment Losses	Fair Value
June 30, 2018 (1)				
Fixed maturity securities				
U.S. Government and federally sponsored agency obligations (2):				
Mortgage-backed securities	\$ 704,330	\$ 19,586	\$ 16,592	\$ 707,324
Other, including U.S. Treasury securities	790,687	15,444	23,908	782,223
Municipal bonds	1,696,693	141,937	11,119	1,827,511
Foreign government bonds	92,872	3,217	584	95,505
Corporate bonds	2,342,531	82,113	26,920	2,397,724
Other mortgage-backed securities	1,664,910	15,663	15,295	1,665,278
Totals	\$ 7,292,023	\$ 277,960	\$ 94,418	\$ 7,475,565

December 31, 2017

Fixed maturity securities				
U.S. Government and federally sponsored agency obligations (2):				
Mortgage-backed securities	\$ 669,297	\$ 30,460	\$ 3,032	\$ 696,725
Other, including U.S. Treasury securities	714,613	26,311	5,516	735,408
Municipal bonds	1,711,581	184,107	2,435	1,893,253
Foreign government bonds	96,780	5,958	—	102,738
Corporate bonds	2,409,426	173,862	4,334	2,578,954
Other mortgage-backed securities	1,701,253	22,935	7,191	1,716,997
Totals	\$ 7,302,950	\$ 443,633	\$ 22,508	\$ 7,724,075

Equity securities (3)	\$ 116,320	\$ 19,425	\$ 279	\$ 135,466
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(1) Effective January 1, 2018, with the adoption of new accounting guidance for recognition and measurement of financial instruments, available for sale equity securities were reclassified to equity securities at fair value and are excluded from the table above as of June 30, 2018.

Fair value includes securities issued by Federal National Mortgage Association (FNMA) of \$384,676 thousand and \$361,955 thousand; (2) Federal Home Loan Mortgage Corporation (FHLMC) of \$395,043 thousand and \$400,001 thousand; and Government National Mortgage Association (GNMA) of \$97,103 thousand and \$104,168 thousand as of June 30, 2018 and December 31, 2017, respectively.

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

Note 2 - Investments (Continued)

The following table presents the fair value and gross unrealized losses of securities in an unrealized loss position at June 30, 2018 and December 31, 2017, respectively. The Company views the decrease in value of all of the securities with unrealized losses at June 30, 2018 -- which was driven largely by changes in interest rates, spread widening, financial market illiquidity and/or market volatility from the date of acquisition -- as temporary. For fixed maturity securities, management does not have the intent to sell the securities and it is not more likely than not the Company will be required to sell the securities before the anticipated recovery of the amortized cost bases, and management expects to recover the entire amortized cost bases of the fixed maturity securities. Therefore, it was determined that the unrealized losses on the securities presented in the table below were not other than temporarily impaired as of June 30, 2018.

(\$ in thousands)

	12 Months or Less		More than 12 Months		Total	Gross Unrealized Losses
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	
June 30, 2018 (1)						
Fixed maturity securities						
U.S. Government and federally sponsored agency obligations:						
Mortgage-backed securities	\$ 354,474	\$ 12,787	\$ 40,302	\$ 3,805	\$ 394,776	\$ 16,592
Other	413,744	14,379	120,081	9,529	533,825	23,908
Municipal bonds	269,872	6,713	75,715	4,406	345,587	11,119
Foreign government bonds	19,912	584	—	—	19,912	584
Corporate bonds	833,370	23,370	36,587	3,550	869,957	26,920
Other mortgage-backed securities	888,965	10,400	158,524	4,895	1,047,489	15,295
Total	\$ 2,780,337	\$ 68,233	\$ 431,209	\$ 26,185	\$ 3,211,546	\$ 94,418
Number of positions with a gross unrealized loss	1,091		160		1,251	
Fair value as a percentage of total fixed maturity securities fair value	36.6	%	5.7	%	42.3	%
December 31, 2017						
Fixed maturity securities						
U.S. Government and federally sponsored agency obligations:						
Mortgage-backed securities	\$ 134,032	\$ 1,053	\$ 40,606	\$ 1,979	\$ 174,638	\$ 3,032
Other	168,634	1,849	122,753	3,667	291,387	5,516
Municipal bonds	29,437	100	79,140	2,335	108,577	2,435
Foreign government bonds	—	—	—	—	—	—
Corporate bonds	115,113	2,701	36,081	1,633	151,194	4,334
Other mortgage-backed securities	457,166	2,791	168,972	4,400	626,138	7,191
Total fixed maturity securities	904,382	8,494	447,552	14,014	1,351,934	22,508
Equity securities (2)	6,027	249	1,277	30	7,304	279
Combined totals	\$ 910,409	\$ 8,743	\$ 448,829	\$ 14,044	\$ 1,359,238	\$ 22,787
Number of positions with a gross unrealized loss	354		158		512	
Fair value as a percentage of total fixed maturity and equity securities fair value	11.6	%	5.7	%	17.3	%

(1) Effective January 1, 2018, with the adoption of new accounting guidance for recognition and measurement of financial instruments, available for sale equity securities were reclassified to equity securities at fair value and are excluded from the table above as of June 30, 2018.

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

Note 2 - Investments (Continued)

Fixed maturity securities with an investment grade rating represented 96.6% of the gross unrealized losses as of June 30, 2018. With respect to fixed maturity securities involving securitized financial assets, the underlying collateral cash flows were stress tested to determine there was no adverse change in the present value of cash flows below the amortized cost basis.

Credit Losses

The following table summarizes the cumulative amounts related to the Company's credit loss component of other-than-temporary impairment (OTTI) losses on fixed maturity securities held as of June 30, 2018 and 2017 that the Company did not intend to sell as of those dates, and it was not more likely than not that the Company would be required to sell the securities before the anticipated recovery of the amortized cost bases, for which the non-credit portions of OTTI losses were recognized in OCI:

(\$ in thousands)	Six Months Ended June 30,	
	2018	2017
Cumulative credit loss (1)		
Beginning of period	\$3,825	\$13,703
New credit losses	—	—
Increases to previously recognized credit losses	246	1,910
Gains (losses) related to securities sold or paid down during the period	—	(2)
End of period	\$4,071	\$15,611

(1) The cumulative credit loss amounts exclude OTTI losses on securities held as of the periods indicated that the Company intended to sell or it was more likely than not that the Company would be required to sell the security before the recovery of the amortized cost basis.

Maturities/Sales of Fixed Maturity Securities

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

(\$ in thousands)	Percent of Total Fair Value		June 30, 2018	
	June 30, 2018	December 31, 2017	Fair Value	Amortized Cost
Estimated expected maturity:				
Due in 1 year or less	4.2 %	3.2 %	\$312,584	\$308,703
Due after 1 year through 5 years	24.5	26.7	1,829,489	1,794,597
Due after 5 years through 10 years	32.4	32.6	2,423,204	2,405,751
Due after 10 years through 20 years	25.2	24.2	1,885,539	1,828,415
Due after 20 years	13.7	13.3	1,024,749	954,557
Total	100.0%	100.0 %	\$7,475,565	\$7,292,023
Average option-adjusted duration, in years	6.0	5.9		

Note 2 - Investments (Continued)*Sales of Fixed Maturity and Equity Securities*

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

(\$ in thousands)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Fixed maturity securities				
Proceeds received	\$ 100,129	\$ 118,818	\$ 190,023	\$ 229,690
Gross gains realized	2,352	4,080	4,022	6,569
Gross losses realized	(1,584)	(496)	(1,637)	(1,377)
Equity securities				
Proceeds received	\$ 3,735	\$ 11,507	\$ 5,783	\$ 16,996
Gross gains realized	977	1,702	1,593	2,750
Gross losses realized	(147)	(236)	(181)	(428)

Net Investment Gains (Losses)

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

(\$ in thousands)	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2018	2017	2018	2017
Impairment write-downs	\$—	\$—	\$—	\$(1,777)
Change in intent write-downs	(1,177)	(3,564)	(1,287)	(4,583)
Net OTTI losses recognized in earnings	(1,177)	(3,564)	(1,287)	(6,360)
Sales and other, net	1,789	5,202	3,992	7,685
Change in fair value - equity securities (1)	(1,156)	—	(6,342)	—
Change in fair value and gains (losses) realized on settlements - derivative instruments	1,279	434	2,718	505
Net investment gains (losses)	\$ 735	\$ 2,072	\$ (919)	\$ 1,830

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

Net Unrealized Investment Gains and Losses on Securities

The following table reconciles the net unrealized investment gains and losses, net of tax, included in AOCI, before the impact of deferred policy acquisition costs (DAC):

(\$ in thousands)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net unrealized investment gains and losses on securities, net of tax				
Beginning of period	\$ 206,293	\$ 228,337	\$ 286,176	\$ 202,941
Change in net unrealized investment gains	(61,724)	54,193	(129,009)	79,386

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Reclassification of net investment (gains) losses to net income	429	(1,065)	2,872	(862)
Reclassification of unrealized gains on equity securities, net of tax, to Retained earnings (1)	—	—	(15,041)	—
End of period	\$ 144,998	\$ 281,465	\$ 144,998	\$ 281,465

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

Note 2 - Investments (Continued)*Offsetting of Assets and Liabilities*

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

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

(\$ in thousands)	Gross Amounts Offset in the	Consolidated Balance Sheets	Net Amounts of Assets/ Liabilities Presented in the	Gross Amounts Not Offset in the Consolidated Balance Sheets	Cash Financial Collateral Instruments Received	Net Amount
June 30, 2018						
Asset derivatives:						
Free-standing derivatives	\$ 9,376	\$ —	\$ 9,376	\$ —	\$ 10,484	\$(1,108)
December 31, 2017						
Asset derivatives:						
Free-standing derivatives	\$ 15,550	\$ —	\$ 15,550	\$ —	\$ 15,584	\$(34)

Deposits

At June 30, 2018 and December 31, 2017, fixed maturity securities with a fair value of \$17,782 thousand and \$17,985 thousand, respectively, were on deposit with governmental agencies as required by law in various states in which the insurance subsidiaries of HMEC conduct business. In addition, at June 30, 2018 and December 31, 2017, fixed maturity securities with a fair value of \$625,165 thousand and \$686,790 thousand, respectively, were on deposit with the Federal Home Loan Bank of Chicago (FHLB) as collateral for amounts subject to funding agreements, advances and borrowings which were equal to \$625,000 thousand at both of the respective dates. The deposited securities are included in Fixed maturity securities on the Company's Consolidated Balance Sheets.

Note 3 - Fair Value of Financial Instruments

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

Information regarding the three-level hierarchy presented below and the valuation methodologies utilized by the Company to estimate fair values at a point in time is included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, specifically in Note 3 -- Fair Value of Financial Instruments.

Note 3 - Fair Value of Financial Instruments (Continued)*Financial Instruments Measured and Carried at Fair Value*

The following table presents the Company's fair value hierarchy for those assets and liabilities measured and carried at fair value on a recurring basis. At June 30, 2018, Level 3 invested assets comprised 3.3% of the Company's total investment portfolio at fair value.

(\$ in thousands)

	Carrying Amount	Fair Value	Fair Value Measurements at Reporting Date Using		
			Level 1	Level 2	Level 3
June 30, 2018					
Financial Assets					
Investments					
Fixed maturity securities					
U.S. Government and federally sponsored agency obligations:					
Mortgage-backed securities	\$ 707,324	\$ 707,324	\$—	\$ 703,543	\$ 3,781
Other, including U.S. Treasury securities	782,223	782,223	13,201	769,022	—
Municipal bonds	1,827,511	1,827,511	—	1,777,590	49,921
Foreign government bonds	95,505	95,505	—	95,505	—
Corporate bonds	2,397,724	2,397,724	13,397	2,291,664	92,663
Other mortgage-backed securities	1,665,278	1,665,278	—	1,539,998	125,280
Total fixed maturity securities	7,475,565	7,475,565	26,598	7,177,322	271,645
Equity securities	130,780	130,780	80,236	—50,538	—6
Short-term investments	176,497	176,497	176,497	—	—
Other investments	21,876	21,876	—	21,876	—
Totals	\$ 7,804,718	\$ 7,804,718	\$ 283,331	\$ 7,249,736	\$ 271,651
Financial Liabilities					
Investment contract and life policy reserves, embedded derivatives	\$ 486	\$ 486	\$—	\$ 486	\$—
Other policyholder funds, embedded derivatives	77,788	77,788	—	—	77,788
December 31, 2017					
Financial Assets					
Investments					
Fixed maturity securities					
U.S. Government and federally sponsored agency obligations:					
Mortgage-backed securities	\$ 696,725	\$ 696,725	\$—	\$ 693,375	\$ 3,350
Other, including U.S. Treasury securities	735,408	735,408	13,393	722,015	—
Municipal bonds	1,893,253	1,893,253	—	1,843,925	49,328
Foreign government bonds	102,738	102,738	—	102,738	—
Corporate bonds	2,578,954	2,578,954	14,345	2,491,630	72,979
Other mortgage-backed securities	1,716,997	1,716,997	—	1,612,403	104,594
Total fixed maturity securities	7,724,075	7,724,075	27,738	7,466,086	230,251
Equity securities	135,466	135,466	82,208	53,252	6
Short-term investments	62,593	62,593	62,593	—	—
Other investments	28,050	28,050	—	28,050	—
Totals	\$ 7,950,184	\$ 7,950,184	\$ 172,539	\$ 7,547,388	\$ 230,257
Financial Liabilities					
Investment contract and life policy reserves, embedded derivatives	\$ 594	\$ 594	\$—	\$ 594	\$—

Other policyholder funds, embedded derivatives	80,733	80,733	—	—	80,733
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Note 3 - Fair Value of Financial Instruments (Continued)

During the six month period ended June 30, 2018, there were no transfers between Level 1 and Level 2. During the six month period ended June 30, 2017, an equity security was transferred into Level 1 from Level 2 as a result of increased liquidity in the market and a sustained increase in the market activity for this asset. The following table presents reconciliations for the periods indicated for all Level 3 assets and liabilities measured at fair value on a recurring basis.

(\$ in thousands)	Financial Assets						Total	Financial Liabilities(1)
	Municipal Bonds	Corporate Bonds	Other Mortgage-Backed Securities (2)	Total Fixed Maturity Securities	Equity Securities	Short-term Investments		
Beginning balance, April, 1, 2018	\$49,748	\$78,780	\$115,334	\$243,862	\$6	\$—	\$243,868	\$78,486
Transfers into Level 3 (3)	—	29,709	18,322	48,031	—	—	48,031	—
Transfers out of Level 3 (3)	—	(11,279)	(4,230)	(15,509)	—	—	(15,509)	—
Total gains or losses								
Net investment gains (losses) included in net income related to financial assets	—	(246)	—	(246)	—	—	(246)	—
Net (gains) losses included in net income related to financial liabilities	—	—	—	—	—	—	—	(1,291)
Net unrealized investment gains (losses) included in OCI	397	(700)	1,659	1,356	—	—	1,356	—
Purchases	—	—	—	—	—	—	—	—
Issuances	—	—	—	—	—	—	—	2,107
Sales	—	—	—	—	—	—	—	—
Settlements	—	—	—	—	—	—	—	—
Paydowns, maturities and distributions	(224)	(3,601)	(2,024)	(5,849)	—	—	(5,849)	(1,514)
Ending balance, June 30, 2018	\$49,921	\$92,663	\$129,061	\$271,645	\$6	\$—	\$271,651	\$77,788
Beginning balance, January 1, 2018	\$49,328	\$72,979	\$107,944	\$230,251	\$6	\$—	\$230,257	\$80,733
Transfers into Level 3 (3)	—	40,487	33,144	73,631	—	—	73,631	—
Transfers out of Level 3 (3)	—	(11,279)	(4,230)	(15,509)	—	—	(15,509)	—
Total gains or losses								
Net investment gains (losses) included in net income related to financial assets	—	(246)	—	(246)	3	—	(243)	—
Net (gains) losses included in net income related to financial liabilities	—	—	—	—	—	—	—	(3,513)
Net unrealized investment gains (losses) included in OCI	840	(1,587)	637	(110)	—	—	(110)	—
Purchases	—	—	—	—	—	—	—	—
Issuances	—	—	—	—	—	—	—	3,439
Sales	—	—	—	—	(3)	—	(3)	—
Settlements	—	—	—	—	—	—	—	—
Paydowns, maturities and distributions	(247)	(7,691)	(8,434)	(16,372)	—	—	(16,372)	(2,871)
Ending balance, June 30, 2018	\$49,921	\$92,663	\$129,061	\$271,645	\$6	\$—	\$271,651	\$77,788

(1) Represents embedded derivatives, all related to FIA products, reported in Other policyholder funds in the Company's Consolidated Balance Sheets.

(2) Includes U.S. Government and federally sponsored agency obligations for mortgage-backed securities and other mortgage-backed securities.

Transfers into and out of Level 3 during the three and six month periods ended June 30, 2018 were attributable to changes in the availability of observable market information for individual fixed maturity securities and short-term investments. The Company's policy is to recognize transfers into and transfers out of the levels as having occurred at the end of the reporting period in which the transfers were determined.

Note 3 - Fair Value of Financial Instruments (Continued)

(\$ in thousands)	Financial Assets							Financial Liabilities(1)
	Municipal Bonds	Corporate Bonds	Mortgage-Backed Securities (2)	Total Fixed Maturity Securities	Equity Securities	Short-term Investments	Total	
Beginning balance, April 1, 2017	\$ 53,462	\$ 82,495	\$ 112,794	\$ 248,751	\$ 6	\$ —	\$ 248,757	\$ 64,261
Transfers into Level 3 (3)	—	2,001	9,482	11,483	—	—	11,483	—
Transfers out of Level 3 (3)	(5,557)	(5,853)	—	(11,410)	—	—	(11,410)	—
Total gains or losses								
Net realized investment gains (losses) included in net income related to financial assets	—	—	(1,714)	(1,714)	—	—	(1,714)	—
Net realized (gains) losses included in net income related to financial liabilities	—	—	—	—	—	—	—	1,238
Net unrealized investment gains (losses) included in other comprehensive income	1,287	359	3,093	4,739	—	—	4,739	—
Purchases	—	—	—	—	—	—	—	—
Issuances	—	—	—	—	—	—	—	3,397
Sales	—	—	—	—	—	—	—	—
Settlements	—	—	—	—	—	—	—	—
Paydowns, maturities and distributions	(69)	(1,950)	(3,331)	(5,350)	—	—	(5,350)	(901)
Ending balance, June 30, 2017	\$ 49,123	\$ 77,052	\$ 120,324	\$ 246,499	\$ 6	\$ —	\$ 246,505	\$ 67,995
Beginning balance, January 1, 2017	\$ 46,497	\$ 60,191	\$ 104,659	\$ 211,347	\$ 6	\$ 751	\$ 212,104	\$ 59,393
Transfers into Level 3 (3)	5,214	31,919	24,521	61,654	—	—	61,654	—
Transfers out of Level 3 (3)	(5,557)	(11,963)	—	(17,520)	—	(751)	(18,271)	—
Total gains or losses								
Net realized investment gains (losses) included in net income related to financial assets	—	—	(1,714)	(1,714)	—	—	(1,714)	—
Net realized (gains) losses included in net income related to financial liabilities	—	—	—	—	—	—	—	3,546
Net unrealized investment gains (losses) included in other comprehensive income	3,158	455	2,322	5,935	—	—	5,935	—
Purchases	—	—	—	—	—	—	—	—
Issuances	—	—	—	—	—	—	—	6,786
Sales	—	—	—	—	—	—	—	—
Settlements	—	—	—	—	—	—	—	—
Paydowns, maturities and distributions	(189)	(3,550)	(9,464)	(13,203)	—	—	(13,203)	(1,730)
Ending balance, June 30, 2017	\$ 49,123	\$ 77,052	\$ 120,324	\$ 246,499	\$ 6	\$ —	\$ 246,505	\$ 67,995

(1) Represents embedded derivatives, all related to FIA products, reported in Other policyholder funds in the Company's Consolidated Balance Sheets.

(2) Includes U.S. Government and federally sponsored agency obligations for mortgage-backed securities and other mortgage-backed securities.

Transfers into and out of Level 3 during the three and six month periods ended June 30, 2017 were attributable to changes in the availability of observable market information for individual fixed maturity securities and short-term investments. The Company's policy is to recognize transfers into and transfers out of the levels as having occurred at the end of the reporting period in which the transfers were determined.

For the six month period ended June 30, 2018, the Company realized a net loss of \$243 thousand on two Level 3

securities. For the six month period ended June 30, 2017, the Company impaired two Level 3 securities for a \$1,714 thousand realized loss. For the three and six month periods ended June 30, 2018, net investment gains of \$1,291 thousand and \$3,513 thousand, respectively, were included in earnings that were attributable to the changes in the fair value of Level 3 liabilities (embedded derivatives) still held; for the three and six months ended June 30, 2017, the respective loss amounts were \$1,238 thousand and \$3,546 thousand.

Note 3 - Fair Value of Financial Instruments (Continued)

The valuation techniques and significant unobservable inputs used in the fair value measurement for financial assets and liabilities classified as Level 3 are subject to the control processes as described in Note 3 -- Fair Value of Financial Instruments -- Investments in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Generally, valuation techniques for fixed maturity securities include spread pricing, matrix pricing and discounted cash flow methodologies; include inputs such as quoted prices for identical or similar securities that are less liquid; and are based on lower levels of trading activity than securities classified as Level 2. The valuation techniques and significant unobservable inputs used in the fair value measurement for equity securities classified as Level 3 use similar valuation techniques and significant unobservable inputs as those used for fixed maturity securities.

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

Financial Instruments Not Carried at Fair Value; Disclosure Required

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

(\$ in thousands)	Carrying Fair Amount Value		Fair Value Measurements at Reporting Date Using		
			Level 1	Level 2	Level 3
June 30, 2018					
Financial Assets					
Investments					
Other investments	\$ 154,327	\$ 159,019	\$—		—\$ 159,019
Financial Liabilities					
Investment contract and life policy reserves, fixed annuity contracts	4,498,302	4,399,614	—		4,399,614
Investment contract and life policy reserves, account values on life contracts	84,163	89,761	—		89,761
Other policyholder funds	640,722	640,722	—	575,928	64,794
Long-term debt	297,603	302,695	—	302,695	—
December 31, 2017					
Financial Assets					
Investments					
Other investments	\$ 154,898	\$ 159,575	\$—		—\$ 159,575
Financial Liabilities					
Investment contract and life policy reserves, fixed annuity contracts	4,452,972	4,366,334	—		4,366,334
Investment contract and life policy reserves, account values on life contracts	82,911	88,620	—		88,620
Other policyholder funds	643,528	643,528	—	575,622	67,906

Long-term debt	297,469	311,315	—	311,315	—
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Note 4 - Derivative Instruments

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

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

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

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

(\$ in thousands)	June 30, December 31,	
	2018	2017
Assets		
Derivative instruments, included in Short-term and other investments	\$9,376	\$ 15,550
Liabilities		
FIA - embedded derivatives, included in Other policyholder funds	\$77,788	\$ 80,733
IUL - embedded derivatives, included in Investment contract and life policy reserves	486	594

Note 4 - Derivative Instruments (Continued)

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

(\$ in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Change in fair value of derivatives (1):				
Revenues				
Net investment gains (losses)	\$ (2)	\$ 1,729	\$ (851)	\$ 4,166
Change in fair value of embedded derivatives:				
Revenues				
Net investment gains (losses)	\$ 1,281	\$ (1,295)	\$ 3,569	\$ (3,661)

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

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

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

(\$ in thousands)	June 30, 2018		December 31, 2017			
	Credit Rating S&P	Moody's	Notional Amount	Fair Value	Notional Amount	Fair Value
Bank of America, N.A.	A+	Aa3	\$ 105,100	\$ 5,195	\$ 85,100	\$ 6,320
Barclays Bank PLC	A	A2	39,100	783	48,900	1,828
Citigroup Inc.	BBB+		—	—	—	—
Credit Suisse International	A	A1	11,000	324	21,100	1,444
Societe Generale	A		103,400	3,074	91,700	5,958
Total			\$ 258,600	\$ 9,376	\$ 246,800	\$ 15,550

As of June 30, 2018 and December 31, 2017, the Company held \$10,484 thousand and \$15,584 thousand, respectively, of cash received from counterparties for derivative collateral, which is included in Other liabilities on the Consolidated Balance Sheets. This derivative collateral limits the Company's maximum amount of economic loss due to credit risk that would be incurred if parties to the call options failed completely to perform according to the terms of the contracts to \$250 thousand per counterparty.

Note 5 - Property and Casualty Unpaid Claims and Claim Expenses

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

(\$ in thousands)	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Property and Casualty				
Beginning gross reserves (1)	\$331,255	\$316,173	\$319,182	\$307,757
Less: reinsurance recoverables	62,917	61,804	57,409	61,199
Net reserves, beginning of period (2)	268,338	254,369	261,773	246,558
Incurred claims and claim expenses:				
Claims occurring in the current period	147,005	148,348	267,993	271,552
Decrease in estimated reserves for claims occurring in prior periods (3)	—	(600)	(300)	(1,600)
Total claims and claim expenses incurred (4)	147,005	147,748	267,693	269,952
Claims and claim expense payments for claims occurring during:				
Current period	80,403	95,645	127,451	148,025
Prior periods	45,006	35,538	112,081	97,551
Total claims and claim expense payments	125,409	131,183	239,532	245,576
Net reserves, end of period (2)	289,934	270,934	289,934	270,934
Plus: reinsurance recoverables	62,883	58,897	62,883	58,897
Ending gross reserves (1)	\$352,817	\$329,831	\$352,817	\$329,831

(1) Unpaid claims and claim expenses as reported in the Consolidated Balance Sheets also include reserves for Life and Retirement of \$27,016 thousand and \$22,682 thousand as of June 30, 2018 and 2017, respectively, in addition to Property and Casualty reserves.

(2) Reserves net of anticipated reinsurance recoverables.

(3) Shows the amounts by which the Company decreased its reserves in each of the periods indicated for claims occurring in previous periods to reflect subsequent information on such claims and changes in their projected final settlement costs.

Benefits, claims and settlement expenses as reported in the Consolidated Statements of Operations also include amounts for Life and Retirement of \$21,273 thousand and \$44,147 thousand for the three and six month periods ended June 30, 2018, respectively, in addition to

(4) Property and Casualty amounts. Benefits, claims and settlement expenses for Life and Retirement were \$18,131 thousand and \$40,023 thousand for the three and six month periods ended June 30, 2017, respectively

Net favorable development of total reserves for Property and Casualty claims occurring in prior years was \$300 thousand and \$1,600 thousand for the six month periods ended June 30, 2018 and 2017, respectively. The favorable development for both of the six month periods ended June 30, 2018 and 2017 was predominantly the result of favorable severity trends in homeowners loss emergence for accident years 2016 and prior.

Note 6 - Debt

Indebtedness outstanding was as follows:

(\$ in thousands)	June 30, 2018	December 31, 2017
Short-term debt:		
Bank Credit Facility, expires June 27, 2023	\$ —	\$ —
Long-term debt:		

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4.50% Senior Notes, due December 1, 2025. Aggregate principal amount of \$250,000 thousand less unaccrued discount of \$518 and \$547 thousand (4.5% imputed rate) and unamortized debt issuance costs of \$1,879 thousand and \$1,984 thousand	247,603	247,469
Federal Home Loan Bank borrowing	50,000	50,000
Total	\$297,603	\$ 297,469

Note 6 - Debt (Continued)

The Credit Agreement with certain financial institutions (Bank Credit Facility), 4.50% Senior Notes due 2025 (Senior Notes due 2025) and FHLB borrowing are described in Notes to Consolidated Financial Statements -- Note 7 -- Debt of the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Credit Agreement with Financial Institutions (Bank Credit Facility)

Effective June 27, 2018, the Bank Credit Facility was amended and restated to extend the commitment termination date to June 27, 2023 from the previous termination date of July 30, 2019. The interest rate spread relative to Eurodollar base rates and the financial covenants within the agreement were not changed. The Bank Credit Facility is by and between HMEC, certain financial institutions named therein and JPMorgan Chase Bank, N.A., as administrative agent, and provides for unsecured borrowings of up to \$150 million. Interest accrues at varying spreads relative to prime or Eurodollar base rates and is payable monthly or quarterly depending on the applicable base rate (Eurodollar base rate plus 1.15%). The unused portion of the Bank Credit Facility is subject to a variable commitment fee, which was 0.15% on an annual basis at June 30, 2018. HMEC had no balance outstanding under its Bank Credit Facility at June 30, 2018.

Note 7 - Reinsurance

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

(\$ in thousands)	Gross Amount	Ceded to Other Companies	Assumed from Other Companies	Net Amount
Three months ended June 30, 2018				
Premiums written and contract deposits (1)	\$ 305,864	\$ 5,483	\$ 1,341	\$ 301,722
Premiums and contract charges earned	209,892	5,505	1,223	205,610
Benefits, claims and settlement expenses	170,459	3,330	1,149	168,278
Three months ended June 30, 2017				
Premiums written and contract deposits (1)	\$ 316,123	\$ 5,643	\$ 1,134	\$ 311,614
Premiums and contract charges earned	200,351	5,665	1,032	195,718
Benefits, claims and settlement expenses	168,218	3,185	846	165,879
Six months ended June 30, 2018				
Premiums written and contract deposits (1)	\$ 594,680	\$ 10,997	\$ 2,047	\$ 585,730
Premiums and contract charges earned	417,629	11,033	2,012	408,608
Benefits, claims and settlement expenses	322,427	12,344	1,757	311,840
Six months ended June 30, 2017				
Premiums written and contract deposits (1)	\$ 617,635	\$ 11,153	\$ 1,864	\$ 608,346
Premiums and contract charges earned	400,806	11,199	1,833	391,440
Benefits, claims and settlement expenses	315,489	7,068	1,554	309,975

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

Note 8 - Commitments*Investment Commitments*

From time to time, the Company has outstanding commitments to purchase investments and/or commitments to lend funds under bridge loans. Unfunded commitments to purchase investments were \$166,740 thousand and \$106,381 thousand at June 30, 2018 and December 31, 2017, respectively.

Note 9 - Segment Information

The Company conducts and manages its business through four segments. The three operating segments, representing the major lines of insurance business, are: Property and Casualty, primarily personal lines automobile and property insurance products; Retirement, primarily tax-qualified fixed and variable annuities; and Life, life insurance. The Company does not allocate the impact of corporate-level transactions to these operating segments, consistent with the basis for management's evaluation of the results of those segments, but classifies those items in the fourth segment, Corporate and Other. In addition to ongoing transactions such as corporate debt service, net investment gains and losses and certain public company expenses, such items also have included corporate debt retirement costs, when applicable. Summarized financial information for these segments is as follows:

(\$ in thousands)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Insurance premiums and contract charges earned				
Property and Casualty	\$ 167,333	\$ 160,460	\$ 332,791	\$ 318,778
Retirement	7,825	6,759	15,893	13,360
Life	30,452	28,499	59,924	59,302
Total	\$ 205,610	\$ 195,718	\$ 408,608	\$ 391,440
Net investment income				
Property and Casualty	\$ 10,300	\$ 8,113	\$ 19,816	\$ 17,290
Retirement	67,787	65,139	131,956	128,581
Life	19,166	18,928	37,506	37,216
Corporate and Other	42	18	78	30
Intersegment eliminations	(194)	(204)	(391)	(412)
Total	\$ 97,101	\$ 91,994	\$ 188,965	\$ 182,705
Net income (loss)				
Property and Casualty	\$(10,896)	\$(13,956)	\$(1,174)	\$(11,221)
Retirement	14,141	11,800	25,562	23,330
Life	5,879	5,610	9,666	9,495
Corporate and Other	(3,207)	(1,193)	(7,982)	(4,025)
Total	\$ 5,917	\$ 2,261	\$ 26,072	\$ 17,579

(\$ in thousands)	June 30,	December 31,
	2018	2017
Assets		
Property and Casualty	\$ 1,227,650	\$ 1,217,394
Retirement	8,033,572	8,063,912
Life	1,786,525	1,815,732
Corporate and Other	141,615	143,784

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Intersegment eliminations	(33,148)	(42,482)
Total	\$ 11,156,214		\$ 11,198,340	

Note 10 - Income Taxes

On December 22, 2017, comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the Tax Act) was enacted by the U.S. government. The Tax Act is generally effective January 1, 2018, and among other changes, reduced the federal corporate income tax rate from 35% to 21%, eliminated the corporate Alternative Minimum Tax, modified numerous insurance-specific provisions, and further limited deductions for executive compensation. The Tax Act reduced the Company's effective tax rate by 9.2% for the six month period ended June 30, 2018. The Company recorded provisional amounts in its December 31, 2017 and June 30, 2018 Consolidated Financial Statements related to partnership investments and discounted loss reserves. Reasonable estimates of the tax impacts of these provisional items were reflected in the Company's results of operations; however, as of June 30, 2018, the Company has not yet completed its accounting for these provisional items. For partnership investments, the Company is waiting to receive schedules K-1, and for discounted loss reserves, the Company is waiting on guidance from the U.S. Treasury. Adjustments to the provisional amounts will impact the Company's consolidated results of operations and must be reflected no later than in the Company's December 31, 2018 Consolidated Financial Statements.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (MD&A)**
(Dollars in millions, except per share data)

Measures within this MD&A that are not based on accounting principles generally accepted in the United States of America (non-GAAP) are marked by an asterisk (*) when such measures are first introduced. An explanation of these measures is contained in the Glossary of Selected Terms included as an exhibit to this Quarterly Report on Form 10-Q.

Forward-looking Information

Statements made in the following discussion that are not historical in nature are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995 and are subject to known and unknown risks, uncertainties and other factors. Horace Mann Educators Corporation (HMEC; and together with its subsidiaries, the Company or Horace Mann) is an insurance holding company. 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 a number of risks and uncertainties inherent in the Company's business. For additional information regarding risks and uncertainties, see Item 1A. Risk Factors in this Quarterly Report on Form 10-Q and in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Executive Summary

Through its subsidiaries, HMEC markets and underwrites personal lines of property and casualty insurance, annuities and life insurance in the United States of America. The Company markets its products primarily to K-12 teachers, administrators and other employees of public schools and their families.

For the three month period ended June 30, 2018, the Company's net income of \$5.9 million increased \$3.6 million compared to the prior year period primarily as a result of a lower level of catastrophe losses and the impact of the lower federal income tax rate on Retirement and Life earnings. After tax net investment gains were \$0.6 million compared to net investment gains of \$1.5 million in the prior year period.

For the three month period ended June 30, 2018, Property and Casualty recorded a net loss of \$10.9 million reflecting a significant level of catastrophe and non-catastrophe weather-related losses. The Property and Casualty net loss was \$3.0 million lower than the \$13.9 million net loss recorded in the prior year period. The Property and Casualty combined ratio of 114.7% improved 3.8 points compared to the prior year period. These improvements were primarily due to 1.1 points of improvement in the underlying auto loss ratio* as a result of an increase in earned premium due to rate actions combined with continued stabilization in auto loss trends, as well as a lower level of auto and property catastrophe losses that were \$26.8 million pretax in the current quarter compared to \$32.4 million pretax in the prior year period.

On a reported basis, the current quarter auto combined ratio of 108.9% improved 1.7 points due to the improvement in the underlying loss ratio and lower catastrophe losses, partially offset by a 0.5 point increase in the expense ratio. The property combined ratio of 127.1% improved 7.5 points as compared to the prior year period. The underlying property loss ratio* was 57.1% in the current quarter, which reflected an increase of 1.1 points compared to the prior year period, in part due to an elevated level of non-catastrophe weather-related losses.

For the three month period ended June 30, 2018, total Property and Casualty written premiums* of \$173.0 million increased 3.0% compared to the prior year period. The growth was driven primarily by rate actions which resulted in

an increase in the average premium per policy for both auto and property.

For the three month period ended June 30, 2018, Retirement net income of \$14.1 million increased 19.5% compared to the prior year period and benefited from higher net investment income, an increase in fee-based product income and the lower federal income tax rate partially offset by an increase in operating expenses.

For the three month period ended June 30, 2018, the total level of Retirement sales deposits* decreased 5.0% compared to the prior year period, reflecting a decrease in traditional annuity products partially offset by an increase in asset flows related to fee-based mutual fund offerings. For the second quarter of 2018, annuity deposits of \$100.2 million decreased 14.2% compared to the prior year period. The decline in annuity deposits was related to lower sales of single premium annuity products in the current quarter. Sales deposit activity related to the Retirement Advantage® mutual fund products, as well as other mutual fund offerings, were strong with \$18.6 million in the current quarter compared to \$10.0 million in the prior year period.

For the three month period ended June 30, 2018, Life net income of \$5.9 million increased 5.4% compared to the prior year period, primarily due to the lower federal income tax rate. Life sales* of \$5.5 million for the current quarter increased 48.6% compared to the prior year period due to an increase in recurring and single premium sales.

For the six month period ended June 30, 2018, the Company's net income of \$26.1 million increased \$8.5 million compared to the prior year period primarily as a result of improved Property and Casualty results and the impact of the lower federal income tax rate on Retirement and Life earnings. After tax net investment losses were \$0.7 million compared to net investment gains of \$1.4 million in the prior year period.

For the six month period ended June 30, 2018, Property and Casualty recorded a net loss of \$1.2 million that was \$10.0 million lower than the \$11.2 million net loss recorded in the prior year period. The Property and Casualty combined ratio of 106.8% improved 5.2 points compared to the prior year period. These improvements were primarily due to a decreased underlying auto combined ratio*, reflecting the impact of rate actions and continued profitability initiatives, as well as a lower level of auto and property catastrophe losses that were \$36.6 million pretax in the current period compared to \$49.6 million pretax in the prior year period.

On a reported basis, the auto combined ratio of 105.4% improved 3.3 points and the property combined ratio of 110.2% improved 8.4 points as compared to the prior year period. The underlying auto loss ratio of 77.1% improved 1.1 points compared to the prior year period as a result of an increase in earned premium due to rate actions combined with continued stabilization in auto loss trends. The auto expense ratio improved 1.2% points. The underlying property loss ratio was 53.3% in the current period, which reflected an increase of 2.0 points compared to the prior year period due to an elevated level of non-catastrophe weather-related losses.

Prior years' reserves continue to develop favorably; however, the \$0.3 million pretax of favorable development in the six month period ended June 30, 2018 was less than the \$1.6 million pretax of favorable development in the prior year period.

For the six month period ended June 30, 2018, total Property and Casualty written premiums of \$332.4 million increased 3.6% compared to the prior year period. The growth was driven primarily by rate actions which resulted in an increase in the average premium per policy for both auto and property. Policy retention continues to be stable with auto and property policy retention rates for the current quarter at 82.6% and 88.0%, respectively.

For the six month period ended June 30, 2018, Retirement net income of \$25.5 million was 9.4% higher than the prior year period and benefited from higher net investment income, an increase in fee-based product income and the lower federal income tax rate partially offset by an increase in operating expenses.

The annualized net interest spread on fixed annuity assets under management for the first half of 2018 was 181 basis points, an increase of 11 basis points compared to March 31, 2018, which was primarily due to an elevated level of prepayments. Retirement assets under management of \$6.9 billion increased 6.3% compared to a year ago, and total cash value persistency remained strong at 94.6% for variable annuities and 94.4% for fixed annuities.

For the six month period ended June 30, 2018, the total level of Retirement sales deposits decreased 4.8% compared to the prior year period, reflecting a decrease in traditional annuity products partially offset by an increase in asset flows related to fee-based mutual fund offerings. For the first half of 2018, annuity deposits of \$199.0 million decreased 15.0% compared to the prior year period. The decline in annuity deposits was related to lower sales of single premium annuity products in the current period. Sales deposit activity related to the Retirement Advantage[®] mutual fund products, as well as other mutual fund offerings, were strong with \$32.7 million in the current period compared to \$15.3 million in the prior year period.

For the six month period ended June 30, 2018, Life net income of \$9.7 million increased \$0.2 million compared to the prior year period, primarily due to the lower federal income tax rate. Life sales of \$9.8 million for the current period increased 16.7% compared to the prior year period due to an increase in recurring and single premium sales. Life persistency of 95.1% was comparable to 12 months earlier.

The Company's book value per share was \$32.93 at June 30, 2018, a decrease of 10.7% and 1.7% compared to December 31, 2017 and a year ago, respectively, due to the impact of higher interest rates and wider credit spreads on net unrealized investment gains.

Critical Accounting Policies

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (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, net income and cash flows. Certain accounting estimates are particularly sensitive because of their significance to the Company's consolidated financial statements and because of the possibility that subsequent events and available information may differ markedly from management's judgments at the time the consolidated financial statements were prepared. Management has discussed with the Audit Committee the quality, not just the acceptability, of the Company's accounting principles as applied in its financial reporting. The discussions generally included such matters as the consistency of the Company's accounting policies and their application, and the clarity and completeness of the Company's consolidated financial statements, which include related disclosures. For the Company, areas most subject to significant management judgments include: fair value measurements, other-than-temporary impairment (OTTI) of investments, goodwill, deferred policy acquisition costs (DAC) for investment contracts and life insurance products with account values, liabilities for Property and Casualty claims and claim expenses and liabilities for future policy benefits.

Compared to December 31, 2017, at June 30, 2018, there were no material changes to accounting policies for areas most subject to significant management judgments identified above. In addition to disclosures in Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, discussion of accounting policies, including certain sensitivity information, was presented in Management's Discussion and Analysis of Financial Condition and Results of Operations -- Critical Accounting Policies in that Form 10-K.

Results of Operations

Insurance Premiums and Contract Charges

(\$ in millions)	Three Months Ended June 30,		Change From Prior Year		Six Months Ended June 30,		Change From Prior Year	
	2018	2017	Percent	Amount	2018	2017	Percent	Amount
Insurance premiums written and contract deposits (includes annuity and life contract deposits)								
Property and Casualty	\$173.0	\$167.9	3.0 %	\$ 5.1	\$332.4	\$320.8	3.6 %	\$ 11.6
Retirement	100.2	116.8	-14.2 %	(16.6)	199.0	234.1	-15.0 %	(35.1)
Life	28.5	26.9	5.9 %	1.6	54.3	53.4	1.7 %	0.9
Total	\$301.7	\$311.6	-3.2 %	\$ (9.9)	\$585.7	\$608.3	-3.7 %	\$ (22.6)
Insurance premiums and contract charges earned (excludes annuity and life contract deposits)								
Property and Casualty	\$167.3	\$160.5	4.2 %	\$ 6.8	\$332.8	\$318.8	4.4 %	\$ 14.0
Retirement	7.9	6.8	16.2 %	1.1	15.9	13.4	18.7 %	2.5
Life	30.4	28.5	6.7 %	1.9	59.9	59.3	1.0 %	0.6
Total	\$205.6	\$195.8	5.0 %	\$ 9.8	\$408.6	\$391.5	4.4 %	\$ 17.1

Number of Policies and Contracts in Force

(actual counts)

	June 30, 2018	December 31, 2017	June 30, 2017
Property and Casualty			
Automobile	470,442	478,951	483,819
Property and other liability	214,740	216,306	218,132
Total	685,182	695,257	701,951
Retirement	223,812	223,287	221,021
Life	197,853	197,889	197,171

For the three month period ended June 30, 2018, the Company's premiums written and contract deposits* of \$301.7 million decreased \$9.9 million, or 3.2%, compared to the prior year period primarily as a result of a decline in annuity deposits due to lower sales of single premium annuity products. The Company's premiums and contract charges earned increased \$9.8 million, or 5.0%, compared to the prior year period, primarily due to increases in average premium per policy for both property and automobile.

Total Property and Casualty premiums written increased 3.6%, or \$11.6 million, in the first six months of 2018, compared to the prior year period, primarily due to increases in average written premium per policy for both property and automobile. Average approved rate changes during the first six months of 2018 were 10.9% for automobile and 3.9% for property.

Based on policies in force, the current year automobile 12 month retention rate for new and renewal policies was 82.6% compared to 82.9% at June 30, 2017, with the decrease due to recent rate and underwriting actions. The current year property 12 month retention rate for new and renewal policies was 88.0% at June 30, 2018 compared to 87.4% at June 30, 2017.

Automobile premiums written* increased 4.0%, or \$8.8 million, compared to the first six months of 2017. In the first six months of 2018, the average written premium per policy and average earned premium per policy increased approximately 7.0% and 6.5%, respectively, compared to the prior year period. The number of educator policies represented approximately 85.4% of the automobile policies in force at June 30, 2018, 85.2% at December 31, 2017 and 85.0% at June 30, 2017.

Property premiums written* increased 2.8%, or \$2.8 million, compared to the first six months of 2017. While the number of property policies in force has declined, the average written premium per policy and average earned premium per policy increased approximately 3.3% and 2.3%, respectively, in the first six months of 2018 compared to the prior year period. The number of educator policies represented approximately 82.4% of the property policies in force at June 30, 2018, 82.3% at December 31, 2017 and 82.2% at June 30, 2017. The number of educator policies and total policies has been, and may continue to be, impacted by the Company's risk mitigation programs, including actions in catastrophe-prone coastal areas, involving policies of both educators and non-educators.

The Company continues to evaluate and implement actions to further mitigate its risk exposure in catastrophe-prone areas. Such actions could include, but are not limited to, non-renewal of property policies, restricted agent geographic placement, limitations on agent new business sales, further tightening of underwriting standards and increased utilization of third-party vendor products.

For the six month period ended June 30, 2018, total annuity deposits decreased 15.0%, or \$35.1 million, compared to the prior year period. New deposits to fixed accounts of \$101.5 million decreased 30.0%, or \$43.5 million, and new deposits to variable accounts of \$97.5 million increased 9.4%, or \$8.4 million, compared to the prior year period.

Total Retirement assets under management, including fee based mutual fund products, increased 6.3% for the six month period ended June 30, 2018 as compared to the prior year period. Annuity accumulated value on deposit of \$6.9 billion at June 30, 2018 increased 5.4% compared to a year earlier, reflecting the increase from new deposits received, market appreciation as well as favorable retention. Accumulated value retention for the variable annuity option was 94.6% and 94.9% for the 12 month periods ended June 30, 2018 and 2017, respectively; fixed annuity retention was 94.4%, comparable to the prior year period.

Variable annuity accumulated balances of \$2.2 billion at June 30, 2018 increased 11.1% compared to June 30, 2017, as positive impacts of deposits and favorable financial market performance and retention offset withdrawals and net transfers to the guaranteed interest rate fixed account option. Fixed annuity accumulated balances of \$4.7 billion at June 30, 2018 increased 2.9% compared to June 30, 2017 reflecting new deposits, interest credited and net transfers from the variable annuity accounts. Compared to the six month period ended June 30, 2017, Retirement contract charges earned increased 18.7%, or \$2.5 million.

Life premiums and contract deposits* for the six month period ended June 30, 2018 increased 1.7%, or \$0.9 million, compared to the prior year period. The ordinary life insurance in force lapse ratio was 4.9% for the 12 months ended June 30, 2018 compared to 4.7% for the 12 month period ended June 30, 2017.

Sales*

For the first six months of 2018, Property and Casualty new annualized sales premiums decreased 4.0% compared to the first six months of 2017, as 5.4%, or \$2.5 million, decline in new automobile sales was accompanied by growth in property sales of 3.4%, or \$0.3 million, compared to the prior year period.

For the six month period ended June 30, 2018, the total level of Retirement sales deposits* decreased 4.8% compared to the prior year period, reflecting a decrease in traditional annuity products partially offset by an increase in asset

flows related to fee-based mutual fund offerings. For the six month period ended June 30, 2018, total annuity deposits decreased 15.0%, or \$35.1 million, compared to the prior year period. New deposits to fixed accounts of \$101.5 million decreased 30.0%, or \$43.5 million, and new deposits to variable accounts of \$97.5 million increased

9.4%, or \$8.4 million, compared to the prior year period. Sales deposit activity related to the Retirement Advantage® mutual fund products, as well as other mutual fund offerings, were strong with \$32.7 million in the current period compared to \$15.3 million in the prior year period.

The Company's introduction of new educator-focused portfolios of term and whole life products in recent years, including a single premium whole life product, as well as the Company's Indexed Universal Life (IUL) product, have contributed to sales of proprietary life products. For the first six months of 2018, sales of Horace Mann's proprietary life insurance products totaled \$9.8 million, representing an increase of \$1.4 million, compared to the prior year period.

Distribution

At June 30, 2018, there was a combined total of 656 Exclusive Distributors, compared to 694 at December 31, 2017 and 703 at June 30, 2017. The Company continues to expect higher quality standards for Exclusive Distributors to focus on improving both customer experiences and agent productivity in their respective territories. The dedicated sales force is supported by the Company's customer contact center which provides a means for educators to begin their experience directly with the Company, if that is their preference. The Customer Contact Center is also able to assist educators in territories which are not currently served by an Exclusive Distributor.

Net Investment Income

For the three and six month periods ended June 30, 2018, net investment income of \$97.1 million and \$189.0 million increased 5.5% and 3.4%, compared to the prior year periods. Net investment income for the second quarter of 2018 benefited from a higher level of prepayments. Overall, investment results reflect continued growth in annuity asset balances along with increased alternative investment results offset by the continued low interest rate environment and a concerted effort to increase portfolio quality, which puts pressure on portfolio yield. The Company believes it is late in the credit cycle so the increase in portfolio quality is a proactive action to opportunistically position the portfolio for a recessionary environment and is consistent with our approach in previous credit cycles.

Average invested assets increased 2.6% over the 12 months ended June 30, 2018. The average pretax yield on the total investment portfolio for the six month period ended June 30, 2018 of 5.1% (4.1% after tax) was higher on an after tax basis when compared to the prior year period. During the six month period ended June 30, 2018, management continued to identify and purchase investments, including a modest level of alternative investments, with attractive risk-adjusted yields relative to market conditions without venturing into asset classes or individual securities that would be inconsistent with the Company's overall conservative investment guidelines.

Net Investment Gains (Losses) - Pretax

For the three month period ended June 30, 2018, net investment gains were \$0.7 million compared to net investment gains of \$2.0 million in the prior year period and the results from the current quarter include \$1.2 million of net investment losses due to the change in fair value of the equity securities portfolio.

For the six month period ended June 30, 2018, net investment losses were \$1.0 million compared to net investment gains of \$1.8 million in the prior year period and the results from the current year period include \$6.3 million of net investment losses due to the change in fair value of the equity securities portfolio.

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

Fixed Maturity and Equity Securities Portfolios

The table below presents the Company's fixed maturity and equity securities portfolios by major asset class, including the 10 largest sectors of the Company's corporate bond holdings (based on fair value). Compared to December 31, 2017, credit spreads were wider across most asset classes, with the 10-year U.S. Treasury rate rising 45 basis points to 2.9%, which resulted in lower net unrealized investment gains on the fixed maturity securities portfolio at June 30, 2018.

(\$ in millions)	June 30, 2018			Pretax Net Unrealized Investment Gain (Loss)
	Number of Issuers	Fair Value	Amortized Cost	
Fixed maturity securities				
Corporate bonds				
Banking & Finance	121	\$ 647.5	\$ 639.7	\$ 7.8
Insurance	60	264.3	250.0	14.3
Energy (1)	57	184.0	179.2	4.8
Technology	36	183.8	183.7	0.1
Real Estate	44	182.2	181.5	0.7
HealthCare,Pharmacy	50	152.0	149.7	2.3
Transportation	38	131.0	129.1	1.9
Utilities	41	122.7	110.4	12.3
Telecommunications	20	75.0	71.2	3.8
Broadcasting & Media	17	70.5	68.2	2.3
All other corporates (2)	186	384.7	379.8	4.9
Total corporate bonds	670	2,397.7	2,342.5	55.2
Mortgage-backed securities				
U.S. Government and federally sponsored agencies	234	421.7	410.3	11.4
Commercial (3)	148	627.4	642.4	(15.0)
Other	29	83.3	83.3	—
Municipal bonds (4)	401	1,827.5	1,696.7	130.8
Government bonds				
U.S.	42	782.2	790.7	(8.5)
Foreign	15	95.5	92.9	2.6
Collateralized loan obligations (5)	117	591.2	591.1	0.1
Asset-backed securities	113	649.0	642.1	6.9
Total fixed maturity securities	1,769	\$ 7,475.5	\$ 7,292.0	\$ 183.5
Equity securities				
Non-redeemable preferred stocks	12	\$ 58.5		
Common stocks	95	52.7		
Closed-end fund	1	19.6		
Total equity securities	108	\$ 130.8		
Total	1,877	\$ 7,606.3		

(1) At June 30, 2018, the fair value amount included \$11.2 million which were non-investment grade.

(2) The All other corporates category contains 19 additional industry sectors. Gaming, natural gas, food and beverage, metal and mining and retail represented \$252.7 million of fair value at June 30, 2018, with the remaining 14 classification each representing less than \$28.2 million.

- (3) At June 30, 2018, 100% were investment grade, with an overall credit rating of AA, and the positions were well diversified by property type, geography and sponsor.
- (4) Holdings are geographically diversified, 39.3% are tax-exempt and 77.1% are revenue bonds tied to essential services, such as mass transit, water and sewer. The overall credit quality of the municipal bond portfolio was AA- at June 30, 2018.
- (5) Based on fair value, 96.8% of the collateralized debt obligation securities were rated investment grade by Standard and Poor's Corporation (S&P), Moody's Investors Service, Inc. (Moody's) and/or Fitch Ratings (Fitch) at June 30, 2018.

At June 30, 2018, the Company's diversified fixed maturity securities portfolio consisted of 2,832 investment positions, issued by 1,769 entities, and totaled approximately \$7.5 billion in fair value. This portfolio was 96.6% investment grade, based on fair value, with an average quality rating of A+. The Company's investment guidelines target single corporate issuer concentrations to 0.5% of invested assets for "AA" or "AAA" rated securities, 0.4% of invested assets for "A" or "BBB" rated securities, and 0.2% of invested assets for non-investment grade securities.

The following table presents the composition and value of the Company's fixed maturity and equity securities portfolios by rating category. At June 30, 2018, 95.7% of these combined portfolios were investment grade, based on fair value, with an overall average quality rating of A+. At June 30, 2018, the Company has classified the entire fixed maturity securities portfolio as available for sale, which is carried at fair value.

Rating of Fixed Maturity Securities and Equity Securities (1)

(\$ in millions)	Percent of Portfolio		June 30, 2018	
	Fair Value	Fair Value	June 30, Fair Value	Amortized Cost
	2017	2018	Value	Cost
Fixed maturity securities				
AAA	7.4	% 7.8	% \$580.2	\$ 573.9
AA (2)	40.4	41.3	3,089.1	3,030.0
A	23.8	23.7	1,782.9	1,707.6
BBB	24.8	23.5	1,754.6	1,720.3
BB	2.2	2.2	167.9	167.7
B	0.6	0.6	41.2	41.2
CCC or lower	0.1	0.1	0.6	0.6
Not rated (3)	0.7	0.8	59.0	50.7
Total fixed maturity securities	100.0%	100.0 %	\$7,475.5	\$ 7,292.0
Equity securities				
AAA	—	—	—	—
AA	—	—	—	—
A	—	—	—	—
BBB	45.4	% 44.6	% \$58.4	
BB	—	—	—	—
B	—	—	—	—
CCC or lower	—	—	—	—
Not rated	54.6	55.4	72.4	
Total equity securities	100.0%	100.0 %	\$ 130.8	
Total			\$7,606.3	

Ratings are as assigned primarily by S&P when available, with remaining ratings as assigned on an equivalent basis by Moody's or Fitch.

(1) Ratings for publicly traded securities are determined when the securities are acquired and are updated monthly to reflect any changes in ratings.

(2) At June 30, 2018, the AA rated fair value amount included \$782.2 million of U.S. Government and federally sponsored agency securities and \$613.2 million of mortgage- and asset-backed securities issued by U.S. Government and federally sponsored agencies.

(3) This category primarily represents private placement and municipal securities not rated by either S&P, Moody's or Fitch.

At June 30, 2018, the fixed maturity securities portfolio had \$94.4 million pretax of gross unrealized losses on \$3,211.5 million of fair value related to 1,251 positions. Of the investment positions with gross unrealized losses, there were none trading below 80.0% of the carrying value at June 30, 2018.

The Company views the unrealized investment losses of all of the fixed maturity securities at June 30, 2018 as temporary. Future changes in circumstances related to these and other securities could require subsequent recognition of OTTI.

Benefits, Claims and Settlement Expenses

(\$ in millions)	Three Months Ended June 30,		Change From Prior Year		Six Months Ended June 30,		Change From Prior Year	
	2018	2017	Percent	Amount	2018	2017	Percent	Amount
Property and Casualty	\$147.0	\$147.8	-0.5 %	\$ (0.8)	\$267.7	\$270.0	-0.9 %	\$ (2.3)
Retirement	1.4	1.3	7.7 %	0.1	3.3	2.4	37.5 %	0.9
Life	19.9	16.8	18.5 %	3.1	40.9	37.6	8.8 %	3.3
Total	\$168.3	\$165.9	1.4 %	\$ 2.4	\$311.9	\$310.0	0.6 %	\$ 1.9
Property and Casualty catastrophe losses, included above (1)	\$26.8	\$32.4	-17.3 %	\$ (5.6)	\$36.6	\$49.6	-26.2 %	\$ (13.0)

(1) Property and Casualty
catastrophe losses were incurred
as follows:

	2018	2017
Three months ended		
March 31	\$9.8	\$17.2
June 30	26.8	32.4
Total year-to-		