

# Central United Life Insurance Company

Statutory-Basis Financial Statements as of and for the  
Years Ended December 31, 2007 and 2006,  
Supplemental Schedules as of and for the Year  
Ended December 31, 2007, and Independent  
Auditors' Report

# CENTRAL UNITED LIFE INSURANCE COMPANY

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
Central United Life Insurance Company  
Houston, Texas

We have audited the accompanying statutory-basis statements of admitted assets, liabilities, and capital and surplus of Central United Life Insurance Company (the "Company") as of December 31, 2007 and 2006, and the related statutory-basis statements of income, changes in capital and surplus, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in Note 2 to the financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the Arkansas Insurance Department, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, such statutory-basis financial statements present fairly, in all material respects, the admitted assets, liabilities, and capital and surplus of Central United Life Insurance Company as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 2.

Our 2007 audit was conducted for the purpose of forming an opinion on the basic 2007 statutory-basis financial statements taken as a whole. The supplemental schedule of selected statutory-basis financial data, the supplemental schedule of investment risk interrogatories and, the supplemental summary investment schedule, as of and for the year ended December 31, 2007, are presented for purposes of additional analysis and are not a required part of the basic 2007 statutory-basis financial statements. These schedules are the responsibility of the Company's management. Such schedules have been subjected to the auditing procedures applied in our audit of the basic 2007 statutory-basis financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic 2007 statutory-basis financial statements taken as a whole.

This report is intended solely for the information and use of the board of directors and management of the Company and for filing with state insurance departments to whose jurisdiction the Company is subject and is not intended to be and should not be used by anyone other than these specified parties.

*Deloitte + Touche LLP*

May 30, 2008

## CENTRAL UNITED LIFE INSURANCE COMPANY

### STATUTORY-BASIS STATEMENTS OF ADMITTED ASSETS, LIABILITIES, AND CAPITAL AND SURPLUS AS OF DECEMBER 31, 2007 AND 2006

(Amounts in thousands, except share and per-share data)

	2007	2006
<b>ASSETS</b>		
<b>CASH AND INVESTED ASSETS:</b>		
Bonds, at amortized cost (fair value of \$196,311 and \$212,831 in 2007 and 2006 respectively)	\$ 194,540	\$ 216,102
Common stocks, at fair value (cost of \$11 and \$11, in 2007 and 2006, respectively)	12	12
Investments in subsidiaries and affiliates	30,623	30,008
Contract loans	8,109	8,477
Real estate	10,905	11,085
Mortgage loans on real estate	1,632	1,751
Cash and short-term investments	29,387	26,684
Total cash and invested assets	275,208	294,119
DUE AND DEFERRED PREMIUMS—Net	3,209	2,782
INVESTMENT INCOME DUE AND ACCRUED	2,964	3,249
PROPERTY AND EQUIPMENT—at cost, net of accumulated depreciation of \$1,847 and \$1,675, in 2007 and 2006, respectively	59	60
RECOVERABLE FROM REINSURERS	460	280
FUNDS HELD BY REINSURER	47,023	46,194
RECEIVABLE FROM AFFILIATE	999	505
CURRENT INCOME TAX RECOVERABLE	-	222
NET DEFERRED TAX ASSET	1,326	1,612
GOODWILL—Net	614	753
OTHER ASSETS	634	462
<b>TOTAL</b>	<b>\$ 332,496</b>	<b>\$ 350,238</b>
<b>LIABILITIES AND CAPITAL AND SURPLUS</b>		
<b>LIABILITIES:</b>		
Aggregate reserves:		
Life and annuities policies	\$ 119,351	\$ 120,973
Accident and health policies	130,889	149,281
Liability for deposit-type contracts	4,172	4,089
Liability for policy and contract claims:		
Life	1,408	1,567
Accident and health	32,494	34,352
Dividends payable to policyholders	378	371
Interest maintenance reserve	2,989	3,795
Commissions, expenses, taxes (other than income taxes), licenses, and other fees accrued	1,711	1,312
Current income tax payable	240	-
Asset valuation reserve	1,105	1,048
Due to affiliates	295	288
Dividend to stockholders declared and unpaid	-	200
Other accrued liabilities	738	1,145
Total liabilities	295,770	318,421
<b>CAPITAL AND SURPLUS:</b>		
Cumulative Series E redeemable preferred stock; \$10 par value, \$100 stated value—authorized, 100,000 shares; issued and outstanding, 20,000 shares in 2007 and 2006	200	200
Common stock, \$0 par value, \$25,000 stated value—authorized, 150 shares; issued and outstanding, 100 shares in 2007 and 2006	2,500	2,500
Paid-in and contributed surplus	9,955	9,955
Surplus note	15,000	15,000
Unassigned surplus	9,071	4,162
Total capital and surplus	36,726	31,817
<b>TOTAL</b>	<b>\$ 332,496</b>	<b>\$ 350,238</b>

See notes to statutory-basis financial statements.



## CENTRAL UNITED LIFE INSURANCE COMPANY

### STATUTORY-BASIS STATEMENTS OF CHANGES IN CAPITAL AND SURPLUS FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006 (Amounts in thousands, except share data)

	Common Stock Amount	Cumulative Redeemable Preferred Stock Amount	Surplus Notes	Paid-In and Contributed Surplus	Unassigned Surplus	Total Capital and Surplus
BALANCE—January 1, 2006	\$2,500	\$ 200	\$15,000	\$ 9,915	\$ 8,397	\$36,012
Net income	-	-	-	-	1,490	1,490
Common stock dividends	-	-	-	-	(1,300)	(1,300)
Deferred reinsurance gain net of amortization	-	-	-	-	(3,925)	(3,925)
Change in valuation basis of reserves	-	-	-	-	1,844	1,844
Stock compensation	-	-	-	40	-	40
Change in asset valuation reserve	-	-	-	-	84	84
Change in unrealized capital gains net of tax	-	-	-	-	(2,595)	(2,595)
Change in nonadmitted assets	-	-	-	-	(556)	(556)
Change in net deferred tax	-	-	-	-	723	723
BALANCE—December 31, 2006	2,500	200	15,000	9,955	4,162	31,817
Net income	-	-	-	-	4,898	4,898
Common stock dividends	-	-	-	-	(600)	(600)
Change in asset valuation reserve	-	-	-	-	(57)	(57)
Change in unrealized capital gains—net of tax	-	-	-	-	406	406
Change in nonadmitted assets	-	-	-	-	761	761
Change in net deferred tax	-	-	-	-	(499)	(499)
BALANCE—December 31, 2007	<u>\$2,500</u>	<u>\$ 200</u>	<u>\$15,000</u>	<u>\$ 9,955</u>	<u>\$ 9,071</u>	<u>\$36,726</u>

See notes to statutory-basis financial statements.

# CENTRAL UNITED LIFE INSURANCE COMPANY

## STATUTORY-BASIS STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006 (Amounts in thousands)

	2007	2006
<b>CASH FROM OPERATIONS:</b>		
Premiums collected—net of reinsurance	\$ 99,993	\$ 108,194
Net investment income	10,890	11,461
Miscellaneous income	2,796	2,640
Benefit and loss-related payments	(104,207)	(109,465)
Commissions, expenses, and taxes paid	(26,340)	(29,841)
Policyholder dividends	(395)	(392)
Federal income taxes paid	(206)	(549)
	<u>(17,469)</u>	<u>(17,952)</u>
Net cash used in operations		
<b>CASH FROM INVESTMENTS:</b>		
Proceeds from investments sold, matured, or repaid:		
Bonds	50,965	113,665
Stocks	-	18
Mortgage loans	119	93
	<u>51,084</u>	<u>113,776</u>
Total investment proceeds		
Cost of investments acquired:		
Bonds	(29,298)	(91,604)
Stocks	-	(11)
Real estate	(120)	(185)
	<u>(29,418)</u>	<u>(91,800)</u>
Total cost of investments acquired		
Net decrease in contract loans	368	875
	<u>22,034</u>	<u>22,851</u>
Net cash provided by investments		
<b>CASH FROM FINANCING AND MISCELLANEOUS SOURCES:</b>		
Capital and paid-in surplus	-	40
Net deposits on deposit-type contract funds	(150)	13
Other	(912)	(270)
Dividends paid to stockholders	(800)	(1,100)
	<u>(1,862)</u>	<u>(1,317)</u>
Net cash used in financing and miscellaneous sources		
<b>NET INCREASE IN CASH AND SHORT-TERM INVESTMENTS</b>	<b>2,703</b>	<b>3,582</b>
<b>CASH AND SHORT-TERM INVESTMENTS:</b>		
Beginning of year	<u>26,684</u>	<u>23,102</u>
End of year	<u>\$ 29,387</u>	<u>\$ 26,684</u>

See notes to statutory-basis financial statements.

# CENTRAL UNITED LIFE INSURANCE COMPANY

## NOTES TO STATUTORY-BASIS FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

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### 1. ORGANIZATION AND OPERATIONS

Effective May 15, 2006, Central United Life Insurance Company (the "Company") is domiciled in the state of Arkansas and was previously domiciled in Texas. The Company operates as a life, accident, and health insurance company. The Company is wholly owned by Harris Insurance Holding, Inc. ("HIHI"), a Delaware insurance holding company. The Company is licensed in 41 states. The Company acquires blocks of life and accident and health insurance from other insurance companies and markets individual life and accident and health insurance. Approximately 9% and 8%, of direct business was written in the state of Arkansas for the years ended December 31, 2007 and 2006, respectively. Direct business written in Mississippi, Texas, Louisiana, Georgia, Oklahoma, and South Carolina accounted for 15%, 11%, 6%, 5%, 5%, and 5%, respectively, of total direct premiums written for the year ended December 31, 2007. No other state accounted for 5% or more of direct premiums written in 2007 and 2006.

The Company owns 51.01% or 313,567 Class B shares of Manhattan Insurance Group, Inc. ("MIG") at December 31, 2007 and 2006. MIG is an insurance holdings company which owns 100% of the Manhattan Life Insurance Company ("MLIC").

On December 31, 2004, the Company purchased all the outstanding shares of Investors Consolidated Insurance Company ("ICIC"), a New Hampshire corporation and an affiliate, which was previously owned by MIG. The purchase price of \$6.2 million consisted of \$5.7 million in cash and a note payable of \$0.5 million. The transaction was accounted for as a statutory purchase. The purchase resulted in goodwill in the amount of approximately \$0.9 million for the Company.

In addition to MIG and ICIC, the Company has a wholly owned subsidiary, Worksite Solutions, Inc. ("Worksite"). CML Church Mortgage was dissolved in 2006.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation**—The accompanying statutory-basis financial statements have been prepared in accordance with accounting practices prescribed or permitted by the Arkansas Insurance Department ("AID"), which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States ("GAAP"). The more significant variances from GAAP are:

- The costs of acquiring and renewing business are expensed when incurred. Under GAAP, acquisition costs related to traditional life insurance and certain long-duration accident and health insurance, to the extent recoverable from future policy revenues, would be deferred and amortized over the premium-paying period of the related policies using assumptions consistent with those used in computing policy benefit reserves; for universal life insurance and investment products, to the extent recoverable from future gross profits, deferred policy acquisition costs are amortized generally in proportion to the present value of expected gross profits from surrender charges and investment, mortality, and expense margins.

- Certain assets designated as “nonadmitted,” principally agents’ balances, furniture and equipment, unsecured loans or cash advances to officers or agents, Company’s stock as collateral for loans, nonbankable checks, and trade names and other intangible assets, and other assets not specifically identified as an admitted asset are excluded from the accompanying statutory-basis financial statements and are charged directly to unassigned surplus. Under GAAP, such assets are reflected on the balance sheet, net of valuation allowances, if any.
- Investments in bonds are reported at amortized cost or market value based on their National Association of Insurance Commissioners’ (“NAIC”) rating; under GAAP, such fixed maturity investments would be designated at purchase as held-to-maturity, trading, or available-for-sale. Held-to-maturity fixed maturity investments would be reported at amortized cost, and the remaining fixed maturity investments would be reported at fair value with unrealized holding gains and losses reported in operations for those designated as trading and as a separate component of shareholders’ equity for those designated as available-for-sale.
- All single class and multiclass mortgage-backed and asset-backed securities are adjusted for the effects of changes in prepayment assumptions on the related accretion of discount or amortization of premium of such securities using the retrospective method. If it is determined that a decline in fair value is other than temporary, the cost basis of the security is written down to the undiscounted estimated future cash flows. Under GAAP, all securities purchased or retained, that represents beneficial interests in securitized assets, other than high-credit quality securities, are adjusted using the prospective method when there is a change in estimated future cash flows. If it is determined that a decline in fair value is other than temporary, the cost basis of the security is written down to fair value based on the discounted cash flows. If high credit quality securities are adjusted, the retrospective method is used.
- The common stock of the Company’s subsidiaries are carried at their statutory equity and are not consolidated with the accounts and operations of the Company, as required under GAAP.
- Investments in real estate are reported net of related obligations. Real estate owned and occupied by the Company is included in investments rather than reported as an operating asset as required under GAAP, and investment income and operating expenses include rent for the Company’s occupancy of the property. Changes between depreciated cost and admitted asset investment amounts are reported as direct adjustments to unassigned surplus rather than to operations, as required under GAAP.
- Valuation allowances, if necessary, are established for mortgage loans based on the difference between the net value of the collateral, determined as the fair value of the collateral less estimated costs to obtain and sell and the recorded investment in the mortgage loan. Under GAAP, such allowances are based on the present value of expected future cash flows discounted at the loan’s effective interest rate or, if foreclosure is probable, on the estimated fair value of the collateral.
- The initial valuation allowance and subsequent changes in the allowance for mortgage loans as a result of a temporary impairment are charged or credited directly to unassigned surplus, rather than being included in operations as required under GAAP.
- The asset valuation reserve (“AVR”) provides a valuation allowance for invested assets. The AVR is determined by an NAIC-prescribed formula with changes in the AVR balance reflected as direct adjustments to unassigned surplus; AVR is not recognized for GAAP.

- The interest maintenance reserve (“IMR”) is maintained as prescribed by the NAIC for the purpose of deferring realized capital gains and losses on sales of fixed income investments, principally bonds and mortgage loans, attributable to changes in the general level of interest rates and such realized gains and losses are amortized over the remaining period to maturity, based on groupings of individual securities. Realized capital gains and losses are reported in operations net of federal income tax and transfers to the IMR. Under GAAP, realized capital gains and losses would be reported in the statement of operations on a pretax basis in the period that the assets giving rise to the gains or losses are sold.
- Deferred tax assets are limited to (1) the amount of federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year, plus (2) the lesser of the remaining gross deferred tax assets expected to be realized within one year of the financial statement date or 10% of capital and surplus excluding any net deferred tax assets, electronic data processing equipment (“EDP”) and operating software, and any net positive goodwill, plus (3) the amount of remaining gross deferred tax assets that can be offset against existing gross deferred tax liabilities. The remaining deferred tax assets are nonadmitted. Changes in deferred taxes are recorded as direct adjustments to unassigned surplus. Deferred taxes do not include amounts for state taxes. Under GAAP, state taxes are included in the computation of deferred taxes, a deferred tax asset is recorded for the amount of gross deferred tax assets expected to be realized in future years, and a valuation allowance is established for deferred tax assets not realizable.
- No statement of comprehensive income or its components are presented in the corresponding statutory-basis financial statements.
- Premiums and considerations received for universal life and annuity policies with mortality or morbidity risk, except for guaranteed interest and group annuity contracts, are reflected as revenue, and benefits incurred represent the total of death benefits paid and the change in policy reserves. Premiums received for annuity policies without mortality or morbidity risk and for guaranteed interest and group annuity contracts are recorded using deposit accounting and credited directly to an appropriate policy reserve account, without recognizing premium income. Under GAAP, premiums received in excess of policy charges would not be recognized as premium revenue, and benefits would represent the excess of benefits paid over the policy account value and interest credited to the policy account values.
- Certain policy reserves are calculated based on statutorily required interest and mortality assumptions rather than the estimated expected experience or actual account balances as required under GAAP.
- Policyholder dividends are recognized when declared rather than over the term of the related policies.
- Cash and short-term investments in the statements of cash flows represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding captions of cash and cash equivalents include cash balances and investments with initial maturities of three months or less.
- A liability for reinsurance balances has been provided for unsecured policy reserves ceded to reinsurers unauthorized to assume such business. Changes to those amounts are credited or charged directly to unassigned surplus. Under GAAP, an allowance for amounts deemed uncollectible would be established through a charge to operations.

- Policy and contract liabilities ceded to reinsurers have been reported as reductions of the related policy reserves rather than as assets, as required under GAAP. Commissions allowed by reinsurers on business ceded are reported as revenue when received rather than being deferred and amortized as required under GAAP.
- Surplus notes are reported as a component of capital and surplus rather than liabilities, as required under GAAP.

The following is a description of the Company's principal accounting policies and practices:

**Investments**—Bonds, preferred stocks, common stocks, and short-term investments are stated at values prescribed by the NAIC, as follows:

- Bonds not backed by other loans are principally stated at amortized cost using the scientific method.
- Single class and multi-class mortgage-backed or asset-backed securities are valued at amortized cost using the scientific method including anticipated prepayments. Prepayment assumptions are obtained from dealer surveys or internal estimates and are based on the current interest rate and economic environment. The retrospective adjustment method is used to value all such securities.
- Common stocks are reported at market value as determined by the SVO and the related net unrealized capital gains (losses) are reported in unassigned surplus net of deferred federal income taxes.
- Included in investments in subsidiaries and affiliates is goodwill in ICIC of \$616,000 at December 31, 2007 and \$721,000 at December 31, 2006. The goodwill in 2006 has been reclassified from goodwill to investments in subsidiaries and affiliates.
- Short-term investments include investments with remaining maturities of one year or less at the time of acquisition and are principally stated at amortized cost.
- Bond and other loan interest is credited to revenue as it accrues. Dividends on preferred and common stocks are credited to income on ex-dividend dates. Due and accrued income, if applicable, are excluded from investment income on bonds, stocks, and other loans where the collection of interest is uncertain. There was no interest excluded from investment income at December 31, 2007 or 2006.
- The Company uses the grouped method of amortization for interest related gains and losses arising from the sale of bonds which have been transferred to the IMR.
- Net realized gains and losses on investments are determined on a specific identification basis. If it is determined that a decline in fair value of investment securities is other than temporary, the cost basis of the security is written down to fair value based on current market values or discounted cash flows, as appropriate.
- Contract loans are reported at unpaid principal balances.

- Mortgage loans are reported at unpaid principal balances, less allowance for impairment. A mortgage loan is considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all principal and interest amounts due according to the contractual terms of the mortgage agreement. When management determines foreclosure is probable and the impairment is deemed other than temporary, the mortgage loan is written down and a realized loss is recognized. The Company did not originate any new loans during 2006 or 2007. The maximum percentage of any one loan to the value of the collateral at the time of the loan, exclusive of insured, guaranteed, or purchased money mortgages, was 90%. Hazard insurance is required on all properties covered by mortgage loans at least equal to the excess of the loan over the maximum loan, which would be permitted by law on the loans. As of December 31, 2007, there were no taxes, assessments, or other amounts advanced by the Company on mortgage loans outstanding. There are no prior liens on any mortgage loan owned.
- Land is reported at cost. Real estate occupied by the Company and real estate held for the production of income are reported at depreciated cost, net of related obligations. Real estate that the Company has the intent to sell is reported at the lower of depreciated cost or fair value, net of related obligations. Depreciation is calculated on a straight-line basis over the estimated useful lives of the properties.

**Subsidiaries**—The Company's investments in insurance and noninsurance subsidiaries are carried at the respective statutory-basis net worth of the subsidiaries. The net change in the subsidiaries' equity is included in the change in net unrealized capital gains or losses.

**Premiums**—Life, accident, and health premiums are recognized as revenue when due. Premiums for annuity policies with mortality and morbidity risk, except for guaranteed interest and group annuity contracts, are also recognized as revenue when due. There were no premiums received for annuity policies without mortality risk.

**Reserve Basis**—Policy reserves are based on statutory mortality and interest requirements without consideration of withdrawals. Policy reserves are computed principally on the basis of the 1958, 1980, and 2001 CSO mortality tables with assumed rates of interest from 2.5% to 6.0%.

Approximately 20% of the reserves are calculated on a net level reserve basis and 80% on a Commissions Reserve Valuation Method ("CRVM") reserve basis. The effect of the use of a modified reserve basis is to partially offset the effect of immediately expensing acquisition costs by providing a policy reserve increase in the first policy year, which is less than the reserve increase in renewal years. The Company waives deductions or deferred fractional premium upon the death of the insured and returns any portion of the final premium beyond the date of death. Surrender values are not promised in excess of the legally computed reserve. Substandard reserves are determined by computing the regular mean reserve for the plan of the rated age and holding in addition to one half of the extra substandard premium.

The aggregate reserve for accident and health policies consists of active life reserves and present values of amounts not yet due on disability claims. Active life reserves consist of unearned premium reserves computed for all accident and health policies, and additional reserves computed for all noncancelable and guaranteed renewable policies. Unearned premium reserves are computed using the daily pro-rata method. Additional reserves are primarily mid-terminal reserves computed using the two-year full preliminary term valuation method. The present value of amounts not yet due for disability claims is calculated using the 1964 Commissioners Disability Table with an interest assumption of 3% to 6.0% prior to 1994, and using the 1985 CIDA with an interest assumption of 4.5% or 5% after 1994.

***Liability for Policy and Contract Claims***—The liability for policy and contract claims is based upon the estimated liability for claims reported to the Company plus claims incurred but not reported. Although considerable variability is inherent in such estimates, in the opinion of management the reserves for policy and contract claims are sufficient in the aggregate under the terms of its policies for all unpaid claims at December 31, 2007 and 2006.

***Participating Policies***—The Company maintains both participating and nonparticipating life insurance policies. Participating business represented approximately 1% of the life insurance in force at December 31, 2007 and 2006, and 10% of life insurance premium income for the years ended December 31, 2007 and 2006. Dividends to participating policyholders are determined annually and are payable only upon declaration of an equitable current dividend plus a provision for such dividend to be paid in the following year by the board of directors.

***Assumption Reinsurance Transactions***—The Company values assets acquired at the date of acquisition at their market values and the reserves are established according to the statutory requirements based on the benefits of the individual policies reinsured. If the liabilities exceed the assets received, the difference represents goodwill that must be amortized into operations using the interest method over the life of the policies, but for a period not to exceed 10 years. If the assets exceed the liabilities, the Company records a deferred liability and amortizes the amount into operations using the interest method over the expected life of the business but not to exceed 10 years.

***Guaranty Fund and Other Assessments***—The Company may be required to record a liability for guaranty fund and other assessments after an insolvency of an insurer in the states where the Company is licensed to write business has occurred.

***Use of Estimates***—The preparation of statutory-basis financial statements requires management to make estimates and assumptions that affect the amounts reported in the statutory-basis financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein. The estimates susceptible to significant change are those used in determining the liability for aggregate reserves for future policy benefits and claims. Although some variability is inherent in these estimates, management believes the amounts provided are adequate.

### 3. RESTRICTED ASSETS

In accordance with the terms of certain coinsurance and assumption reinsurance agreements, the Company is required to maintain funds in custodial accounts. Such funds are restricted as to withdrawal, unless approved by written authorization from both the Company and the ceding companies. Such restricted funds may be used to service the respective assumed blocks of business. No restrictions are placed on the types of investments to be made with the funds. At December 31, 2007 and 2006, the admitted asset value of investments held in the custodial accounts totaled \$47.0 million and \$46.2 million, respectively.

Bonds with an admitted asset value of \$9.0 million and \$9.3 million as of December 31, 2007 and 2006, respectively, were held on deposit with state insurance departments to satisfy regulatory requirements.

#### 4. INVESTMENTS

The amortized cost and estimated fair value of investments in bonds at December 31, 2007 and 2006 are as follows (amounts in thousands):

	2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. treasury securities and obligations of U.S. government corporations and agencies	\$ 138,194	\$ 2,532	\$ (262)	\$ 140,464
Industrial/miscellaneous	49,397	680	(1,193)	48,884
Mortgage-backed securities	<u>6,949</u>	<u>33</u>	<u>(19)</u>	<u>6,963</u>
Total fixed maturity securities	<u>\$ 194,540</u>	<u>\$ 3,245</u>	<u>\$ (1,474)</u>	<u>\$ 196,311</u>
	2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. treasury securities and obligations of U.S. government corporations and agencies	\$ 153,309	\$ 113	\$ (3,098)	\$ 150,324
Industrial/miscellaneous	54,639	575	(782)	54,432
Mortgage-backed securities	<u>8,154</u>	<u>32</u>	<u>(111)</u>	<u>8,075</u>
Total fixed maturity securities	<u>\$ 216,102</u>	<u>\$ 720</u>	<u>\$ (3,991)</u>	<u>\$ 212,831</u>

The following tables at December 31, 2007 and 2006 show investments with gross unrealized losses and their fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (amounts in thousands):

2007	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. treasury securities and obligations of U.S. government corporations and agencies	\$ 5,500	\$ (35)	\$ 26,522	\$ (227)	\$ 32,022	\$ (262)
Industrial/miscellaneous	-	-	24,804	(1,193)	24,804	(1,193)
Mortgage-backed securities	-	-	<u>5,032</u>	<u>(19)</u>	<u>5,032</u>	<u>(19)</u>
Total fixed maturity securities	<u>\$ 5,500</u>	<u>\$ (35)</u>	<u>\$ 56,358</u>	<u>\$ (1,439)</u>	<u>\$ 61,858</u>	<u>\$ (1,474)</u>

2006	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. treasury securities and obligations of U.S. government corporations and agencies	\$ 45,820	\$ (528)	\$ 90,888	\$ (2,570)	\$ 136,708	\$ (3,098)
Industrial/miscellaneous	11,129	(167)	17,263	(615)	28,392	(782)
Mortgage-backed securities	7,380	(111)	-	-	7,380	(111)
Total fixed maturity securities	<u>\$ 64,329</u>	<u>\$ (806)</u>	<u>\$ 108,151</u>	<u>\$ (3,185)</u>	<u>\$ 172,480</u>	<u>\$ (3,991)</u>

At December 31, 2007, 99.6% of the Company's investment portfolio was rated investment grade. Due to the Company's investment policy of investing in high-quality securities with the intention of holding these securities until the stated maturity, the portfolio does have exposure to interest rate risk. Interest rate risk is the risk that funds are invested today at a market interest rate and in the future interest rates rise causing the current market price on that investment to be lower. This risk is not a significant factor relative to the Company's buy and hold portfolio since the original intention was to receive the stated interest rate and principal at maturity to match liability requirements of policyholders. Also, the Company takes steps to manage these risks. For example, the Company purchases the type of mortgage-backed securities that have more predictable cash flow patterns. The above temporary declines in fair value are primarily due to interest rate risk. Of the debt securities reporting temporary declines in fair value as of December 31, 2007, 50.4% or \$31.2 million are U.S. Treasury securities and obligations of U.S. government corporations and agencies, while the remaining 49.6% or \$30.7 million, are investment-grade securities. The Company currently expects to receive all principal and interest payments on these securities in accordance with their stated terms. The Company continually monitors pertinent information as noted above to ensure expected returns in order to pay future policyholder obligations.

The amortized cost and estimated fair value of bonds at December 31, 2007, by contractual maturity, are as follows (amounts in thousands):

	Amortized Cost	Fair Value
Due within 1 year	\$ 18,442	\$ 18,448
Due after 1 year through 5 years	41,152	41,561
Due after 5 years through 10 years	91,392	92,363
Due after 10 years	36,605	36,976
Mortgage-backed securities	<u>6,949</u>	<u>6,963</u>
	<u>\$ 194,540</u>	<u>\$ 196,311</u>

Expected maturities will differ from contractual maturity because issuers may have the right to call or prepay obligations with or without penalties.

Unrealized gains and losses on investments in unaffiliated common stock are reported as direct adjustments to unassigned surplus and do not affect operations. The cost and estimated fair value of investments in unaffiliated common stock at December 31, 2007 and 2006, are as follows (amounts in thousands):

	2007			Fair Value
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Common stock	<u>\$ 11</u>	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 12</u>

  

	2006			Fair Value
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Common stock	<u>\$ 11</u>	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 12</u>

Components of realized capital gains and losses as of December 31, 2007 and 2006 are as follows (amounts in thousands):

	2007		
	Gross Gains	Gross Losses	Net Gains (Losses)
Bonds	<u>\$ 214</u>	<u>\$ (15)</u>	<u>\$ 199</u>
Total	<u>\$ 214</u>	<u>\$ (15)</u>	199
Federal income tax expense			(68)
Transfer to interest maintenance reserve of \$187, net of taxes of \$64			<u>(123)</u>
Net realized capital gain			<u>\$ 8</u>

  

	2006		
	Gross Gains	Gross Losses	Net Gains (Losses)
Bonds	\$ 971	\$ -	\$ 971
Common stock-unaffiliated	<u>8</u>	<u>-</u>	<u>8</u>
Total	<u>\$ 979</u>	<u>\$ -</u>	979
Federal income tax expense			-
Transfer to interest maintenance reserve of \$940, net of taxes of \$0			<u>940</u>
Net realized capital gain			<u>\$ 39</u>

Proceeds from sales of bonds, excluding maturities and redemptions, during 2007 and 2006, were \$7.4 million and \$27.8 million, respectively.

At December 31, 2007, 99.6% of the Company's bonds were investment grade. The Company performs periodic evaluations of the relative credit standing of the issuance of these bonds.

The Company maintains investments in money market accounts with a major bank, which exceed the federally insured limit. The Company thoroughly investigates its depositories and has experienced no losses with respect thereto.

There were no mortgage loan impairments in 2007 or 2006.

Major categories of the Company's net investment income for the years ended December 31, 2007 and 2006 are summarized as follows (amounts in thousands):

	2007	2006
Investment income:		
Bonds	\$ 10,406	\$ 11,522
Mortgage loans	97	112
Real estate*	1,919	1,828
Contract loans	413	567
Short-term investments and cash	1,312	942
Other	<u>12</u>	<u>33</u>
Total investment income	<u>14,159</u>	<u>15,004</u>
Investment expenses:		
Investment expenses	1,996	2,054
Interest on surplus note	1,443	1,383
Depreciation on real estate	300	295
Investment taxes on real estate	<u>225</u>	<u>242</u>
Total investment expenses	<u>3,964</u>	<u>3,974</u>
Net investment income	<u>\$ 10,195</u>	<u>\$ 11,030</u>

\*The income and expense for the occupancy of Company-owned property was \$0.6 million for 2007 and 2006.

## 5. INVESTMENTS IN SUBSIDIARIES AND AFFILIATES

A summary of the Company's investments in subsidiaries as of December 31, 2007 and 2006 are as follows (amounts in thousands):

	2007		2006	
	Cost	Carrying Value	Cost	Carrying Value
Worksite Solutions, Inc.	\$ 150	\$ 360	\$ 150	\$ 303
ICIC	5,577	7,261	5,577	6,829
MIG	<u>13,898</u>	<u>23,002</u>	<u>13,898</u>	<u>22,876</u>
	<u>\$ 19,625</u>	<u>\$ 30,623</u>	<u>\$ 19,625</u>	<u>\$ 30,008</u>

The change in the unrealized appreciation of investments in subsidiaries has been booked to unassigned surplus as a component of change in unrealized capital gains and does not affect net income.

## 6. PREMIUMS AND OTHER CONSIDERATIONS DEFERRED AND UNCOLLECTED

Deferred and uncollected life insurance premiums and annuity considerations as of December 31, 2007 and 2006, are as follows (amounts in thousands):

	2007		2006	
	Gross	Net of Loading	Gross	Net of Loading
Ordinary new business	\$ 463	\$ 437	\$ 351	\$ 231
Ordinary renewal	1,598	1,125	1,327	944
Group life	-	-	-	-
Total	<u>\$ 2,061</u>	<u>\$ 1,562</u>	<u>\$ 1,678</u>	<u>\$ 1,175</u>

## 7. PROPERTY AND EQUIPMENT

The Company's property and equipment at December 31, 2007 and 2006 are as follows (amounts in thousands):

	2007	2006
Furniture and fixtures	\$ 857	\$ 857
Data processing equipment	1,105	970
Leasehold improvements	334	357
Artwork	964	941
Other	<u>6</u>	<u>6</u>
	3,266	3,131
Less accumulated depreciation	<u>(1,847)</u>	<u>(1,675)</u>
Property and equipment before amount nonadmitted	1,419	1,456
Less nonadmitted assets	<u>(1,360)</u>	<u>(1,396)</u>
Property and equipment	<u>\$ 59</u>	<u>\$ 60</u>

Depreciation expense for the years ended December 31, 2007 and 2006 was \$0.2 million and \$0.3 million for each period presented.

## 8. FAIR VALUES OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Company in estimating the fair value of financial instruments:

- *Bonds and Stocks*—The fair values for bonds and stocks are based on market values prescribed by the SVO; however, for certain securities, the NAIC does not provide a market value and the Company uses quoted market value where available.
- *Mortgage Loans on Real Estate*—The carrying amounts reported approximate their fair values.

- *Contract Loans*—Contract loans are an integral part of the life insurance policies which the Company has in force and, in the Company’s opinion, cannot be valued separately. Contract loans are stated at their aggregate unpaid balance.
- *Cash and Short-Term Investments*—The carrying amounts reported approximate their fair values.
- *Annuity Contract Reserves*—Fair values of the Company’s liabilities under contracts not involving significant mortality or morbidity risks (principally deferred annuities) are stated at the account value which represents the amount payable by the Company upon demand.
- *Surplus Note*—The carrying amounts reported approximate the fair value.

The carrying amounts and fair values of the Company’s financial instruments at December 31, 2007 and 2006, are as follows (amounts in thousands):

	2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
Bonds	\$ 194,540	\$ 196,311	\$ 216,102	\$ 212,831
Common stocks	12	12	12	12
Mortgage loans on real estate	1,632	1,632	1,751	1,751
Cash and short-term investments	29,387	29,387	26,684	26,684
Liabilities—annuities and supplementary contracts	13,947	13,947	14,968	14,968
Surplus—surplus note	15,000	15,000	15,000	15,000

## 9. LIFE AND ANNUITY ACTUARIAL RESERVES

At December 31, 2007 and 2006, the Company’s annuity reserves and deposit fund liabilities that are subject to discretionary withdrawal (with adjustment), subject to discretionary withdrawal (without adjustment), and not subject to discretionary withdrawal provisions are summarized as follows (amounts in thousands):

	2007		2006	
	Amount	Percent	Amount	Percent
Subject to discretionary withdrawal:				
With market value adjustment	\$ -	0.0 %	\$ -	0.0 %
At book value less current surrender charge of 5% or more	-		-	
At market value	-		-	
Total with adjustment or at market value	-		-	
At book value without adjustment (with minimal or no charge or adjustment)	12,489	74.3	11,509	65.6
Not subject to discretionary withdrawal	4,314	25.7	6,023	34.4
Total annuity reserves and deposit fund liabilities before reinsurance	16,803	100.0 %	17,532	100.0 %
Less reinsurance ceded	(217)		-	
Total annuity reserves and deposit fund liabilities	<u>\$ 16,586</u>		<u>\$ 17,532</u>	

## 10. FEDERAL INCOME TAXES

The Company files a consolidated income tax return with its parent, HIHI. The Company is subject to federal income taxation as a life insurance company under the Internal Revenue Code of 1986 ("IRC"). Life insurance companies are taxed at corporate rates on taxable income.

In 2004, the consolidated group entered into a tax allocation agreement which was approved by the board of directors and the Texas Department of Insurance. As a result of the redomestication, this tax allocation agreement has been approved by the AID on June 20, 2007. Under the written agreement, the parent company collects from or refunds to the respective subsidiaries the amount of taxes or benefits determined based on the portion of consolidated taxable income generated by the member joining in the return. The taxes so apportioned cannot exceed the tax liability that would have arisen if a member had filed a separate return. Under a special provision of the agreement, the Company cannot reimburse any other nonlife member for the use of any nonlife net operating losses without the specific permission of the AID.

The components of the net deferred tax asset and the change in net deferred income taxes at December 31, 2007 and 2006, are as follows (amounts in thousands):

	2007	2006	
Deferred tax assets:			
Policy reserves	\$ 4,467	\$ 4,940	
Deferred policy acquisition costs	5,126	5,915	
Real estate, furniture and equipment	554	625	
Net operating loss carryforward	-	239	
Other	<u>378</u>	<u>451</u>	
Total deferred tax assets	10,525	12,170	
Nonadmitted deferred tax assets	<u>-</u>	<u>(422)</u>	
Admitted deferred tax assets	10,525	11,748	
Deferred tax liabilities:			
Unrealized capital gains	3,402	3,193	
Policy reserves	5,090	6,344	
Other	<u>707</u>	<u>599</u>	
Total deferred tax liabilities	<u>9,199</u>	<u>10,136</u>	
	2007	2006	Change
Deferred tax assets	\$ 10,525	\$ 12,170	\$ (1,645)
Deferred tax liabilities	<u>9,199</u>	<u>10,136</u>	<u>(937)</u>
Net deferred tax asset	<u>\$ 1,326</u>	<u>\$ 2,034</u>	(708)
Tax effect of change in unrealized gains			<u>(209)</u>
Total change in net deferred income tax			<u>\$ (499)</u>

At December 31, 2007, the Company had no net operating loss carryforward. The Company has an AMT carryforward of \$271,856.

The provisions for incurred taxes on earnings for the years ended December 31, 2007 and 2006, are as follows (amounts in thousands):

	2007	2006
Current income tax expense (benefit)	\$ 600	\$ (260)
Current income tax expense on capital gains	68	-
Change in net deferred tax	<u>499</u>	<u>(723)</u>
Total tax expense (benefit) incurred	<u>\$ 1,167</u>	<u>\$ (983)</u>

The Company's income tax expense and change in deferred taxes differs from its amount obtained by applying the federal statutory rate of 34% to net gain (loss) from operations after dividends to policyholders for the following reasons:

	2007	2006
Expected income tax expense at applicable rate	\$ 1,867	\$ 418
Deferred reinsurance gain, net of amortization	-	(1,335)
Capital gains tax	68	13
Prior taxes and other amounts	<u>(768)</u>	<u>(79)</u>
Total income tax expense (benefit) incurred	<u>\$ 1,167</u>	<u>\$ (983)</u>

Under the Life Insurance Company Act of 1959, life insurance companies were required to maintain a policyholders' surplus account containing the accumulated portion of current income that had not been subjected to income tax in the year earned. The Deficit Reduction Act of 1984 required that no future amounts be added after 1983 to the policyholders' surplus account and that any future distributions to shareholders from the account would become subject to income tax at the general corporate income tax rate then in effect. During 2004, the American Jobs Creation Act of 2004 ("AJCA") was enacted. The AJCA provides, in part, that distributions from policyholders' surplus accounts during 2005 and 2006 will not be taxed. The Company distributed the entire balance of its policyholders' surplus account to its parent during 2006. As a result of the dividend there is no need to setup any current or deferred income taxes since the policyholders' surplus account is \$0.

## 11. RELATED-PARTY TRANSACTIONS

Effective January 1, 1999, the Company began providing certain administrative services to subsidiaries and affiliated companies. The services performed were pursuant to intercompany service agreements and include policy administration, marketing, accounting, and data processing services. Amounts received pursuant to these service agreements were \$3.8 million and \$1.8 million for 2007 and 2006, respectively. The Company had receivables from affiliates primarily related to amounts due under the intercompany service agreement.

## 12. CAPITAL AND SURPLUS

Under the laws of the State of Arkansas, the Company must maintain minimum statutory capital and surplus of \$750,000. Accordingly, a portion of the Company's surplus is unavailable for distribution to its stockholders. Additionally, statutory regulations generally will not allow the payment of dividends in any one year to exceed the greater of statutory net gain from operations or 10% of statutory surplus for the preceding year.

Life and health insurance companies are subject to certain risk-based capital ("RBC") requirements as specified by the NAIC. Under those requirements, the amount of capital and surplus maintained by a life and health insurance company is to be determined based on the various risk factors related to it. At December 31, 2007 and 2006, the Company met the minimum RBC requirements.

On May 22, 2003, the Company issued a surplus note to InCapS Funding I, Ltd. for \$15 million which is due May 23, 2033, and was approved by the TDI. The interest rate for this surplus note is London InterBank Offered Rate ("LIBOR") plus 4.10%. On the date of issuance, the LIBOR rate was 1.28%. Any payment of principle and interest is subject to prior approval by AID. During 2007 and 2006 the Company paid \$1.4 million and \$1.4 million in interest, respectively, which was approved by the AID.

The portion of unassigned surplus increased or (reduced) by each item below as of December 31, 2007 and 2006 is as follows (amounts in thousands):

	2007	2006
Net unrealized gains—net of deferred tax	\$ 7,596	\$ 7,190
Nonadmitted asset values	(1,960)	(2,721)
Asset valuation reserve	(1,105)	(1,048)

## 13. EMPLOYEE BENEFIT PLAN

All full-time employees of the Company over the age of 18 are eligible to participate in the Manhattan Insurance Group 401(k) Plan, a qualified defined contribution plan, after the completion of three months of service with the Company. Employees who elect to participate may contribute from 1% to 20% of their base pay. Effective January 1, 2001, the Company's contribution was based on the safe harbor matching formula provisions of the IRC, which is a rate of 25% on the first 4% of employee contributions.

## 14. COMMITMENTS AND CONTINGENCIES

In February 2003, the Company implemented an administrative change in connection with adjudicating radiation and chemotherapy benefits under certain cancer policies. The Company began requesting its policyholders to submit Explanation of Benefits ("EOB") forms from their primary insurance carriers in order to determine and pay the policyholder the amount actually charged for the covered treatments in accordance with policy terms. The Company is a defendant in various lawsuits arising from this change in claims payment practice and is vigorously defending itself in connection with these cases. Although the ultimate outcome of this litigation cannot presently be determined, the Company believes that the resolution of these lawsuits will not have a material effect on its statutory-basis financial position, results of operations, or capital and surplus.

This Company is a defendant in various lawsuits arising in the normal course of business and is defending the cases vigorously. The Company believes that the total amounts that would ultimately have to be paid arising from these lawsuits would have no material effect on its statutory-basis financial position, results of operations, or capital and surplus.

From time to time, assessments are levied on the Company by the guaranty associations of the states in which the Company is licensed to write business. Such assessments are made primarily to cover the losses of policyholders of insolvent or rehabilitated insurers. In some states, these assessments can be recovered through a reduction in future premium taxes. However, the economy and other factors have recently caused the number and size of insurance company failures to increase. Based on information currently available, management believes that it is probable that these failures will result in future assessments. However, the amounts of such assessments are not presently determinable, and accordingly, no provision has been reflected in the accompanying statutory-basis financial statements for such assessments.

The Company leases office space, automobiles, and equipment under various operating leases. Total lease expense during 2007 and 2006 under such agreements was approximately \$0.7 million and \$0.8 million, respectively, and is included in general insurance expenses.

Future minimum rental payments under noncancelable leases as of December 31, 2007, are as follows (amounts in thousands):

<b>Years Ending December 31</b>	
2008	\$ 443
2009	358
2010	275
2011	241
2012 and after	<u>104</u>
	<u>\$ 1,421</u>

## **15. REINSURANCE**

The Company is engaged in various types of reinsurance transactions, including both assumed and ceded risks. Risks are ceded based on management's evaluation, and cessions of business are approved by the board of directors. All ceded insurance transactions are accomplished by fully executed agreements with reinsurance companies. Life insurance agreements are ceded on a yearly renewable term, coinsurance, modified coinsurance, and co-modified coinsurance basis. The Company's maximum life retention varies from \$50,000 to \$400,000. Health reinsurance is ceded on a coinsurance basis or a stop-loss basis. The Company's maximum retention is approximately \$1,000 per monthly benefit on disability insurance and approximately \$75,000 to \$100,000 per individual on major medical insurance.

Following is information for the years ended December 31, 2007 and 2006 related to premiums ceded and assumed and the related benefits (amounts in thousands):

	<u>2007</u>		
	<u>Life and Annuities</u>	<u>Accident and Health</u>	<u>Total</u>
Premiums ceded	<u>\$ 993</u>	<u>\$ 248</u>	<u>\$ 1,241</u>
Premiums assumed	<u>\$ 2,202</u>	<u>\$ 35,821</u>	<u>\$ 38,023</u>
Benefits ceded	<u>\$ 1,281</u>	<u>\$ 949</u>	<u>\$ 2,230</u>
Benefits assumed	<u>\$ 2,119</u>	<u>\$ 36,590</u>	<u>\$ 38,709</u>
	<u>2006</u>		
	<u>Life and Annuities</u>	<u>Accident and Health</u>	<u>Total</u>
Premiums ceded	<u>\$ 842</u>	<u>\$ 335</u>	<u>\$ 1,177</u>
Premiums assumed	<u>\$ 1,900</u>	<u>\$ 37,861</u>	<u>\$ 39,761</u>
Benefits ceded	<u>\$ 1,738</u>	<u>\$ 1,060</u>	<u>\$ 2,798</u>
Benefits assumed	<u>\$ 2,222</u>	<u>\$ 34,174</u>	<u>\$ 36,396</u>

For the years ended December 31, 2007 and 2006, the Company ceded life insurance in force of \$235.0 million and \$222.0 million, respectively. As of December 31, 2007 and 2006, respectively, the Company had \$0.5 million and \$0.3 million in recoverables from reinsurers. Amounts deducted from the policy liability reserves in connection with reinsurance ceded were \$3.7 million and \$4.6 million for accident and health and \$0.8 million and \$0.6 million for life at December 31, 2007 and 2006, respectively. The Company is liable for insurance ceded to other companies in the event such companies are unable to meet their obligations under reinsurance agreements. The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. The Company has various coinsurance agreements with funds held provisions that are secured by investment balances in trusts. The aggregate funds held balances at December 31, 2007 and 2006 was \$47.0 million and \$46.2 million, respectively, which is included in funds held by reinsurer in the statutory-basis financial statements.

The Company entered into a 100% coinsurance agreement with MLIC to assume risk on certain Latin American policies issued on or after January 1, 2007. Total premiums assumed during 2007 were \$0.5M. Total commissions and expense during 2007 were \$0.6M. As of December 31, 2007 the Company owed MLIC \$0.6M for the commissions and expense allowances and had reserves of \$0.2M.

The Company entered into a 50% retrocession agreement with MLIC on the policies noted above that returned 50% of all risk retained by the Company, after cession of risk to its third party reinsurers, to the MLIC effective January 1, 2007. Total premiums ceded during 2007 were \$0.1M. Total commissions and expenses during 2007 were \$0.1M. As of December 31, 2007 the Company recorded an asset for \$0.1M for the commissions and expense allowances due from MLIC and a reserve credit of \$0.05M.

In 2006, the Company entered into an assumption reinsurance transaction with Selective Insurance Company of America (“Selective”) whereby the Company agreed to assume blocks of accident and health business issued by Selective. As a result of the assumption of the Selective block, the Company received approximately \$1.3 million of cash and posted \$1.3 million of reserves and \$50,000 of goodwill. The goodwill was fully amortized in 2007.

In 2005, the Company entered into an assumption reinsurance transaction with Life of Georgia Insurance Company (“LOG”) whereby the Company agreed to assume blocks of accident and health business issued by LOG. As a result of the assumption of the LOG block, the Company received approximately \$8.4 million of cash and posted \$9.1 million of reserves and \$0.7 million of goodwill. The goodwill at December 31, 2007 is \$0.6 million.

#### 16. LIABILITY FOR UNPAID ACCIDENT AND HEALTH CLAIMS

Activity in the liability for unpaid accident and health claims as of December 31, 2007 and 2006 is summarized as follows (amounts in thousands):

	2007	2006
Net balance—January 1	<u>\$ 47,974</u>	<u>\$ 52,781</u>
Increase in liability due to the Selective acquisition	<u>-</u>	<u>852</u>
Incurred related to:		
Current year	90,948	94,185
Prior year	<u>(1,766)</u>	<u>(734)</u>
Total incurred	<u>89,182</u>	<u>93,451</u>
Paid related to:		
Current year	62,038	64,783
Prior year	<u>31,200</u>	<u>34,327</u>
Total paid	<u>93,238</u>	<u>99,110</u>
Net balance—December 31	<u>\$ 43,918</u>	<u>\$ 47,974</u>

The claim liability represents accident and health policy and contract claims and the claim reserve portion of the aggregate reserve for accident and health policies. The claim liability is established based on case basis estimates and estimates of incurred but unreported claims based on historical experience. Actual experience will vary from the Company’s estimates due to volatility in both the amount of future payments on known existing claims and in the number of claims, which become known after the financial statement date. This volatility is due to the nature of personal health, changes in the Company’s underwriting standards, and to overall economic and societal conditions and will result in redundancies or deficiencies in the liability for unpaid claims. The foregoing reconciliation reflects a redundancy in 2007 and 2006 of \$1.8 million and \$0.7 million, respectively. The changes in those reserves were primarily the result of differences in actual and assumed morbidity assumptions.

## 17. RECONCILIATION TO ANNUAL STATEMENTS

The following are reconciliations of amounts previously reported to state regulatory authorities in the 2007 and 2006 Annual Statement to those reported in the accompanying statutory-basis financial statements (amounts in thousands):

	2007	2006
Admitted assets as reported in the Company's Annual Statement	\$332,548	\$350,238
Current income tax recoverable	<u>(52)</u>	<u>-</u>
Admitted assets as reported in the accompanying statutory-basis statements of admitted assets, liabilities, and capital and surplus	<u>\$332,496</u>	<u>\$350,238</u>
Liabilities as reported in the Company's Annual Statement	\$295,530	\$317,959
Adjustment to general expenses due and accrued	-	462
Current income tax payable	<u>240</u>	<u>-</u>
Liabilities as reported in the accompanying statutory-basis statements of admitted assets, liabilities, and capital and surplus	<u>\$295,770</u>	<u>\$318,421</u>
Capital and surplus as reported in the Company's Annual Statement	\$ 37,018	\$ 32,279
Adjustment to increase general expenses due and accrued	-	(462)
Adjustment for income taxes	<u>(292)</u>	<u>-</u>
Capital and surplus as reported in the accompanying statutory-basis statements of admitted assets, liabilities, and capital and surplus	<u>\$ 36,726</u>	<u>\$ 31,817</u>
Statutory net income as reported in the Company's Annual Statement	\$ 5,190	\$ 1,692
Adjustment for income taxes	(292)	260
Adjustment to general expenses due and accrued	<u>-</u>	<u>(462)</u>
Net income as reported in the accompanying statutory-basis statements of operations	<u>\$ 4,898</u>	<u>\$ 1,490</u>

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**SUPPLEMENTAL SCHEDULES**

**(See Independent Auditors' Report)**

# CENTRAL UNITED LIFE INSURANCE COMPANY

## SUPPLEMENTAL SCHEDULE OF SELECTED STATUTORY-BASIS FINANCIAL DATA AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2007 (Amounts in thousands)

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Investment income earned:	
Government bonds	\$ 7,043
Other bonds (unaffiliated)	3,363
Preferred stocks (unaffiliated)	-
Common stocks (unaffiliated)	-
Mortgage loans	97
Real estate	1,919
Premium notes, policy loans, and liens	413
Short-term investments	1,306
Cash on hand	6
Other invested assets	-
Other investment	<u>12</u>
Gross investment income	<u>\$ 14,159</u>
Mortgage loans—book value:	
Farm mortgages	\$ -
Residential mortgages	1,610
Commercial mortgages	<u>22</u>
Total mortgage loans	<u>\$ 1,632</u>
Mortgage loans by standing—book value—good standing	<u>\$ 1,632</u>
Bonds and short-term investments by maturity statement value:	
Due within one year or less	\$ 50,310
Over 1 year through 5 years	45,932
Over 5 years through 10 years	91,434
Over 10 years through 20 years	25,960
Over 20 years	<u>11,496</u>
Total by maturity	<u>\$ 225,132</u>

(Continued)

# CENTRAL UNITED LIFE INSURANCE COMPANY

## SUPPLEMENTAL SCHEDULE OF SELECTED STATUTORY-BASIS FINANCIAL DATA AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2007 (Amounts in thousands)

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Bonds and short-term investments by class—statement value:	
Class 1	\$ 218,868
Class 2	5,269
Class 3	-
Class 4	-
Class 5	995
	<u>225,132</u>
Total by class	\$ <u>225,132</u>
Total bonds publicly traded	\$ <u>221,131</u>
Total bonds privately placed	\$ <u>4,001</u>
Preferred stocks—statement value	\$ <u>-</u>
Common stocks—market value	\$ <u>12</u>
Subsidiaries' and affiliates common stock—book value	\$ <u>30,623</u>
Short-term investments—book value	\$ <u>30,592</u>
Cash on deposit (overdraft)	\$ <u>(1,205)</u>
Life insurance in force	
Ordinary	\$ <u>861,796</u>
Group	\$ <u>4,736</u>
Amount of accidental death insurance in force under ordinary policies	\$ <u>28,874</u>
Insurance policies with disability provision in force—ordinary	\$ <u>149,999</u>
Supplementary contracts in force—ordinary—not involving life contingencies:	
Amount on deposit	\$ <u>217</u>
Income payable	\$ <u>30</u>
Ordinary—involving life contingencies—income payable	\$ <u>182</u>

(Continued)

# CENTRAL UNITED LIFE INSURANCE COMPANY

## SUPPLEMENTAL SCHEDULE OF SELECTED STATUTORY-BASIS FINANCIAL DATA AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2007 (Amounts in thousands)

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Annuities:	
Ordinary:	
Immediate—amount of income payable	<u>\$ 198</u>
Deferred—fully paid account balance	<u>\$ 2,977</u>
Deferred—not fully paid—account balance	<u>\$ 5,779</u>
Accident and health insurance—premiums in force:	
Ordinary	<u>\$ 87,590</u>
Group	<u>\$ 5,059</u>
Deposit funds and dividend accumulations:	
Deposit funds—account balance	<u>\$ 1,163</u>
Dividend accumulations—account balance	<u>\$ 1,476</u>
Claim payments in 2007—accident and health:	
2007	<u>\$ 62,038</u>
2006	<u>\$ 31,200</u>
2005	<u>\$</u>
2004	<u>\$</u>
2003	<u>\$</u>

(Concluded)

# CENTRAL UNITED LIFE INSURANCE COMPANY

## SUPPLEMENTAL SCHEDULE OF INVESTMENT RISK INTERROGATORIES FOR THE YEAR ENDED DECEMBER 31, 2007

### Investment Risk Interrogatories

- The Company's total admitted assets for the year ended December 31, 2007 are \$332,495,989.
- Following are the 10 largest exposures to a single issuer/borrower/investment, by investment category, excluding (i) U.S. government, U.S. government agency securities, and those U.S. government money market funds listed in the Appendix to the *SVO Practices and Procedures Manual* as exempt; (ii) property occupied by the Company; and (iii) policy loans:

	Investment Category/Issuer	Amount	Percentage of Total Admitted Assets
2.01	Manhattan Insurance Group, Inc.— common stock	\$23,002,312	6.9%
2.02	Investors Consolidated Ins. Co. — common stock	7,261,185	2.2
2.03	CML Realty Corp- Real Estate	5,145,082	1.5
2.04	General Electric Co.	2,063,839	0.6
2.05	JP Morgan Chase & Co.	2,002,311	0.6
2.06	Principal Financial Group	1,999,735	0.6
2.07	Goldman Sachs	1,497,788	0.5
2.08	Merrill Lynch	1,353,938	0.4
2.09	St. Louis County	1,315,000	0.4
2.10	Residential Mortgage Loan-1190	1,230,259	0.4

- The Company's total admitted assets held in bonds and preferred stocks, by NAIC rating, are:

	Bonds			Preferred Stocks		
3.01	NAIC-1	\$218,867,517	65.8%	P/PSF-1	\$	%
3.02	NAIC-2	5,269,084	1.6	P/PSF-2		-
3.03	NAIC-3		-	P/PSF-3		-
3.04	NAIC-4		-	P/PSF-4		-
3.05	NAIC-5	995,120	0.3	P/PSF-5		-
3.06	NAIC-6		-	P/PSF-6		-

(Continued)

4. Assets held in foreign investments:

4.01	Are assets held in foreign investments less than 2.5% of the reporting entity's total admitted assets?		Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
4.02	Total admitted assets held in foreign investments.	\$1,786,035	0.5%
4.03	Foreign-currency denominated investments.		
4.04	Insurance liabilities denominated in that same foreign currency		

If response to 4.01 above is yes, responses are not required for interrogatories 5-10.

5. Aggregate foreign investment exposure categorized by NAIC sovereign ratings:

5.01	Countries rated NAIC-1	\$	0.0%
5.02	Countries rated NAIC-2		0.0%
5.03	Countries rated NAIC-3 or below		0.0%
		<u>\$</u>	<u>0.0%</u>

6. Two largest foreign investment exposures to a single country, categorized by the country's NAIC sovereign rating:

Countries rated NAIC-1			
Country:	_____	\$	0.0%
Country:	_____		0.0%
Countries rated NAIC-2			
Country:	_____		0.0%
Country:	_____		0.0%
Countries rated NAIC-3 or below:			
Country:	_____		0.0%
Country:	_____		0.0%
		<u>\$</u>	<u>0.0%</u>

7. Aggregate unhedged foreign currency exposure:

\$ - - %

8. Aggregate unhedged foreign currency exposure, categorized by NAIC sovereign rating:

8.01	Countries rated NAIC-1	\$	0 %
8.02	Countries rated NAIC-2		
8.03	Countries rated NAIC-3 or below		
		<u>\$</u>	<u>0 %</u>

(Continued)

9. Two largest unhedged foreign currency exposures to a single country, categorized by the country's NAIC sovereign rating:

9.01 Countries rated NAIC-1	\$	0 %
Country: _____		
Country: _____		
9.02 Countries rated NAIC-2		
Country: _____		
Country: _____		
9.03 Countries rated NAIC-3 or below:		
Country: _____		
Country: _____		
	<u>\$</u>	<u>0 %</u>

10. Ten largest non-sovereign (i.e., non-governmental) foreign issues:

10.01 NAIC rating	\$
10.02 NAIC rating	
10.03 NAIC rating	
10.04 NAIC rating	
10.05 NAIC rating	
10.06 NAIC rating	
10.07 NAIC rating	
10.08 NAIC rating	
10.09 NAIC rating	
10.10 NAIC rating	

11. Amounts and percentages of the reporting entity's total admitted assets held in Canadian investments and unhedged Canadian currency exposure:

11.01 Are assets held in Canadian investments less than 2.5% of the reporting entity's total admitted assets	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
If response to 11.01 above is yes, detail is not required for the remainder of interrogatory 11.	
11.02 Total admitted assets held in Canadian investments	\$ %
11.03 Canadian-currency-denominated investments	
11.04 Canadian-denominated insurance liabilities	
11.05 Unhedged Canadian currency exposure	

12. None.

13. Assets held in investments with contractual sales restrictions are less than 2.5% of the Company's total admitted assets.

(Continued)

14. The Company's admitted assets held in the largest 10 equity interests (including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other equity securities, and excluding money market and bond mutual funds listed in the Appendix to the *SVO Practices and Procedures Manual* as exempt or Class 1) at December 31, 2006 are:

**Investment Category/Issuers**

14.01	Manhattan Insurance Group, Inc.	\$ 23,002,312	6.9%
14.02	Investors Consolidated Ins. Co.	7,261,185	2.2
14.03	Worksite Solutions	359,630	0.1
14.04	Prosperity Bancshares, Inc.	11,673	0.0

15. Assets held in nonaffiliated, privately placed equities are less than 2.5% of the reporting entities total admitted assets.
16. Assets held in general partnership interests are less than 2.5% of the reporting entity's total admitted assets.
17. Mortgage loans reported in Schedule B are less than 2.5% of the reporting entity's total admitted assets.
18. Aggregate mortgage loans having the following loan-to-value ratios as determined from the most current appraisal as of the annual statement date:

		Residential		Commercial		Agricultural	
Loan-to-Value		Residential Amount	Percentage of Total Admitted Assets	Commercial Amount	Percentage of Total Admitted Assets	Amount	Percentage of Total Admitted Assets
18.01	Above 95%	\$ -	0 %	\$ -	0 %	\$ -	0 %
18.02	91% to 95%						
18.03	81% to 90%	1,605,353	0.5%				
18.04	71% to 80%						
18.05	Below 70%	4,677	0.0%	22,048	0.0%		
						<b>Amount</b>	<b>Percentage of Total Admitted Assets</b>
18.06	Construction loans					\$ -	0 %
18.07	Mortgage loans over 90 days past due						
18.08	Mortgage loans in the process of foreclosure						
18.09	Mortgage loans foreclosed						
18.10	Restructured mortgage loans						

(Continued)

19. Assets held in each of the five largest investments in one parcel or group of contiguous parcels of real estate reported in Schedule A are less than 2.5% of the reporting entity's total admitted assets.

20. The Company's total admitted assets subject to the following types of agreements as of:

	At Year-End		Unaudited At End of Each Quarter		
	Amount	Percentage of Total Admitted Assets	1st Quarter Amount	2nd Quarter Amount	3rd Quarter Amount
20.01 Securities lending (do not include assets held as collateral for such transactions)	\$ -	0 %	\$ -	\$ -	\$ -
20.02 Repurchase agreements					
20.03 Reverso repurchase agreements					
20.04 Dollar repurchase agreements					
20.05 Dollar reverse repurchase agreements					
	<u>\$ -</u>	<u>0 %</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

21. Warrants not attached to other financial instruments, options, caps, and floors at December 31, 2006:

	Owned		Written	
21.01 Hedging	\$ -	0 %	\$ -	0 %
21.02 Income generation				
21.03 Other				

22. The Company's potential exposure for collars, swaps, and forwards as of:

	At Year-End		Unaudited At End of Each Quarter		
	Amount	Percentage of Total Admitted Assets	1st Quarter Amount	2nd Quarter Amount	3rd Quarter Amount
22.01 Hedging	\$ -	0 %	\$ -	\$ -	\$ -
22.02 Income generation					
22.03 Replications					
22.04 Other					
	<u>\$ -</u>	<u>0 %</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

(Continued)

23. The Company's potential exposure for futures contracts as of the following dates:

	At Year-End		Unaudited At End of Each Quarter		
	Amount	Percentage of Total Admitted Assets	1st Quarter Amount	2nd Quarter Amount	3rd Quarter Amount
23.01 Hedging	\$ -	0 %	\$ -	\$ -	\$ -
23.02 Income generation					
23.03 Replications					
23.04 Other					
	<u>\$ -</u>	<u>0 %</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

24. The 10 largest investments included in the Write-ins for Invested Assets category included on the Summary Investment Schedule at December 31, 2007 are:

	Amount	Percentage of Total Admitted Assets
24.01	\$ -	0 %
24.02		
24.03		
24.04		
24.05		
24.06		
24.07		
24.08		
24.09		
24.10		

(Concluded)

# CENTRAL UNITED LIFE INSURANCE COMPANY

## SUPPLEMENTAL SUMMARY INVESTMENT SCHEDULE AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2007

Investment Categories	Gross Investment Holdings*		Admitted Assets	
	Amount	Percentage of Total Invested Assets	Amount	Percentage of Total Admitted Assets
<b>Bonds:</b>				
U.S. treasury securities	\$ 24,722,676	8.983%	\$ 24,722,676	8.983%
U.S. government agency obligations (excluding mortgage-backed securities):				
Issued by U.S. government agencies				
Issued by U.S. government-sponsored agencies	113,471,554	41.231%	113,471,554	41.231%
Foreign government (including Canada, excluding mortgage-backed securities)				
Securities issued by states, territories and possessions, and political subdivisions in the United States:				
State, territory, and possessions general obligations				
Political subdivisions of states, territories and possessions, and political subdivisions general obligations				
Revenue and assessment obligations	2,893,652	1.051%	2,893,652	1.051%
Industrial development and similar obligations	1,375,303	0.500%	1,375,303	0.500%
Mortgage-backed securities (including residential and commercial MBS):				
Pass-through securities:				
Issued or guaranteed by GNMA	551		551	
Issued or guaranteed by FNMA and FHLMC				
All other				
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC or VA	6,948,748	2.525%	6,948,748	2.525%
Issued by non-U.S. Government issuers and collateralized by mortgage-backed securities issued or guaranteed by agencies shown in Line 1.521				
All other				
Other debt and other fixed income securities (excluding short-terms):				
Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	41,527,011	15.089%	41,527,011	15.089%
Unaffiliated foreign securities	3,600,039	1.308%	3,600,039	1.308%
Affiliated securities				
<b>Equity interests:</b>				
Investments in mutual funds				
Preferred stocks:				
Affiliated				
Unaffiliated				
Publicly traded equity securities (excluding preferred stocks):				
Affiliated				
Unaffiliated				
Other equity securities:				
Affiliated	30,623,126	11.127%	30,623,126	11.127%
Unaffiliated	11,699	0.004%	11,699	0.004%
Other equity interests including tangible personal property under lease:				
Affiliated				
Unaffiliated				
<b>Mortgage loans:</b>				
Construction and land development				
Agricultural				
Single family residential properties	1,610,030	0.585%	1,610,030	0.585%
Multifamily residential properties				
Commercial loans	22,048	0.008%	22,048	0.008%
Mezzanine real estate loans				
<b>Real estate investments:</b>				
Property occupied by company	5,760,323	2.093%	5,760,323	2.093%
Property held for production of income (includes \$0 of property acquired in satisfaction of debt)	5,145,082	1.870%	5,145,082	1.870%
Property held for sale (\$0 including property acquired in satisfaction of debt)	8,109,277	2.947%	8,109,277	2.947%
<b>Contract loans</b>	8,109,277	2.947%	8,109,277	2.947%
Receivables for securities				
Cash, cash equivalents and short-term investments	29,386,557	10.678%	29,386,557	10.678%
Other invested assets				
<b>Total invested assets</b>	<b>\$275,207,676</b>	<b>100.0%</b>	<b>\$275,207,676</b>	<b>100.0%</b>

\*Gross investment holding as valued in compliance with NAIC Accounting Practices and Procedures Manual.