FINANCIAL STATEMENTS – STATUTORY BASIS

Government Personnel Mutual Life Insurance Company
Years Ended December 31, 2011 and 2010
With Report of Independent Auditors

Ernst & Young LLP

ERNST & YOUNG

Government Personnel Mutual Life Insurance Company

Financial Statements – Statutory Basis

Years Ended December 31, 2011 and 2010

Contents

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Report of Independent Auditors

The Board of Directors
Government Personnel Mutual Life Insurance Company

We have audited the accompanying statutory-basis balance sheets of Government Personnel Mutual Life Insurance Company as of December 31, 2011 and 2010, and the related statutory-basis statements of income, changes in surplus, and cash flow 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Company presents its financial statements in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and accounting principles also are described in Note 1. The effects on the financial statements of these variances are not reasonably determinable but are presumed to be material.

In our opinion, because of the effects of the matter described in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of Government Personnel Mutual Life Insurance Company at December 31, 2011 and 2010, or the results of its operations or its cash flows for the years then ended.

However, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Government Personnel Mutual Life Insurance Company at December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended, in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance.

Ernst + Young LLP

May 29, 2012

Government Personnel Mutual Life Insurance Company

Balance Sheets – Statutory-Basis

	December 31	
	2011	**2010**
Admitted assets		
Cash and invested assets:		
Bonds	**$ 540,849,565**	$ 536,497,047
Preferred stock	**3,017,100**	3,017,100
Common stock	**4,720,389**	5,411,474
Mortgage loans	**134,658,370**	123,670,619
Real estate, less accumulated depreciation (2011 – $1,932,797; $2010 – $1,547,250):		
Properties occupied by the company	**6,888,227**	6,944,022
Properties held for the production of income	**5,627,397**	9,759,335
Properties held for sale	**2,250,000**	–
Policy loans	**73,390,041**	73,657,571
Short term investments	**11,794,233**	21,856,434
Cash	**17,022,483**	5,015,061
Receivable for securities	**19,687**	19,687
Total cash and invested assets	**800,237,492**	785,848,350
Deferred premiums, less loading (2011 – $2,523,070; 2010 – $2,499,165)	**8,417,729**	8,576,323
Uncollected premiums	**739,456**	812,497
Federal tax recoverable, including net deferred tax asset (2011 – $12,027,518; 2010 – $11,580,239)	**12,925,246**	12,658,611
Accrued investment income	**9,226,970**	9,280,064
Electronic data processing equipment, less accumulated depreciation (2011 – $919,284; 2010 – $884,485)	**95,771**	74,163
Amounts due from reinsurers	**1,882,312**	3,103,282
Other admitted assets	**601,252**	844,742
Total admitted assets	**$ 834,126,228**	$ 821,198,032

	December 31 2011	December 31 2010
Liabilities and surplus		
Liabilities:		
Policy and contract liabilities		
Life and annuity reserves	**$ 618,776,265**	$ 615,386,220
Accident and health reserves	**529,921**	541,664
Deposit type contracts	**62,642,582**	61,625,549
Dividends and coupons payable	**6,609,225**	6,706,225
Unpaid claims	**7,166,447**	7,058,581
Other	**216,368**	1,168,606
Total policy and contract liabilities	**695,940,808**	692,486,845
Benefits for employees	**5,189,635**	5,022,905
Accounts payable and accrued expenses	**6,598,410**	7,002,188
Unearned investment income	**2,215,168**	2,223,834
Asset valuation reserve	**13,760,594**	13,677,366
Federal income taxes payable	**627,334**	-
Interest maintenance reserve	**5,621,937**	5,684,431
Other	**7,177,562**	3,052,394
Total liabilities	**737,131,448**	729,149,963
Surplus:		
Surplus guarantee fund	**400,000**	400,000
Special surplus funds	**3,198,458**	3,131,541
Unassigned surplus	**93,396,322**	88,516,528
Total surplus	**96,994,780**	92,048,069
Total liabilities and surplus	**$ 834,126,228**	$ 821,198,032

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Income – Statutory-Basis

	Year Ended December 31 2011	2010
Premiums and other revenues:		
Premiums on life, annuity, and accident & health policies	**$ 54,568,197**	$ 56,495,371
Consideration for supplementary contracts with life contingencies	**180,532**	390,387
Net investment income	**44,229,139**	43,759,016
Amortization of the interest maintenance reserve	**1,176,497**	1,038,815
Commissions and expense allowances on reinsurance ceded	**9,199,792**	5,657,823
Miscellaneous income	**184,050**	60,287
Total premiums and other revenues	**109,538,207**	107,401,699
Benefits paid or provided:		
Death benefits	**30,008,636**	29,682,803
Annuity benefits	**6,457,209**	5,067,534
Surrender benefits	**15,678,319**	17,995,252
Interest and adjustments on policy or deposit-type contract funds	**2,362,642**	2,603,972
Payments from supplementary contracts with life contingencies	**1,208,968**	1,237,391
Other benefits	**2,436,844**	1,524,947
Increase in policy reserves	**3,378,301**	7,779,693
Total benefits paid or provided	**61,530,919**	65,891,592
Insurance expenses:		
Commissions	**9,528,513**	7,483,116
General expenses	**19,479,107**	18,045,305
Insurance taxes, licenses, and fees	**1,661,018**	1,545,672
Total insurance expenses	**30,668,638**	27,074,093
Total benefits paid or provided and insurance expenses	**92,199,557**	92,965,685
Gain from operations before dividends to policyholders, income taxes, and net realized capital gains (losses)	**17,338,650**	14,436,014
Dividends to policyholders	**(6,569,730)**	(6,685,764)
Gain from operations before income taxes and net realized capital gains (losses)	**10,768,920**	7,750,250
Federal income taxes	**2,803,955**	1,934,622
Gain from operations before net realized capital gains/losses	**7,964,965**	5,815,628
Net realized capital gains/losses, net of federal income tax (benefit) expense (2011 - $(18,770): 2010 - $(1,649,649)) and net of amounts transferred to IMR	**(1,133,575)**	1,432,787
Net income	**$ 6,831,390**	$ 7,248,415

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Changes in Surplus – Statutory-Basis

	Year Ended December 31	
	2011	**2010**
Surplus at beginning of year	**$ 92,048,069**	$ 87,788,292
Net income (loss)	**6,831,390**	7,248,415
Change in net unrealized capital gain (loss)	**(567,236)**	231,538
Change in net deferred tax	**422,244**	(1,769,483)
Change in nonadmitted assets	**(1,723,377)**	1,342,405
Change in liability for reinsurance in unauthorized companies	**1**	(99)
Change in asset valuation reserve	**(83,228)**	(2,750,188)
Other	**66,917**	(42,811)
Net increase	**4,946,711**	4,259,777
Surplus at end of year	**$ 96,994,780**	$ 92,048,069

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Cash Flow – Statutory-Basis

	Year Ended December 31	
	2011	**2010**
Operating activities		
Premiums collected net of reinsurance	**$ 54,767,809**	$ 57,246,452
Net investment income	**44,794,644**	43,145,513
Miscellaneous income	**9,311,584**	5,585,993
Total	**108,874,037**	105,977,958
Benefits paid	**56,199,119**	55,829,088
Commissions, expenses paid, and aggregate write-ins for deductions	**30,138,893**	26,454,695
Dividends paid to policyholders	**6,666,730**	6,686,764
Federal income taxes paid, net of tax on capital gains	**2,551,087**	2,141,796
Total	**95,555,829**	91,112,343
Net cash provided by operating activities	**13,318,208**	14,865,615
Investing activities		
Proceeds from investments sold, matured, or repaid:		
Bonds	**65,360,782**	171,524,605
Stocks	**715,182**	699,003
Mortgage loans	**14,817,249**	15,136,868
Total investment proceeds	**80,893,213**	187,360,476
Cost of investments acquired:		
Bonds	**68,407,971**	173,091,193
Stocks	**343,474**	2,873,644
Mortgage loans	**26,135,000**	11,835,000
Real estate	**295,364**	3,275,394
Total investments acquired	**95,181,809**	191,075,231
Net decrease in policy loans	**(255,525)**	(628,550)
Net cash (used in) provided by investing activities	**(14,033,071)**	(3,086,205)
Financing and miscellaneous activities		
Net deposits on deposit-type contract funds	**(1,021,044)**	(1,388,657)
Other cash provided (applied)	**3,681,126**	416,135
Net cash provided by (used in) miscellaneous activities	**2,660,082**	(972,522)
Net change in cash and short-term investments	**1,945,221**	10,806,888
Cash, cash equivalents, and short-term investments:		
At beginning of year	**26,871,495**	16,064,607
At end of year	**$ 28,816,716**	$ 26,871,495

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Notes to Statutory-Basis Financial Statements

Years Ended December 31, 2011 and 2010

1. Nature of Operations and Significant Accounting Policies

Government Personnel Mutual Life Insurance Company (the Company) is domiciled in the state of Texas. Effective November 1, 2010, the Company owns 100% of the outstanding common stock of Texas Directors Life Insurance Company (TDLIC). TDLIC is included in the Company's common stock investments as an unconsolidated subsidiary at the net statutory-basis equity of $534,768 plus unamortized goodwill of $1,323,920.

The Company is a mutual life insurance organization specializing in the armed forces, civil service, and final expense markets. Coverages are also available to the middle-to-upper-income general civilian market.

Operations are conducted primarily on personal producing and managing general agent plans through approximately 1,400 general and soliciting agents. The Company is licensed in 48 states and the District of Columbia. Its primary markets are the states of Texas, South Carolina, Florida, Virginia, Georgia, and North Carolina. The Company is also accredited to solicit sales at some overseas military installations. The Company offers a portfolio of the usual forms of individual permanent, term, flexible premium universal life, and annuity policies, all without a war clause. Life insurance and annuity plans are available to United States military personnel and Civil Service employees through a federal allotment plan. Automatic payment plans are available to the civilian populace. The Company also offers policies in the Senior Final Expense market. The Company is the underwriter for the group association coverages for members of the Military Benefit Association (MBA). The Company derives substantially all of its direct group life and group accident and health business from the group policy issued to the MBA. The Company entered the Medicare supplement market in 2010 and has in place an agreement with an experienced company in that market to administer this business.

The Company has in place an intercompany agreement with its subsidiary, TDLIC, in which administration and investment services are provided to TDLIC. Fees collected during 2011 were $77,025 for administration services and $15,748 for investment services.

Basis of Presentation

The Company's financial statements are prepared in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, whose practices may differ from U.S. generally accepted accounting principles. The more significant variances from GAAP are as follows:

1. Nature of Operations and Significant Accounting Policies (continued)

Investments: Investments in bonds are reported at amortized cost or fair value based on their National Association of Insurance Commissioners (NAIC) rating; for 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 surplus for those designated as available-for-sale. Fair value for statutory purposes is based on the price published by the Securities Valuation Office of the NAIC (SVO), if available, whereas fair value for GAAP is based on quoted market prices. If no fair value is available from SVO, then the fair value is based on prices received from third-party pricing vendors.

All single-class and multi-class mortgage-backed/asset-backed securities (e.g., CMOs) 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. For GAAP purposes, all securities, purchased or retained, that represent beneficial interests in securitized assets (e.g., CMO, CBO, CDO, CLO, MBS, and ABS securities), 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. If high credit quality securities are adjusted, the retrospective method is used.

Real estate owned and occupied by the Company is included in investments rather than reported as an operating asset, as under GAAP. Investment income and operating expenses for statutory reporting include rent for the Company's occupancy of those properties.

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.

1. Nature of Operations and Significant Accounting Policies (continued)

The initial valuation allowance and subsequent changes in the allowance for mortgage loans are charged or credited directly to unassigned surplus rather than included as a component of earnings, as would be required under GAAP.

Changes in investment admitted asset carrying amounts are credited or charged directly to unassigned surplus.

Valuation Reserves: Under a formula prescribed by the NAIC, the Company defers the portion of realized capital gains and losses on sales of fixed-income investments attributable to changes in the general level of interest rates and amortizes those deferrals over the remaining period to maturity based on groupings of individual securities sold in five-year bands. That net deferral is reported as the interest maintenance reserve (IMR) in the accompanying statutory-basis balance sheets. Realized capital gains and losses are reported in income, net of federal income tax and transfers to the IMR. Under GAAP, realized capital gains and losses would be reported in the income statement on a pretax basis in the period that the assets giving rise to the gains or losses are sold.

The asset valuation reserve (AVR) provides a valuation allowance for invested assets. The AVR is determined by an NAIC-prescribed formula, with changes reflected directly to unassigned surplus; AVR is not recognized for GAAP.

Policy Acquisition Costs: 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.

Nonadmitted Assets: Certain assets designated as "nonadmitted," principally agents' balances, furniture and equipment, and other assets not specifically identified as an admitted asset within the *NAIC Accounting Practices and Procedures Manual*, are excluded from the accompanying statutory-basis balance sheets and charged directly to unassigned surplus. Under GAAP, such assets are included in the balance sheet to the extent that those assets are not impaired.

1. Nature of Operations and Significant Accounting Policies (continued)

Universal Life and Annuity Policies: Revenues for universal life and annuity policies with mortality or morbidity risk consist of the entire premium received, and benefits incurred represent the total of death benefits paid, surrender benefits paid, and the change in policy reserves. Proceeds received for annuity policies without mortality or morbidity risk 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 account values.

Benefit Reserves: Certain policy reserves are calculated based on statutorily required interest and mortality assumptions rather than on estimated expected experience or actual account balances, as would be required under GAAP.

Reinsurance: Policy and contract liabilities ceded to reinsurers have been reported as reductions of the related reserves rather than as assets, as would be required under GAAP.

Commissions allowed by reinsurers on business ceded are reported as income when incurred rather than being deferred and amortized with deferred policy acquisition costs, as would be required under GAAP. In addition, liability for reinsurance balances has been provided for unsecured policy reserves ceded to reinsurers not authorized to assume such business. Changes to the liability are credited or charged directly to unassigned surplus. Under GAAP, an allowance for amounts deemed uncollectible would be established through a charge to earnings.

Employee Benefits: For purposes of calculating the Company's postretirement and postemployment benefit obligations, only vested participants and current retirees are included in the valuation. Under GAAP, active participants not currently eligible would also be included.

Deferred Income Taxes: The Company has elected to admit deferred tax assets pursuant to paragraph 10(e) of SSAP 10R, Realizable deferred tax assets are limited to (I) 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 he

1. Nature of Operations and Significant Accounting Policies (continued)

realized within three years of the balance sheet date or 15% of capital and surplus excluding any net deferred tax assets, electronic data processing (EDP) equipment, 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. 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.

Investment in Subsidiaries: Under NAIC SAP, investments in subsidiaries are carried at values prescribed by the Texas Department of Insurance and the NAIC, typically at audited statutory equity plus any unamortized goodwill. Under GAAP, investments in wholly owned subsidiaries are consolidated.

Policyholder Dividends: Policyholder dividends are recognized when declared rather than over the term of the related policies. Dividends are determined annually by the Company's Board of Directors. Individual ordinary life participating premium approximates 86% of the Company's ordinary life insurance collected premiums.

The effects of the foregoing variances from GAAP on the accompanying statutory-basis financial statements have not been determined, but are presumed to be material.

Other significant accounting practices are as follows:

Investments

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

Bonds are stated at amortized cost or, for certain bonds, at fair value as determined by the SVO or third-party pricing services, with related unrealized capital gains/losses reported in unassigned surplus, net of federal income tax.

1. Nature of Operations and Significant Accounting Policies (continued)

Bonds not backed by other loans are stated at amortized cost using the interest method. Loan-backed bonds and structured securities are valued at amortized cost using the interest method, including anticipated prepayments. Prepayment assumptions are obtained from broker dealer survey values 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.

Redeemable preferred stocks are reported at cost or amortized cost as determined by the SVO or third party pricing services.

Common stocks are reported at fair value as determined by the SVO or third-party pricing services, and the related unrealized capital gains or (losses) are reported in unassigned surplus, net of federal income taxes. The change in the statutory equity of its wholly owned subsidiary is recorded as a change in unrealized capital gains or (losses), a component of unassigned surplus, net of federal income tax.

There are no restrictions on common or preferred stock.

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.

Cash equivalents are short-term, highly liquid investments with original maturities of three months or less at time of acquisition and are principally stated at amortized cost.

Mortgage loans are reported at unpaid principal balances, less an allowance for impairment, as needed. 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, the impairment is other-than-temporary; the mortgage loan is written down to a realizable value and a realized loss is recognized.

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, with depreciation calculated on a straight-line basis over the estimated useful lives of the properties.

Real estate held for sale is carried at the lower of cost or market value.

1. Nature of Operations and Significant Accounting Policies (continued)

Policy loans are reported at their unpaid principal balance.

Realized capital gains and losses are determined using the specific-identification basis. Changes in admitted asset carrying amounts of bonds, mortgage loans, policy loans, and common and preferred stocks are credited or charged directly to unassigned surplus.

Furniture and Equipment

The Company's electronic data processing equipment and operating software are reported at cost, less accumulated depreciation. Depreciation is provided in amounts sufficient to charge the cost of electronic processing equipment and operating software to operations over the lesser of their estimated service lives, or three years, on a straight-line basis. Nonoperating software is depreciated on a straight-line basis over the lesser of its useful life or five years. Other furniture and equipment are depreciated on a straight-line basis over the lesser of their estimated service lives or five years. Depreciation and amortization expense charged to operations was $247,423 for 2011 and $320,542 for 2010.

Premiums

Life and accident and health premiums are recognized as revenue when due. Premiums for annuity policies with mortality and morbidity risk are also recognized as revenue when due. Premiums received for annuity policies without mortality or morbidity risk and for group annuity contracts are recorded using deposit accounting.

Benefit Reserves

Life, annuity, and accident and health benefit reserves are developed by actuarial methods and are determined based on published tables using statutorily-specified interest rates and valuation methods that will provide, in the aggregate, reserves that are greater than the minimum required by the Texas Department of Insurance.

The Company waives deduction of deferred fractional premiums upon the death of insureds and refunds any premium beyond the month of death. Surrender values on policies do not exceed the corresponding benefit reserves. Extra premiums are charged for substandard lives plus the gross premium for the true age. The mean-reserve method is used to adjust the calculated terminal reserve to the appropriate reserve at December 31. Mean reserves are determined by computing the regular mean reserve for the plan at the true age and holding, in addition, one-half of the

1. Nature of Operations and Significant Accounting Policies (continued)

extra premium charge for the year. An asset is recorded for deferred premiums, net of loading to adjust the reserve for modal premium payments. Additional reserves are established when the results of cash flow testing under various interest rate scenarios indicate the need for such reserves. There has been no need for such reserves.

As of December 31, 2011 and 2010, reserves of $1,398,882 and $1,351,290, respectively, were recorded on in-force amounts of $112,350,766 and $81,649,754, respectively, for which gross premiums are less than the net premiums according to the standard of valuation required by the Texas Department of Insurance.

The tabular interest, tabular cost less actual reserve released, and tabular cost have been determined by formula. For determination of tabular interest on funds not involving life contingencies, the tabular interest is actual interest credited or due on the accounts for the valuation year.

Deposit-Type Contracts

Deposit-type contracts consist primarily of dividend accumulations, premium deposits, and supplemental contracts not involving life contingencies and annuities certain. Premium deposits relate primarily to the MBA group business. Deposit-type contracts are increased and decreased according to the deposits and withdrawals, respectively, of the applicable policyholders, as well as by retrospectively rated credits and debits for favorable and unfavorable, respectively, underwriting and investment experience of the MBA business.

Unpaid Claims

The liability for unpaid policy and contract claims represents the estimate of the ultimate net cost of all reported and unreported claims incurred through year-end. The liability is estimated using individual case-basis valuations and Company history. Those estimates are subject to the effects of trends in claim severity and frequency. Although considerable variability is inherent in such estimates, management believes that the reserve for unpaid claims is adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

1. Nature of Operations and Significant Accounting Policies (continued)

Reinsurance

Reinsurance premiums and benefits paid or provided are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Guaranty Fund Assessments

Guaranty fund assessments are accrued when the Company receives notice or other information that a reasonably estimable amount is or is likely to be payable to a guaranty fund.

Use of Estimates

The preparation of statutory-basis financial statements requires management to make estimates and assumptions that affect amounts reported in the 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. Significant estimates in the accompanying financial statements include reserves for policy benefits.

2. Investments

Bonds: The amortized cost and the fair value of investments in bonds are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2011				
U.S. Government and agencies	**$ 58,007,264**	**$ 5,852,841**	**$ (33,865)**	**$ 63,826,240**
State and political subdivisions	**210,059,713**	**21,024,728**	**(717,972)**	**230,366,469**
Corporate securities	**272,284,451**	**31,605,416**	**(3,099,074)**	**300,790,793**
Mortgage-backed securities	**498,137**	**72,003**	**–**	**570,140**
Total bonds	**$ 540,849,565**	**$ 58,554,989**	**$ (3,850,911)**	**$ 595,553,642**
At December 31, 2010				
U.S. Government and agencies	$ 44,171,019	$ 3,645,473	$ (100,501)	$ 47,715,991
State and political subdivisions	201,340,852	1,681,300	(5,042,681)	197,979,471
Corporate securities	286,336,244	22,785,539	(2,761,435)	306,360,348
Mortgage-backed securities	4,648,932	372,896	–	5,021,828
Total bonds	$ 536,497,047	$ 28,485,208	$ (7,904,617)	$ 557,077,638

2. Investments (continued)

The following table shows gross unrealized losses and fair values of bonds, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2011						
U.S. Government and agencies	$ 9,991,775	$ (33,865)	$ –	$ –	$ 9,991,775	$ (33,865)
State and political subdivisions	2,708,520	(321,034)	3,308,678	(396,938)	6,017,198	(717,972)
Corporate securities	20,230,968	(1,093,839)	11,696,079	(2,005,235)	31,927,047	(3,099,074)
Total bonds	$ 32,931,263	$ (1,448,738)	$ 15,004,757	$ (2,402,173)	$ 47,936,020	$ (3,850,911)

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2010						
U.S. Government and agencies	$ 7,123,870	$ (100,501))	$ –	$ –	$ 7,123,870	$ (100,501)
State and political subdivisions	103,052,223	(3,384,549)	17,304,595	(1,658,132)	120,356,818	(5,042,681)
Corporate securities	20,395,051	(663,570)	27,253,709	(2,097,865)	47,648,760	(2,761,435
Total bonds	$ 130,571,144	$ (4,148,620)	$ 44,558,304	$ (3,755,997)	$ 175,129,448	$ (7,904,617)

A summary of the amortized cost and fair value of the Company's investments in bonds at December 31, 2011, by contractual maturity, is as follows:

	Amortized Cost	Fair Value
Years to maturity:		
One or less	$ 17,720,905	$ 18,250,583
After one through five	90,446,966	98,587,232
After five through ten	85,478,500	95,434,420
After ten	346,705,057	382,711,267
Mortgage-backed securities	498,137	570,140
Total	$ 540,849,565	$ 595,553,642

2. Investments (continued)

The actual maturities may differ from the contractual maturities in the foregoing table because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from sales of investments in bonds during 2011 and 2010 were $25,312,250 and $70,895,110, respectively; gross gains of $1,746,728 and $3,498,800 and gross losses of $0 and $283,940 were realized on those sales, respectively.

At December 31, 2011, bonds with an admitted asset value of $7,338,373 were on deposit with state insurance departments to satisfy regulatory requirements.

Stocks: Unrealized gains and losses on investments in common stocks are reported directly in unassigned surplus and do not affect operations.

Effective November 1, 2010, the Company recorded the statutory purchase of 100% of the 100,000 outstanding common stock shares of Texas Directors Life Insurance Company (TDLIC). TDLIC is licensed only in Texas for the sale of individual life products exclusively. The cost of the acquired company was $1,766,144, resulting in goodwill in the amount of $1,498,778. The amortization of goodwill during 2011 was $149,878. Net unamortized goodwill is included within common stocks in the accompanying statutory-basis balance sheets. Effective December 31, 2010, the Company purchased the remaining 100,000 authorized but unissued common shares of TDLIC.

The cost and fair value of investments in preferred stocks and common stocks are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2011				
Preferred stocks	**$ 3,017,100**	**$ 37,900**	**$ (285,350)**	**$ 2,769,650**
Affiliated common stocks	**$ 1,866,144**	**$ –**	**$ (7,456)**	**$ 1,858,688**
Unaffiliated common stocks	**2,692,955**	**453,334**	**(284,588)**	**2,861,701**
Total common stocks	**$ 4,559,099**	**$ 453,334**	**$ (292,044)**	**$ 4,720,389**

2. Investments (continued)

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2010				
Preferred stocks	$ 3,017,100	$ 30,000	$ (139,675)	$ 2,907,425
Affiliated common stocks	$ 1,866,144	$ –	$ (9,079)	$ 1,857,065
Unaffiliated common stocks	3,063,133	573,705	(82,429)	3,554,409
Total common stocks	$ 4,929,277	$ 573,705	$ (91,508)	$ 5,411,474

The following table shows gross unrealized losses and fair values of preferred and common stocks, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2011						
Stocks:						
Preferred stocks	$ –	$ –	$ 1,731,750	$ (285,350)	$ 1,731,750	$ (285,350)
Common stocks	578,282	(136,121)	2,265,338	(155,923)	2,843,620	(292,044)
Total	$ 578,282	$ (136,121)	$ 3,997,088	$ (441,273)	$ 4,575,370	$ (577,394)
December 31, 2010						
Stocks:						
Preferred stocks	$ 1,877,425	$ (139,675)	$ –	$ –	$ 1,877,425	$ (139,675)
Common stocks	68,838	(1,794)	2,706,106	(89,714)	2,774,944	(91,508)
Total	$ 1,946,263	$ (141,469)	$ 2,706,106	$ (89,714)	$ 4,652,369	$ (231,183)

Mortgage Loans: During 2011, the minimum and maximum lending rates for mortgage loans were 5.40% and 6.37%, respectively. At the issuance of a loan, the percentage of loan to value on any one loan does not exceed 75%. Fire insurance is required on all properties covered by mortgage loans at least equal to the excess of each loan over the maximum loan that would be permitted by law on the land without the buildings. At December 31, 2011 and 2010, the Company held no mortgages with interest overdue beyond 180 days. There was no nonadmitted interest or principal at December 31, 2011 and 2010.

2. Investments (continued)

At December 31, 2011 and 2010, taxes, assessments, and amounts advanced not included in the mortgage loan total were $30,354 and $13,642, respectively. At December 31, 2011, none of the Company's investments in mortgage loans were subject to prior liens.

The Company's investments in mortgage loans all involve commercial real estate. At December 31, 2011, all such mortgages involve properties located in the states of Texas, Arizona, Utah, New Mexico, Colorado, Nevada, and Alabama. Such investments consist of first mortgage liens on completed income-producing properties. At December 31, 2011, the mortgage outstanding on any individual property did not exceed $4,000,000.

The total recorded investment in restructured loans at December 31, 2011 and 2010, was $2,241,321 and $2,842,220, respectively. There were no realized capital losses related to these loans. There were no contractual commitments to extend credit to debtors owing receivables whose terms have been modified in troubled debt restructurings. The Company accrues interest income on impaired loans to the extent deemed collectible and the loan continues to perform under its original or restructured contractual terms. Interest income on nonperforming loans generally is recognized on an accrual basis to the extent deemed collectible.

During 2011, the Company established a $330,000 valuation allowance on a loan that was restructured in 2005. During 2010, the Company foreclosed on two investment properties in Salt Lake City, Utah, and transferred the foreclosed properties to its real estate investments. In addition, during 2010, the Company established a $100,000 valuation allowance on a third loan.

Real Estate: Properties held for the production of income includes two properties adjacent to the Home Office property and three foreclosed properties. Two of the foreclosed properties were added in 2010. Also included are two condominiums purchased for the use of Company employees. At December 31, 2011, the condominiums were reclassified to residential as a result of the Texas Department of Insurance financial examination and therefore nonadmitted.

Real Estate Held for Sale: The Company held one property for sale at December 31, 2011 for which a write down of $997,177 was recorded.

2. Investments (continued)

Net Investment Income: Net investment income consists of the following:

	Year Ended December 31	
	2011	**2010**
Income:		
Bonds	**$ 31,773,649**	$ 32,016,355
Preferred stocks	**193,875**	163,250
Common stocks	**103,788**	88,399
Mortgage loans	**8,830,840**	8,411,738
Real estate[1]	**1,306,452**	1,200,638
Policy loans	**4,748,754**	4,806,882
Short-term investments and cash	**7,296**	12,271
Other	**157,693**	12,819
Total investment income	**47,122,347**	46,712,352
Expenses:		
Real estate operating and maintenance	**1,172,717**	1,180,184
Real estate taxes	**212,008**	235,656
Depreciation	**385,547**	358,886
Other	**1,122,936**	1,178,610
Total investment expenses	**2,893,208**	2,953,336
Net investment income	**$ 44,229,139**	$ 43,759,016

[1]Real estate includes $674,745 in 2011 and $674,745 in 2010 for the Company's occupancy of its own building.

2. Investments (continued)

Realized Capital Gains (Losses): Realized capital gains (losses) are reported net of federal income taxes and amounts transferred to the IMR as follows:

	Year Ended December 31 2011	2010
Realized capital gains (losses)	$ **535,538**	$ 3,166,159
Less amount transferred to IMR (net of related taxes of $573,880 in 2011 and $1,150,227 in 2010)	**1,114,003**	2,232,794
	(578,465)	933,365
Less federal income tax (benefit) expense on realized capital (losses) gains realized capital gains (losses)	**555,110**	(499,422)
	$ **(1,133,575)**	$ 1,432,787

Asset Impairments – Other-Than-Temporary: Management regularly reviews the value of the Company's investments. If the value of any investment falls below its cost basis, the decline is analyzed to determine whether it is an other-than-temporary decline in value. To make this determination for each security, the following is considered:

- How long and by how much the fair value has been below its cost
- The financial condition and near-term prospects of the issuer of the security, including any specific events that may affect its operations or earnings potential
- Management's intent to hold the security long enough for it to recover its value
- Any downgrades of the security by a rating agency
- Any reduction or elimination of dividends, or nonpayment of scheduled interest payments
- The impact interest rates have had on the value of the security

2. Investments (continued)

Loan-Backed Securities: The Company held two Collateralized Debt Obligations for which the present value of the cash flows expected to be collected is less than the amortized cost basis of the security. The Company recorded losses of $169,585 during 2011 on these two loan-backed bonds considered to be impaired. A loss of $448,903 was recorded on the same bonds in 2010.

None of the bonds are held with the intent to sell nor with the inability or lack of intent to retain the investment for a period of time sufficient to recover the amortized cost basis.

Held securities with a recognized other-than-temporary impairment, as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities:

Description	Pre-OTTI Amortized Cost Basis	Current-Year OTTI Realized	Fair Value	Post-OTTI Amortized Cost Basis
Trapeza CDO	$ 454,841	$ 108,402	$ 43,306	$ 346,439
ALESCO Pref Fdg, Ltd.	$ 430,353	$ 61,183	$ 98,818	$ 369,170

The following bonds have fair values below the amortized cost of the bonds for which an interest-related impairment remains as of December 31, 2011. Other-than-temporary impairments have been recognized for noninterest-related declines. All of the bonds have been in a continuous unrealized loss positions for more than 12 months.

Description	a. Unrealized Loss	b. Fair Value
ALESCO Pref FDG. Ltd.	$ 270,352	$ 98,818
Trapeza CDO LLC	303,133	43,306
Totals	$ 573,485	$ 142,124

2. Investments (continued)

The Company reviewed the cash flows of impaired loan-backed bonds and determined that the present values of the cash flows for two bonds was less than the amortized cost of the bonds. Based on this determination and the fact that the Company had no intent to sell the bonds and did not lack the ability to hold the bonds until the cash flows were received, the Company impaired the bonds to the present value of the projected cash flows. The Company considers the probable return of principal in a bond, the ability of the Company to hold the bond until the fair value can reach the amortized book value, and whether the borrower has filed bankruptcy in concluding that a bond should be other-than-temporarily impaired.

There were no bonds held by the Company where it was not practicable to estimate fair value. All bonds and stocks that have a fair value below 80% of amortized book value are reviewed quarterly.

Stocks: No common stocks were impaired during 2011 or 2010.

Mortgages: During 2011 The Company held a valuation allowance of $430,000 and $100,000 at year-end 2011 and 2010 respectively. The Company had no mortgage loans that were considered to be other-than-temporarily impaired.

Real Estate: During 2010, the Company foreclosed on two mortgage loans. The loans were written down by $79,784 to equal the appraised value of the properties. The properties were classified as held for investment as of December 31, 2010 and 2011. During 2011, the Company accepted an offer for the purchase of a previously foreclosed property. The carrying value of the property was impaired by $997,177 to equal the offer price. The property was classified as held for sale as of December 31, 2011, with the sale of the property expected to close during the second or third quarter of 2012. The loss is recorded as a realized loss in the summary of operations.

Market Segment Concentrations

The Company has $88,744,523 in corporate bonds of banks, insurance, and finance related corporations. In the event of a severe market event in this segment, the Company could lose a material amount in these investments. At year-end, there was a net unrealized gain of $4,042,157 on this exposure to the financial industry.

3. Fair Values

The fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties. The fair value of a liability is the amount at which the liability could be incurred or settled in a current transaction between willing parties.

Fair values are based on SVO or other third-party quoted market prices when available. If quoted market prices are not available for the specific security, then fair values are estimated by using pricing models utilized by an independent pricing service to ascertain the fair values. Fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality (matrix pricing). In instances where there is little or no market activity for the same or similar instruments, we estimate fair value using methods, models, and assumptions that management believes market participants would use to determine a current transaction price. These valuation techniques involve some level of management estimation and judgment, which becomes significant with increasingly complex instruments or pricing models. Where appropriate, adjustments are included to reflect the risk inherent in a particular methodology, model, or input used.

Our financial assets and liabilities carried at fair value have been classified, for disclosure purposes, based on a hierarchy defined by SSAP 100. SSAP 100 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows.

> Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
>
> Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
>
> Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

3. Fair Values (continued)

Included in various investment-related line items in the financial statements are certain financial instruments carried at fair value. Other financial instruments are periodically measured at fair value, such as certain bonds and preferred stock when carried at the lower of cost or fair value. As of December 31, 2011, the Company's investments reported at fair value were $142,124 in Level 3 and $4,720,389 of common stocks in Level 1. As of December 31, 2010, the Company's investments reported at fair value were $194,842 in Level 3 and $3,554,409 of common stock in Level 1.

There were no significant transfers between Levels during 2011.

The table below includes a rollforward for assets classified within the Level 3 hierarchy.

	Bonds Industrial and Miscellaneous
Assets at fair value, January 1, 2011	$ 194,842
Transfers into Level 3	–
Transfers out of Level 3	–
Total realized losses included in net income	–
Other-than-temporary impairment recognized	(169,585)
Total unrealized (losses) gain included in surplus	(131,330)
Purchases, issuances, and settlements (net):	
Purchases	–
Sales	–
Payment-in-kind dividends	248,197
Assets at fair value, December 31, 2011	$ 142,124

We classify our investment in certain debt securities as Level 3 securities. The fair value of the bonds is valued using unobservable inputs since independent pricing information is not available for these securities.

3. Fair Values (continued)

As of December 31, 2011, the reported fair value of the Company's investment in Level 3, NAIC rated 6, Collateralized Debt obligations, (CDO's), were $142,124. This consists of two bonds backed by the preferred stock of banks, insurance companies, and REITS. Both are mezzanine tranches. To value these securities, the Company uses discounted projected cash flows. The cash flows from the CDO's are obtained from Morgan Keegan through Intex. The cash flows are then valued based on current defaults and deferrals at an interest approximately 10% above the current 10-year US Treasury. The bonds are then carried at the present value of the cash flows at that discount level.

Other methods and assumptions used by the Company in estimating the fair value disclosures for financial instruments in the accompanying statutory-basis financial statements are as follows:

Cash, Short-Term Investments, and Receivables for Securities: The carrying amounts reported in the accompanying statutory-basis balance sheets for these financial instruments approximate their fair values due to the short-term nature of such instruments.

Policy Loans: The carrying amounts reported in the accompanying statutory-basis balance sheets for these financial instruments approximate their fair values.

Investment Securities: The fair values for fixed-maturity securities are based on unit prices prescribed by the SVO or, in the absence of SVO unit prices or when amortized cost is used by the SVO as the unit price, quoted market prices by other third-party organizations. The fair value of mortgage-backed securities is based on quoted market prices by third-party organizations. The fair values for equity securities are based on fair values prescribed by the SVO.

Mortgage Loans: The fair values for mortgage loans are estimated using weighted average maturity analyses, using interest rates currently being offered for similar loans to borrowers with similar credit ratings. Loans with similar characteristics are aggregated for purposes of the calculations.

Investment Contracts: The fair values for the Company's liabilities under investment-type insurance contracts are estimated using discounted cash flow calculations, based on interest rates currently being offered for similar contracts with maturities consistent with those remaining for the contracts being valued.

3. Fair Values (continued)

The carrying amounts and fair values of the Company's financial instruments at December 31 were as follows:

	2011		2010	
	Carrying Value	**Fair Value**	**Carrying Value**	**Fair Value**
Bonds	**$ 540,849,565**	**$ 595,553,642**	$ 536,497,047	$ 557,077,638
Preferred stocks	**3,017,100**	**2,769,650**	3,017,100	2,907,425
Common stocks	**4,720,389**	**4,720,389**	5,411,474	5,411,474
Mortgage loans	**134,658,370**	**150,368,962**	123,670,619	120,030,271
Policy loans	**73,390,041**	**73,390,041**	73,657,571	73,657,571
Short-term investments	**11,794,233**	**11,794,233**	21,856,434	21,856,434
Cash	**17,022,483**	**17,022,483**	5,015,061	5,015,061
Receivables for securities	**19,687**	**19,687**	19,688	19,688

The carrying amounts and fair values of the Company's liabilities for investment-type insurance contracts at December 31 were as follows:

	2011		2010	
	Carrying Value	**Fair Value**	**Carrying Value**	**Fair Value**
Individual annuities	**$ 82,371,614**	**$ 81,788,521**	$ 82,149,687	$ 81,416,013
Supplemental contracts not involving life contingencies	**19,066,748**	**19,817,534**	18,700,186	19,293,804

The fair values for the Company's insurance contracts other than investment contracts are not required to be disclosed. However, the fair values of liabilities under all insurance contracts are taken into consideration in the Company's overall management of interest rate risk, such that the Company's exposure to changing interest rates is minimized through the matching of investment maturities with amounts due under insurance contracts.

4. Reinsurance

Certain premiums and benefits are assumed from and ceded to other insurance companies under various reinsurance agreements. The ceded reinsurance agreements provide the Company with increased capacity to write larger risks. The Company remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations.

Amounts payable or recoverable for reinsurance on policy and contract liabilities are not subject to periodic or maximum limits. The Company has $1,463,457 of amounts recoverable on paid losses and commissions and expense allowances due from a single reinsurer. This amount does not exceed 3% of the Company's total surplus at December 31, 2011.

The Company has entered into a reinsurance agreement in which the reinsurer may unilaterally cancel any reinsurance for reasons other than nonpayment of premiums or other similar credits. The total amount of reinsurance credits taken for this agreement at December 31, 2011 and 2010 was $23,733,491 and $21,026,318, respectively.

The Company does not have any reinsurance agreements in effect in which the amount of losses paid or accrued through December 31, 2011, would result in a payment to the reinsurer of amounts that, in the aggregate and allowing for offset of mutual credits from other insurance agreements with the same reinsurer, exceed the total direct premiums collected under the reinsured policies.

The amounts related to the Company's ceded and assumed reinsurance arrangements for life insurance are summarized as follows:

	Ceded to Other Companies	Assumed From Other Companies
2011		
Premiums for the year ended December 31	**$ 29,955,914**	**$ 654,874**
Benefits paid or provided for the year ended December 31	**19,545,345**	**560,953**
Credit taken against policy and contract liabilities at December 31	**41,689,338**	**–**
2010		
Premiums for the year ended December 31	$ 21,638,131	$ 613,684
Benefits paid or provided for the year ended December 31	14,311,469	591,742
Credit taken against policy and contract liabilities at December 31	37,175,176	–

5. Retrospectively-Rated Contracts

In October 2001, the Company became the group carrier for the MBA, a nonprofit association of military and civil service personnel. Group term life and health policies were issued to the MBA. These policies can be terminated on anniversary, with notice. Members of the MBA field of membership are eligible to apply for group term life coverage or group TRICARE supplement insurance. Life coverage is individually underwritten. Coverage from the prior carrier was continued in the new group policies. The contract with the MBA requires that the MBA maintain a premium stabilization fund (PSF) with the Company. The group is experience-rated, and the PSF will increase or decrease depending on the experience for the year. Interest is credited at the end of each fiscal year. A refund to members is considered annually and is paid at various levels when considered appropriate. The PSF level is currently in excess of a reserve that would be required for group term life; as such, no additional reserves are held. The PSF is held as a deposit reserve. Claim reserves are held separately for both life and health claims.

The Company estimates accrued retrospective premium adjustments for its group association life and health insurance business using the refund calculation specified in the agreement with the association and records them as an adjustment to earned premium. The amount of net premiums collected by the Company at December 31, 2011, that are subject to retrospective-rating features was \$5,323,032 in group life and \$1,369,311 in group health. The net premiums represent 99% of the group life and 100% of the group health premiums collected. No other net premiums are subject to retrospective-rating features.

The full balance of retrospective premium adjustments is admitted and considered collectible.

6. Federal Income Taxes

Income before federal income taxes differs from taxable income, principally due to the differences in timing for recognizing accrual of market discounts on bonds; deferred compensation; policyholder dividends; dividends-received tax deductions; policy acquisition costs; interest maintenance reserve; and differences in reserves for policy and contract liabilities for tax and financial reporting purposes.

In November 2011, the NAIC issued SSAP 101, *Income Taxes*, a replacement of SSAP No. 10R and SSAP No. 10. This statement, which is a permanent replacement of existing guidance, establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes. This statement changes the statutory accounting for income

6. Federal Income Taxes (continued)

taxes in two key areas related to tax loss contingencies and the admissibility of deferred tax assets. This guidance will be effective January 1, 2012, and is not expected to have a material impact on the financial statements.

The components of the net deferred tax assets (DTAs) and deferred tax liabilities (DTLs) for the year ended December 31 are as follows:

	2011			2010		
	Ordinary	**Capital**	**Total**	**Ordinary**	**Capital**	**Total**
Gross deferred tax asset	**$ 18,609,639**	**$ 3,718,607**	**$ 22,328,246**	$ 18,816,919	$ 2,902,609	$ 21,719,528
Statutory valuation allowance	**–**	**–**	**–**	–	–	–
Adjusted gross deferred tax asset	**18,609,639**	**3,718,607**	**22,328,246**	18,816,919	2,902,609	21,719,528
Deferred tax liability	**3,939,496**	**187,601**	**4,127,097**	3,958,858	196,767	4,155,625
Net deferred tax asset	**14,670,143**	**3,531,006**	**18,201,149**	14,858,061	2,705,842	17,563,903
Deferred tax asset nonadmitted	**2,981,665**	**3,191,966**	**6,173,631**	3,277,822	2,705,842	5,983,664
Net admitted deferred tax asset	**$ 11,688,478**	**$ 339,040**	**$ 12,027,518**	$ 11,580,239	$ –	$ 11,580,239

Increase (decrease) in deferred tax asset non-admitted $189,967 $(1,723,070)

The Company has elected to admit deferred tax assets pursuant to paragraph 10e of SSAP10R.

The Company's admitted adjusted gross deferred tax assets under SSAP 10R paragraphs 10a,b,c and SSAP 10R paragraph 10e are as follows:

	2011			2010		
	10a,b,c	**10e**	**Difference**	**10a,b,c**	**10e**	**Difference**
Ordinary	**$ 12,429,516**	**$ 15,627,974**	**$ 3,198,458**	$ 12,407,556	$ 15,539,097	$ 3,131,541
Capital	**526,641**	**526,641**	**–**	196,767	196,767	–
Total	**$ 12,956,157**	**$ 16,154,615**	**$ 3,198,458**	$ 12,604,323	$ 15,735,864	$ 3,131,541

6. Federal Income Taxes (continued)

The Company's admitted adjusted gross deferred tax assets under SSAP10R are as follows:

	2011			2010		
	Ordinary	Capital	Total	Ordinary	Capital	Total
Paragraphs 10a, 10b and 10c:						
Federal tax paid in carryback years (10a)	$ 6,558,577	$ 339,040	$ 6,897,617	$ 6,346,865	$ –	$ 6,346,865
Lesser of:						
Deferred taxes expected to be realized within 1 year (10bi)	1,931,443	–	1,931,443	2,101,833	–	2,101,833
10% of statutory capital of previously filed statement (10bii)						
Amount of gross DTA's that can be offset against DTL's (10c)	3,939,496	187,601	4,127,097	3,958,858	196,767	4,155,625
Admitted deferred tax asset – SSAP 10R paragraphs 10a, 10b and 10c	$ 12,429,516	$ 526,641	$ 12,956,157	$ 12,407,556	$ 196,767	$ 12,604,323
Paragraphs 10e:						
Federal tax paid in carryback years (10ei)	$ 6,558,577	$ 339,040	$ 6,897,617	$ 6,346,865	$ –	$ 6,346,865
Lesser of:						
Deferred taxes expected to be realized within 3 years (10eii(a))	5,129,901	–	5,129,901	5,233,374	–	5,233,374
15% of statutory capital of previously filed statement (10eii(b))						
Amount of gross DTA's that can be offset against DTL's (10eiii)	3,939,496	187,601	4,127,097	3,958,858	196,767	4,155,625
Admitted deferred tax asset – SSAP 10R paragraph 10e	$ 15,627,974	$ 526,641	$ 16,154,615	$ 15,539,097	$ 196,767	$ 15,735,864
The risk-based capital level for the test in paragraph 10(d) is						
Total adjusted capital in the risk-based capital calculation	–	–	$ 114,066,286	–	–	$ 109,075,435
Authorized control level of risk-based capital			9,224,638			9,263,306
Applicable % for application of SSAP 10R			1237%			1178%

The impact of SSAP 10R is as follows:

	2011			2010		
	Ordinary	Capital	Total	Ordinary	Capital	Total
SSAP 10R , paragraph 10a, 10b, 10c						
a. Admitted deferred tax assets	$ 12,429,516	$ 526,641	$ 12,956,157	$ 12,407,556	$ 196,767	$ 12,604,323
b. Admitted assets			$ 830,927,770			$ 818,066,491
c. Statutory surplus			$ 93,796,322			$ 88,916,528
d. Total adjusted Capital from DTAs			$ 12,956,157			$ 12,604,323
Increase due to SSAP 10R, paragraph 10e.						
e. Admitted deferred tax assets	$ 3,198,458	$ –	$ 3,198,458	$ 3,131,541	$ –	$ 3,131,541
f. Admitted assets	$ 3,198,458	$ –	$ 3,198,458	$ 3,131,541	$ –	$ 3,131,541
g. Statutory surplus	$ 3,198,458	$ –	$ 3,198,458	$ 3,131,541	$ –	$ 3,131,541

6. Federal Income Taxes (continued)

At December 31, 2011, tax planning strategies did not impact adjusted gross deferred tax assets or net admitted deferred tax assets.

There were no unrecognized deferred tax liabilities as of December 31, 2010 and 2009. The major components of the deferred tax amounts are as follows:

	2011	2010	Change
Deferred tax assets-ordinary:			
Reserves	$ 7,205,653	$ 7,511,602	$ (305,949)
Proxy DAC	4,499,597	4,615,724	(116,127)
Dividends apportioned for payment	2,244,000	2,278,000	(34,000)
Accrued deferred compensation	1,834,676	1,798,982	35,694
Postretirement benefits and other general expenses	1,354,542	1,207,911	146,631
Other	1,471,171	1,404,700	66,471
Subtotal ordinary deferred tax assets	18,609,639	18,816,919	(207,280)
Ordinary deferred tax assets nonadmitted	2,981,665	3,277,822	(296,157)
Admitted ordinary deferred tax assets	15,627,974	15,539,097	88,877
Capital:			
Premium bonds	106,699	141,098	(34,399)
Other-than-temporary impairments	2,981,597	2,577,178	404,419
Unrealized capital losses	341,185	184,333	156,852
Real estate	289,126	–	289,126
Subtotal capital deferred tax assets	3,718,607	2,902,609	815,998
Capital deferred tax assets nonadmitted	3,191,966	2,705,842	486,124
Admitted capital deferred tax assets	526,641	196,767	329,874
Total admitted deferred tax assets	16,154,615	15,735,864	418,751
Deferred tax liabilities:			
Ordinary:			
Depreciable assets	72,259	34,599	37,660
Deferred and uncollected premiums	3,051,484	3,110,836	(59,352)
Market discount	577,746	637,981	(60,235)
Reserve change	51,572	48,656	2,916
Other	186,435	126,786	59,649
Subtotal ordinary deferred tax liabilities	3,939,496	3,958,858	(19,362)
Capital:			
Unrealized capital gain	114,290	172,440	(58,150)
Real estate	73,311	24,327	48,984
Subtotal capital deferred tax liabilities	187,601	196,767	(9,166)
Total deferred tax liabilities	4,127,097	4,155,625	(28,528)
Net deferred tax assets/liabilities	$ 12,027,518	$ 11,580,239	$ 447,279

6. Federal Income Taxes (continued)

Current income taxes incurred consist of the following major components:

	2011	2010	Change
Ordinary:			
Total gross deferred tax assets	**$ 22,328,246**	$ 21,719,528	$ 608,718
Total gross deferred tax liabilities	**4,127,097**	4,155,625	(28,528)
Net deferred tax asset (including unrealized capital gains)	**18,201,149**	17,563,903	637,246
Deferred tax on change in net unrealized capital gains			(215,002)
Change in net deferred income tax(excluding unrealized capital gains)			$ 422,244

Current income taxes incurred consist of the following major components:

	2011	2010	Change
Federal income tax on operations	**$ 3,065,154**	$ 2,298,500	$ 766,654
Prior year over/under accrual	**(261,199)**	(363,878)	102,679
Federal income tax on operations incurred	**2,803,955**	1,934,622	869,333
Federal income tax on net realized capital gains (losses)	**555,110**	(499,422)	1,054,532
Current federal income tax incurred (benefit)	**$ 3,359,065**	$ 1,435,200	$ 1,923,865

6. Federal Income Taxes (continued)

Reconciliation of Federal Income Tax Rate to Actual Effective Rate

The significant items causing a difference between the statutory federal income tax rate and the Company's effective income tax rate are as follows:

	2011	Effective Tax Rate	2010	Effective Tax Rate
Provision computed at statutory rate	**$ 3,849,558**	**34.05%**	$ 3,711,580	34.00%
Amortization of interest maintenance reserve	**(400,638)**	**(3.54)**	(353,197)	(3.24)
Nondeductible items	**7,959**	**0.07**	9,035	0.08
Change in nonadmitted assets	**(499,391)**	**(4.42)**	(143,982)	(1.32)
Prior year true-up	**(33,816)**	**(0.30)**	(11,144)	(0.10)
Other	**13,149**	**0.12**	(7,608)	(0.07)
Total effective tax	**$ 2,936,821**	**25.98%**	$ 3,204,684	29.35%
Federal and foreign income taxes incurred	**$ 3,359,065**	**29.71%**	$ 1,435,200	13.15%
Change in net deferred income taxes	**(422,244)**	**(3.74)**	1,769,484	16.20
Total statutory income taxes	**$ 2,936,821**	**25.97%**	$ 3,204,684	29.35%

The Company does not have any operating loss or tax credit carryforwards available for tax purposes. Federal taxes available for recovery in the event of the carryback of future operations loss deductions are as follows:

	Ordinary	Capital	Total
2011	**$ 3,065,154**	**$ 539,846**	**$ 3,605,000**
2010	2,037,299	–	2,037,299
2009	1,456,122	–	1,456,122

The Company does not have any deposits admitted under Section 6603 of the IRS Code.

6. Federal Income Taxes (continued)

Consolidated Return:

Although the company has a consolidation agreement with its wholly owned subsidiary, Texas Directors Life Insurance Company, Government Personnel Mutual did not consolidate for 2010 and does not plan to consolidate for 2011. The method of allocation is subject to written agreement with the wholly owned subsidiary. The method of allocation between the companies is based upon separate-return calculations with current credit for net losses. Intercompany tax balances are settled annually within 90 days after the federal income tax return is completed and filed. The agreement is on file with the Texas Department of Insurance.

7. Surplus

Unassigned surplus funds were earned by the participating policyholders. There are no restrictions on the unassigned surplus.

Life/health insurance companies are subject to certain risk-based capital (RBC) requirements as specified by the NAIC. Under those requirements, the amount of surplus to be maintained by a life/health insurance company is to be determined based on the various risk factors related to it. At December 31, 2011 and 2010, the Company exceeded the RBC requirements.

The main components of the change in nonadmitted assets are as follows:

	2011	**2010**	**Change**
Investment real estate	**$ 850,372**	$ –	$ 850,372
Furniture and equipment	**303,311**	132,555	170,756
Nonoperating software	**758,209**	549,809	208,400
Miscellaneous receivables and deposits	**525,091**	508,698	16,393
Agent balances	**2,338,884**	2,130,318	208,566
Policy loans and investment income due	**80,048**	68,042	12,006
Deferred tax assets	**6,173,631**	5,983,664	189,967
	$ 11,029,546	$ 9,373,086	1,656,460
Change as a result of SSAP 10R adoption			(66,917)
			$ 1,723,377

7. Surplus (continued)

The Company elected to admit deferred tax assets pursuant to paragraph 10.e of SSAP 10R. The additional amount admitted and reported as special surplus funds was \$3,198,458 and \$3,131,541 at year-end 2011 and 2010, respectively.

8. Leases

The Company leases office equipment under various noncancelable operating lease agreements that expire at various intervals through 2015. Rental expense was approximately \$262,000 and \$236,000 during 2011 and 2010, respectively. At January 1, 2012, future minimum payments under noncancelable leases are as follows (in thousands):

2012	$	217
2013		169
2014		79
2015		38
	$	503

9. Commitments and Contingencies

The Company is named as a defendant in various legal actions arising principally from claims made under life insurance policies. Those actions are considered by the Company in estimating the policy and contract liabilities. The Company's management believes that the resolution of those actions will not have a material effect on the Company's financial position or results of operations.

10. Annuity Reserves

At December 31, 2011 and 2010, the Company's annuity reserves and deposit fund liabilities that were subject to discretionary withdrawal (with adjustment), subject to discretionary withdrawal (without adjustment) and not subject to discretionary withdrawal provisions are summarized as follows:

	At December 31, 2011	
	Amount	**Percent**
Subject to discretionary withdrawal (with adjustment):		
(1) With market value adjustment	$ –	–%
(2) At book value less current surrender charge of 5% or more	14,412,082	8.17
(3) At market value	–	–
(4) Total with adjustment or at market value	14,412,082	8.17
(5) At book value without adjustment (minimal or no charge or adjustment)	115,830,025	65.68
Not subject to discretionary withdrawal	46,108,672	26.15
Total gross	176,350,779	100.00%
Reinsurance ceded	21,588,083	
Total (net)	$ 154,762,696	

	At December 31, 2011	
	Amount	**Percent**
Subject to discretionary withdrawal (with adjustment):		
(1) With market value adjustment	$ –	–%
(2) At book value less current surrender charge of 5% or more	16,673,722	9.62
(3) At market value	–	–
(4) Total with adjustment or at market value	16,673,722	9.62
(5) At book value without adjustment (minimal or no charge or adjustment)	112,686,154	64.98
Not subject to discretionary withdrawal	44,043,321	25.40
Total gross	173,403,197	100.00%
Reinsurance ceded	18,844,495	
Total (net)	$ 154,558,702	

11. Life Premium and Annuity Considerations Deferred and Uncollected

Deferred and uncollected life insurance premiums and annuity considerations at December 31, 2011 and 2010, were as follows:

Type	Gross	Net of Loading
At December 31, 2011:		
Ordinary life new business	**$ 1,116,912**	**$ 243,238**
Ordinary life renewal	**9,989,216**	**8,339,933**
Individual annuity	**987**	**873**
Group life	**438,532**	**438,533**
Group accident and health	**134,608**	**134,608**
Total	**$ 11,680,255**	**$ 9,157,185**
At December 31, 2010:		
Ordinary life new business	$ 1,103,664	$ 225,662
Ordinary life renewal	10,196,372	8,575,324
Individual annuity	987	873
Group life	439,177	439,177
Total	$ 11,740,200	$ 9,241,036

12. Employee Benefits

Company employees are covered by a qualified defined-contribution (Section 401(k)) plan sponsored by the Company. Assets are held under various elective separate investment accounts by the Massachusetts Mutual Life Insurance Company (Springfield, Massachusetts).

Matching contributions are made at 62.5% on participants' contributions of up to 6% of their salary. The Company's contributions to the plan were $193,393 and $180,725 for 2011 and 2010, respectively. Additional contributions in the amount of $195,346 and $191,625 for 2011 and 2010, respectively, (representing 3% of total compensation of all eligible) were made to the retirement plan. At December 31, 2011, the fair value of plan assets was $13,915,797. Any liabilities for this plan are reflected on the financial statements of the Massachusetts Mutual Life Insurance Company.

12. Employee Benefits (continued)

The Company provides certain life insurance and health care benefits for retired employees. Substantially all employees may become eligible for these benefits if they reach retirement age while working for the Company. Retirees may elect certain prepaid health care benefit plans. Medical coverage may require retiree contributions. The Company's policy is to make payments to these plans sufficient to provide for benefit payments required under the plans.

Life insurance benefits, generally amounting to annual earnings at retirement decreasing uniformly over 15 years to 25% of the entire amount for life thereafter, are provided under a retired lives reserve. The retired lives reserve was $588,507 at December 31, 2011, and $589,417 at December 31, 2010.

The estimated unfunded accumulated postretirement health care benefit obligations, unrecognized transition obligation, and accrued postretirement health care benefit liability for the Company were as follows:

	December 31	
	2011	**2010**
Actuarial present value of health care benefit obligations:		
Retirees	**$ 5,535,988**	$ 4,558,925
Fully eligible and vested plan participants	**3,425,574**	2,942,352
Accumulated postretirement health care benefit obligation for fully vested participants	**$ 8,961,562**	$ 7,501,277
Actuarial present value of health care benefit obligation for nonvested employees	**$ 5,364,880**	$ 3,957,777
Unrecognized transition obligation	**$ 130,552**	$ 174,072
Accrued postretirement health care benefit liability	**$ 3,174,175**	$ 2,795,567

The weighted average discount rate used in determining the actuarial present value of the postretirement health care benefit obligation was 4.55% in 2011 and 5.43% in 2010.

For measurement purposes, an 8.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for the year following the date of the valuation, and that rate was assumed to decrease gradually to 5.0% in 2019 and remain at that level. A 1.0% increase in the assumed annual rate of increase in the per capita cost of health care benefits results in an

12. Employee Benefits (continued)

increase in the accumulated postretirement benefit obligation and postretirement benefit expense. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the postretirement benefit obligation as of December 31, 2011, by $817,135 and the estimated eligibility cost and interest cost components of net periodic postretirement benefit cost by $110,284.

Postretirement benefit cost for 2011 was $987,561 and for 2010 was $609,623, including amortization of the transition obligation plus the expected cost of health care benefits for newly eligible or vested employees, the expected cost of life insurance benefits for eligible employees, and interest cost.

It has been determined that the Company's prescription drug benefit is actuarially equivalent to Medicare Part D under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Act) and will therefore qualify for the federal subsidy. The postretirement benefit obligation and net periodic benefit cost reflect amounts associated with the subsidy.

For the year ended December 31, 2011, the effect of the Act was a $2,565 reduction in the net postretirement benefit cost for the subsidy related to benefits attributed to former employees.

In March 2010, the Patient Protection and Affordable Care Act (PPACA) was enacted. One of the key aspects of PPACA was the removal of the tax-free status of the Retiree Drug Subsidy (RDS) beginning in 2013. Since the Company has not recognized a deferred tax expense, there are not necessary adjustments due to PPACA.

Expected 2011 gross benefit payments were $537,104 and actual gross benefit payments were $633,238. The subsidy was $36,145 during 2011.

Supplemental Retirement Plans

The Company has nonqualified deferred-compensation agreements with certain employees and agents. Benefits under the agreements with the home-office employees vest immediately. Benefits under agent agreements have a graded vesting dependent on various factors. The Company records nonvested balances as a nonadmitted asset. The liability for these agreements was $5,039,635 and $4,872,905 at December 31, 2011 and 2010, respectively. The nonvested balance at December 31, 2011, was $59,135. The expense for these agreements amounted to $287,488 and $287,742 in 2011 and 2010, respectively.

12. Employee Benefits (continued)

The Company has accrued for compensated absences/vacation pay in accordance with SSAP No. 11, *Postemployment Benefits and Compensated Absences*. A liability of $875,034 is recorded in salaries and wages general expense.

13. Other

The Company is a member of the Federal Home Loan Bank (FHLB) of Dallas. Through its membership, the Company has available a $30,000,000 line of credit and has issued no funding agreements to the FHLB of Dallas. The Company has no advances for cash to use in an investment spread strategy. The Company will apply SSAP No. 52 *Deposit-Type Contracts* accounting treatment to funds utilized in an investment spread strategy. The Company has not utilized funds for operations, and any funds obtained from the FHLB for use in general operations will be accounted for as liabilities related to the agreement with the FHLB of Dallas, consistent with SSAP No. 15, *Debt and Holding Company Obligations*.

14. Subsequent Events

The Company has reached an oral agreement for the acquisition of North Coast Life Insurance Company, domiciled in the State of Washington, for slightly under $12 million. The transaction, which is expected to be completed before year-end 2012, will be recorded as a statutory purchase.

The date to which events occurring after December 31, 2011, have been evaluated for possible adjustment to the financial statements or disclosure is May 29, 2012, which is the date on which the financial statements were available to be issued.

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FINANCIAL STATEMENTS – STATUTORY-BASIS

Government Personnel Mutual Life Insurance Company
Years Ended December 31, 2010 and 2009
With Report of Independent Auditors

Ernst & Young LLP

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Financial Statements – Statutory-Basis

Government Personnel Mutual Life Insurance Company
Years Ended December 31, 2010 and 2009
With Report of Independent Auditors

Government Personnel Mutual Life Insurance Company

Financial Statements – Statutory-Basis

Years Ended December 31, 2010 and 2009

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Financial Statements – Statutory-Basis

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Report of Independent Auditors

The Board of Directors
Government Personnel Mutual Life Insurance Company

We have audited the accompanying statutory-basis balance sheets of Government Personnel Mutual Life Insurance Company as of December 31, 2010 and 2009, and the related statutory-basis statements of income, changes in surplus, and cash flow 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Company presents its financial statements in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and accounting principles also are described in Note 1. The effects on the financial statements of these variances are not reasonably determinable but are presumed to be material.

In our opinion, because of the effects of the matter described in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of Government Personnel Mutual Life Insurance Company at December 31, 2010 and 2009, or the results of its operations or its cash flows for the years then ended.

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However, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Government Personnel Mutual Life Insurance Company at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended, in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance.

Ernst + Young LLP

May 26, 2011

Government Personnel Mutual Life Insurance Company

Balance Sheets – Statutory-Basis

	December 31	
	2010	**2009**
Admitted assets		
Cash and invested assets:		
Bonds	**$ 536,497,047**	$ 531,859,636
Preferred stocks	**3,017,100**	2,009,600
Common stocks	**5,411,474**	3,567,374
Mortgage loans	**123,670,619**	127,023,286
Real estate, less accumulated depreciation (2010 – $1,547,250; 2009 – $1,190,063):		
Properties occupied by the Company	**6,944,022**	7,158,242
Properties held for the production of income	**9,759,335**	6,635,643
Policy loans	**73,657,571**	74,344,102
Short-term investments	**21,856,434**	12,006,665
Cash	**5,015,061**	4,057,942
Receivable for securities	**19,688**	19,688
Total cash and invested assets	**785,848,351**	768,682,178
Deferred premiums, less loading (2010 – $2,499,165; 2009 –$2,363,990)	**8,576,324**	8,777,115
Uncollected premiums	**812,497**	828,964
Federal tax recoverable, including net deferred tax asset (2010 – $11,580,239; 2009 – $11,758,798)	**12,658,611**	12,172,371
Accrued investment income	**9,280,064**	8,437,621
Electronic data processing equipment, less accumulated depreciation (2010 – $884,485; 2009 – $1,118,391)	**74,162**	115,711
Amounts due from reinsurers	**3,103,282**	2,268,871
Other admitted assets	**844,742**	604,235
Total admitted assets	**$ 821,198,032**	$ 801,887,066

See accompanying notes.

	December 31	
	2010	**2009**
Liabilities and surplus		
Liabilities:		
Policy and contract liabilities:		
Life and annuity reserves	**$ 615,386,220**	$ 607,575,087
Accident and health reserves	**541,664**	573,104
Deposit-type contracts	**61,625,549**	60,784,248
Dividends and coupons payable	**6,706,225**	6,707,225
Unpaid claims	**7,058,581**	7,450,726
Other	**1,168,606**	525,787
Total policy and contract liabilities	**692,486,845**	683,616,177
Benefits for employees	**5,022,905**	4,854,486
Accounts payable and accrued expenses	**7,002,188**	5,538,201
Unearned investment income	**2,223,834**	2,229,485
Asset valuation reserve	**13,677,366**	10,927,178
Interest maintenance reserve	**5,684,431**	4,490,451
Other	**3,052,394**	2,442,796
Total liabilities	**729,149,963**	714,098,774
Surplus:		
Surplus guarantee fund	**400,000**	400,000
Special surplus funds	**3,131,541**	3,174,352
Unassigned surplus	**88,516,528**	84,213,940
Total surplus	**92,048,069**	87,788,292
Total liabilities and surplus	**$ 821,198,032**	$ 801,887,066

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Income – Statutory-Basis

	Years Ended December 31	
	2010	**2009**
Premiums and other revenues:		
Premium on life, annuity and accident and health policies	**$ 56,495,371**	$ 54,957,813
Consideration for supplementary contracts with life contingencies	**390,387**	257,423
Net investment income	**43,759,016**	42,528,241
Amortization of the interest maintenance reserve	**1,038,815**	696,890
Commissions and expense allowances on reinsurance ceded	**5,657,823**	4,531,021
Miscellaneous income	**60,287**	99,796
Total premiums and other revenues	**107,401,699**	103,071,184
Benefits paid or provided:		
Death benefits	**29,682,803**	27,005,673
Annuity benefits	**5,067,534**	4,739,123
Surrender benefits	**17,995,252**	15,477,270
Interest and adjustments on policy or deposit-type contract funds	**2,603,972**	2,706,753
Payments from supplementary contracts with life contingencies	**1,237,391**	1,228,638
Other benefits	**1,524,947**	1,546,051
Increase in policy reserves	**7,779,693**	11,181,929
Total benefits paid or provided	**65,891,592**	63,885,437
Insurance expenses:		
Commissions	**7,483,116**	5,908,383
General expenses	**18,045,305**	17,301,277
Insurance taxes, licenses, and fees	**1,545,672**	1,494,548
Total insurance expenses	**27,074,093**	24,704,208
Total benefits paid or provided and insurance expenses	**92,965,685**	88,589,645
Gain from operations before dividends to policyholders, income taxes, and net realized capital gains/losses	**14,436,014**	14,481,539
Dividends to policyholders	**(6,685,764)**	(6,704,029)
Gain from operations before income taxes and net realized capital gains/losses	**7,750,250**	7,777,510
Federal income taxes	**1,934,622**	1,916,796
Gain from operations before net realized capital gains/ losses	**5,815,628**	5,860,714
Net realized capital gains/ losses, net of federal income tax (benefit) expense (2010 – $(1,649,649) ; 2009 – $(766,369)), and net of amounts transferred to IMR	**1,432,787**	(5,230,348)
Net income	**$ 7,248,415**	$ 630,366

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Changes in Surplus – Statutory-Basis

	Years Ended December 31	
	2010	**2009**
Surplus at beginning of year	**$ 87,788,292**	$ 83,559,138
Net income (loss)	**7,248,415**	630,366
Change in net unrealized capital gain (loss)	**231,538**	250,839
Change in net deferred tax	**(1,769,483)**	640,927
Change in nonadmitted assets	**1,342,405**	91,233
Change in liability for reinsurance in unauthorized companies	**(99)**	85
Change in asset valuation reserve	**(2,750,188)**	(558,648)
Change in additional admitted deferred tax asset under SSAP 10R	**(42,811)**	3,174,352
Net increase	**4,259,777**	4,229,154
Surplus at end of year	**$ 92,048,069**	$ 87,788,292

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Cash Flow – Statutory-Basis

	Years Ended December 31 2010	2009
Operating activities:		
Premiums collected net of reinsurance	$ **57,246,452**	$ 55,435,080
Net investment income	**43,145,513**	43,050,621
Miscellaneous income	**5,585,993**	4,567,708
Total	**105,977,958**	103,053,409
Benefits paid	**55,829,088**	51,494,102
Commissions, expenses paid and aggregate write-ins for deductions	**26,454,695**	24,275,033
Dividends paid to policyholders	**6,686,764**	6,650,029
Federal income taxes paid, net of tax on capital gains	**2,141,796**	1,620,000
Total	**91,112,343**	84,039,164
Net cash provided by operating activities	**14,865,615**	19,014,245
Investing activities:		
Proceeds from investments sold, matured or repaid:		
Bonds	**171,524,605**	103,903,389
Stocks	**699,003**	1,755,088
Mortgage loans	**15,136,868**	15,972,805
Other proceeds	**–**	63,111
Total investment proceeds	**187,360,476**	121,694,393
Cost of investments acquired:		
Bonds	**173,091,193**	139,636,431
Stocks	**2,873,644**	1,970,265
Mortgage loans	**11,835,000**	20,462,500
Real estate	**3,275,394**	3,588,754
Miscellaneous applications	**–**	–
Total investments acquired	**191,075,231**	165,657,950
Net increase (decrease) in policy loans	**(628,550)**	1,199,810
Net cash (used in) provided by investing activities	**(3,086,205)**	(45,163,367)
Financing and miscellaneous activities:		
Net deposits on deposit-type contract funds	**(1,388,657)**	(2,226,743)
Other cash provided (applied)	**416,135**	(452,376)
Net cash (used in) miscellaneous activities	**(972,522)**	(2,679,119)
Net change in cash and short-term investments	**10,806,888**	(28,828,241)
Cash, cash equivalents, and short-term investments:		
At beginning of year	**16,064,607**	44,892,848
At end of year	$ **26,871,495**	$ 16,064,607

See accompanying notes.

1. Nature of Operations and Significant Accounting Policies

Government Personnel Mutual Life Insurance Company (the Company) is domiciled in the state of Texas. Effective November 1, 2010, the Company owns 100% of the outstanding common stock of Texas Directors Life Insurance Company (TDLIC). TDLIC is included in the Company's common stock investments as an unconsolidated subsidiary at the net statutory-basis equity of $383,263 plus unamortized goodwill of $1,473,802.

The Company is a mutual life insurance organization specializing in the armed forces, civil service, and final expense markets. Coverages are also available to the middle-to-upper-income general civilian market.

Operations are conducted primarily on personal producing and managing general agent plans through approximately 1,400 general and soliciting agents. The Company is licensed in 48 states and the District of Columbia. Its primary markets are the states of Texas, South Carolina, Florida, Virginia, Georgia and North Carolina. The Company is also accredited to solicit sales at some overseas military installations. The Company offers a portfolio of the usual forms of individual permanent, term, flexible premium universal life, and annuity policies, all without a war clause. Life insurance and annuity plans are available to United States military personnel and Civil Service employees through a federal allotment plan. Automatic payment plans are available to the civilian populace. The Company also offers policies in the Senior Final Expense market. The Company is the underwriter for the group association coverages for members of the Military Benefit Association (MBA). The Company derives substantially all of its direct group life and group accident and health business from the group policy issued to the MBA. The Company entered the medicare supplement market in 2010 and has in place an agreement with an experienced company in that market to administer this business.

Basis of Presentation

The Company's financial statements are prepared in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, whose practices may differ from U.S. generally accepted accounting principles. The more significant variances from GAAP are as follows:

> *Investments*: Investments in bonds are reported at amortized cost or fair value based on their National Association of Insurance Commissioners (NAIC) rating; for 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

1. Nature of Operations and Significant Accounting Policies (continued)

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 surplus for those designated as available-for-sale. Fair value for statutory purposes is based on the price published by the Securities Valuation

Office of the NAIC (SVO), if available, whereas fair value for GAAP is based on quoted market prices.

All single-class and multi-class mortgage-backed/asset-backed securities (e.g., CMOs) 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. For GAAP purposes, all securities, purchased or retained, that represent beneficial interests in securitized assets (e.g., CMO, CBO, CDO, CLO, MBS, and ABS securities), 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. If high credit quality securities are adjusted, the retrospective method is used.

Real estate owned and occupied by the Company is included in investments rather than reported as an operating asset, as under GAAP. Investment income and operating expenses for statutory reporting include rent for the Company's occupancy of those properties.

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 are charged or credited directly to unassigned surplus rather than included as a component of earnings, as would be required under GAAP.

1. Nature of Operations and Significant Accounting Policies (continued)

Universal Life and Annuity Policies: Revenues for universal life and annuity policies with mortality or morbidity risk consist of the entire premium received, and benefits incurred represent the total of death benefits paid, surrender benefits paid and the change in policy reserves. Proceeds received for annuity policies without mortality or morbidity risk 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 account values.

Benefit Reserves: Certain policy reserves are calculated based on statutorily required interest and mortality assumptions rather than on estimated expected experience or actual account balances, as would be required under GAAP.

Reinsurance: Policy and contract liabilities ceded to reinsurers have been reported as reductions of the related reserves rather than as assets, as would be required under GAAP.

Commissions allowed by reinsurers on business ceded are reported as income when incurred rather than being deferred and amortized with deferred policy acquisition costs, as would be required under GAAP. In addition, liability for reinsurance balances has been provided for unsecured policy reserves ceded to reinsurers not authorized to assume such business. Changes to the liability are credited or charged directly to unassigned surplus. Under GAAP, an allowance for amounts deemed uncollectible would be established through a charge to earnings.

Employee Benefits: For purposes of calculating the Company's postretirement and postemployment benefit obligations, only vested participants and current retirees are included in the valuation. Under GAAP, active participants not currently eligible would also be included.

Deferred Income Taxes: Under SSAP No. 10, *Income Taxes* (SSAP No. 10), deferred tax assets (DTAs) 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 balance sheet

1. Nature of Operations and Significant Accounting Policies (continued)

Changes in investment admitted asset carrying amounts are credited or charged directly to unassigned surplus.

Valuation Reserves: Under a formula prescribed by the NAIC, the Company defers the portion of realized capital gains and losses on sales of fixed-income investments attributable to changes in the general level of interest rates and amortizes those deferrals over the remaining period to maturity based on groupings of individual securities sold in five-year bands. That net deferral is reported as the interest maintenance reserve (IMR) in the accompanying balance sheets. Realized capital gains and losses are reported in income, net of federal income tax and transfers to the IMR. Under GAAP, realized capital gains and losses would be reported in the income statement on a pretax basis in the period that the assets giving rise to the gains or losses are sold.

The asset valuation reserve (AVR) provides a valuation allowance for invested assets. The AVR is determined by an NAIC-prescribed formula, with changes reflected directly to unassigned surplus; AVR is not recognized for GAAP.

Policy Acquisition Costs: 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.

Nonadmitted Assets: Certain assets designated as "nonadmitted," principally agents' balances, furniture and equipment, and other assets not specifically identified as an admitted asset within the *NAIC Accounting* Practices *and Procedures Manual*, are excluded from the accompanying balance sheets and charged directly to unassigned surplus. Under GAAP, such assets are included in the balance sheet to the extent that those assets are not impaired.

1. Nature of Operations and Significant Accounting Policies (continued)

date or 10% of surplus excluding any net deferred tax assets, and EDP equipment and operating software, 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. Effective December 31, 2009, *Income Taxes Revised, a Temporary Replacement of SSAP No. 10,* (SSAP 10R), modified the computation of admitted deferred taxes. If a company's risk-based capital level is above a certain threshold, the prescribed time frame for expected realization of DTAs is three years and the prescribed percentage of surplus is 15%. Also beginning in 2009, only adjusted gross DTAs that are more likely than not to be realized are considered in determining admitted DTAs. The character (capital or ordinary) is required to be considered in the admitted asset determination. Deferred taxes do not include amounts for state taxes. Under GAAP, state income 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.

Investment in subsidiaries: Under NAIC SAP, investments in subsidiaries are carried at values prescribed by the Texas Department of Insurance and the NAIC, typically at audited statutory equity plus any unamortized goodwill. Under GAAP, investments in wholly owned subsidiaries are consolidated.

Policyholder Dividends: Policyholder dividends are recognized when declared rather than over the term of the related policies. Dividends are determined annually by the Company's Board of Directors. Individual ordinary life participating premium approximates 86% of the Company's ordinary life insurance collected premiums.

The effects of the foregoing variances from GAAP on the accompanying statutory-basis financial statements have not been determined, but are presumed to be material.

Other significant accounting practices are as follows:

1. Nature of Operations and Significant Accounting Policies (continued)

Investments

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

Bonds are stated at amortized cost or, for certain bonds, at fair value as determined by the SVO, with related unrealized capital gains/losses reported in unassigned surplus, net of federal income tax.

Bonds not backed by other loans are stated at amortized cost using the interest method. Loan- backed bonds and structured securities are valued at amortized cost using the interest method including anticipated prepayments. Prepayment assumptions are obtained from broker dealer survey values 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.

Redeemable preferred stocks are reported at cost or amortized cost as determined by the SVO.

Common stocks are reported at fair value as determined by the SVO, and the related unrealized capital gains or (losses) are reported in unassigned surplus, net of federal income taxes. The change in the statutory equity of its wholly owned subsidiary is recorded as a change in unrealized capital gains or (losses), a component of unassigned surplus, net of federal income tax.

There are no restrictions on common or preferred stock.

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.

Cash equivalents are short-term highly liquid investments with original maturities of three months or less at time of acquisition and are principally stated at amortized cost.

1. Nature of Operations and Significant Accounting Policies (continued)

Mortgage loans are reported at unpaid principal balances, less an allowance for impairment as needed. 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, the impairment is other-than-temporary; the mortgage loan is written down to a realizable value and a realized loss is recognized.

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, with depreciation calculated on a straight-line basis over the estimated useful lives of the properties.

Policy loans are reported at their unpaid principal balance.

Realized capital gains and losses are determined using the specific identification basis. Changes in admitted asset carrying amounts of bonds, mortgage loans, policy loans, common and preferred stocks are credited or charged directly to unassigned surplus.

Furniture and Equipment

The Company's electronic data processing equipment and operating software are reported at cost, less accumulated depreciation. Depreciation is provided in amounts sufficient to charge the cost of electronic processing equipment and operating software to operations over the lesser of their estimated service lives or three years on a straight-line basis. Nonoperating software is depreciated on a straight-line basis over the lesser of its useful life or five years. Other furniture and equipment are depreciated on a straight-line basis over the lesser of their estimated service lives or five years. Depreciation and amortization expense charged to operations was $320,542 for 2010 and $386,583 for 2009.

1. Nature of Operations and Significant Accounting Policies (continued)

Premiums

Life and accident and health premiums are recognized as revenue when due. Premiums for annuity policies with mortality and morbidity risk are also recognized as revenue when due. Premiums received for annuity policies without mortality or morbidity risk and for group annuity contracts are recorded using deposit accounting.

Benefit Reserves

Life, annuity, and accident and health benefit reserves are developed by actuarial methods and are determined based on published tables using statutorily specified interest rates and valuation methods that will provide, in the aggregate, reserves that are greater than the minimum required by the Texas Department of Insurance.

The Company waives deduction of deferred fractional premiums upon the death of insureds and refunds any premium beyond the month of death. Surrender values on policies do not exceed the corresponding benefit reserves. Extra premiums are charged for substandard lives plus the gross premium for the true age. The mean reserve method is used to adjust the calculated terminal reserve to the appropriate reserve at December 31. Mean reserves are determined by computing the regular mean reserve for the plan at the true age and holding, in addition, one-half of the extra premium charge for the year. An asset is recorded for deferred premiums net of loading to adjust the reserve for modal premium payments. Additional reserves are established when the results of cash flow testing under various interest rate scenarios indicate the need for such reserves. There has been no need for such reserves.

As of December 31, 2010 and 2009, reserves of $1,351,290 and $1,643,030, respectively, were recorded on in-force amounts of $81,649,754 and $106,445,424, respectively, for which gross premiums are less than the net premiums according to the standard of valuation required by the Texas Department of Insurance.

The tabular interest, tabular cost less actual reserve released and tabular cost have been determined by formula. For determination of tabular interest on funds not involving life contingencies, the tabular interest is actual interest credited or due on the accounts for the valuation year.

1. Nature of Operations and Significant Accounting Policies (continued)

Deposit-Type Contracts

Deposit-type contracts consist primarily of dividend accumulations, premium deposits, and supplemental contracts not involving life contingencies and annuities certain. Premium deposits relate primarily to the MBA group business. Deposit-type contracts are increased and decreased according to the deposits and withdrawals, respectively, of the applicable policyholders, as well as by retrospectively rated credits and debits for favorable and unfavorable, respectively, underwriting and investment experience of the MBA business.

Unpaid Claims

The liability for unpaid policy and contract claims represents the estimate of the ultimate net cost of all reported and unreported claims incurred through year-end. The liability is estimated using individual case-basis valuations and Company history. Those estimates are subject to the effects of trends in claim severity and frequency. Although considerable variability is inherent in such estimates, management believes that the reserve for unpaid claims is adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

Reinsurance

Reinsurance premiums and benefits paid or provided are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Guaranty Fund Assessments

Guaranty fund assessments are accrued when the Company receives notice or other information that a reasonably estimable amount is or is likely to be payable to a guaranty fund.

Recently Issued Accounting Standards — In September 2009, the Statutory Accounting Principles Working Group issued SSAP No. 43-Revised, *Loan-backed and Structured Securities* ("SSAP No. 43R"). The new pronouncement supersedes SSAP No. 98, *Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, An Amendment of SSAP No. 43,*

1. Nature of Operations and Significant Accounting Policies (continued)

Loan-Backed and Structured Securities, as well as paragraph 13 of SSAP No. 99, *Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment.* SSAP No. 43R provides guidance on recording other than temporary impairments on loan-backed securities and structured securities. The Company adopted SSAP No. 43R effective December 31, 2009. Adoption of this statement did not have a material impact on the Company's statutory-basis financial statements.

In December 2009, the Statutory Accounting Principles Working Group issued SSAP No. 100, *Fair Value Measurements* ("SSAP No. 100"), which defines fair value, establishes a framework for measuring fair value in statutory accounting principles and expands disclosures about fair value measurements. This statement does not require any new fair value measurements. SSAP No. 100 applies under other accounting pronouncements that require or permit fair value measurements. The provisions of SSAP No. 100 are effective for December 31, 2010 annual financial statements, with interim and annual financial statement reporting thereafter. The Company adopted SSAP No. 100 as of December 31, 2010, its required effective date. Adoption of this statement did not have a material impact on the Company's statutory- basis financial statements.

In December 2009, the Statutory Accounting Principles Working Group issued SSAP No. 10R, *A Temporary Replacement of SSAP No. 10, Income Taxes* ("SSAP No. 10R"), SSAP No. 10R establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income tax. This statement provides revisions to the existing standard allowing an option to increase the admitted deferred tax assets for companies with risk-based capital that exceeds a stated threshold. The statement also provides for additional disclosure requirements of income tax related balances. See Note 6 for additional disclosures required by this statement.

Use of Estimates

The preparation of statutory-basis financial statements requires management to make estimates and assumptions that affect amounts reported in the 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.

1. Nature of Operations and Significant Accounting Policies (continued)

Reclassifications

If necessary, certain 2009 amounts in the Company's statutory-basis financial statements have been reclassified to conform to the 2010 financial statement presentation.

2. Investments

Bonds: The amortized cost and the fair value of investments in bonds are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2010				
U.S. Government and agencies	$ 44,171,019	$ 3,645,473	$ (100,501)	$ 47,715,991
State and political subdivisions	201,340,852	1,681,300	(5,042,681)	197,979,471
Corporate securities	286,336,244	22,785,539	(2,761,435)	306,360,348
Mortgage-backed securities	4,648,932	372,896	–	5,021,828
Total bonds	$ 536,497,047	$ 28,485,208	$ (7,904,617)	$ 557,077,638
At December 31, 2009				
U.S. Government and agencies	$ 85,791,050	$ 2,536,285	$ (866,411)	$ 87,460,924
State and political subdivisions	69,974,183	472,428	(4,283,039)	66,163,572
Corporate securities	349,042,070	13,100,113	(12,418,692)	349,723,491
Mortgage-backed securities	27,052,333	1,246,764	(54,471)	28,244,626
Total bonds	$ 531,859,636	$ 17,355,590	$ (17,622,613)	$ 531,592,613

2. Investments (continued)

The following table shows gross unrealized losses and fair values of fixed maturities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2010						
U.S. Government and agencies	$ 7,123,870	$ (100,501)	$ –	$ –	$ 7,123,870	$ (100,501)
State and political subdivisions	103,052,223	(3,384,549)	17,304,595	(1,658,132)	120,356,818	(5,042,681)
Corporate securities	20,395,051	(663,570)	27,253,709	(2,097,865)	47,648,760	(2,761,435)
Total bonds	$ 130,571,144	$ (4,148,620)	$ 44,558,304	$ (3,755,997)	$ 175,129,448	$ (7,904,617)
December 31, 2009						
U.S. Government and agencies	$ 35,606,309	$ (760,023)	$ 3,801,860	$ (106,388)	$ 39,408,169	$ (866,411)
State and political subdivisions	37,662,771	(1,708,148)	16,654,349	(2,574,891)	54,317,120	(4,283,039)
Corporate securities	6,913,655	(110,057)	111,177,051	(12,308,635)	118,090,706	(12,418,692)
Mortgage-backed securities	448,279	(314)	913,330	(54,157)	1,361,609	(54,471)
Total bonds	$ 80,631,014	$ (2,578,542)	$ 132,546,590	$ (15,044,071)	$ 213,177,604	$ (17,622,613)

A summary of the amortized cost and fair value of the Company's investments in bonds at December 31, 2010 by contractual maturity, is as follows:

	Amortized Cost	Fair Value
Years to maturity:		
One or less	$ 15,236,871	$ 15,609,624
After one through five	99,861,552	108,156,388
After five through ten	90,191,226	98,032,488
After ten	326,558,466	330,257,310
Mortgage-backed securities	4,648,932	5,021,828
Total	$ 536,497,047	$ 557,077,638

The actual maturities may differ from the contractual maturities in the foregoing table because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

2. Investments (continued)

Proceeds from sales of investments in bonds during 2010 and 2009 were $70,895,110 and $16,127,960, respectively; gross gains of $3,498,800 and $1,539,818 and gross losses of $283,940 and $31,439 were realized on those sales, respectively.

At December 31, 2010, bonds with an admitted asset value of $7,034,999 were on deposit with state insurance departments to satisfy regulatory requirements.

Stocks: Unrealized gains and losses on investments in common stocks are reported directly in unassigned surplus and do not affect operations.

Effective November 1, 2010, the Company recorded the statutory purchase of 100% of the 100,000 outstanding common stock shares of Texas Directors Life Insurance Company (TDLIC). TDLIC is licensed in Texas only and sells individual life products exclusively. The cost of the acquired company was $1,766,144, resulting in goodwill in the amount of $1,498,778. The amortization of goodwill during 2010 was $24,980. Net unamortized goodwill is included within common stocks in the accompanying balance sheets. Effective December 31, 2010, the Company purchased the remaining 100,000 authorized but unissued common shares of TDLIC.

The cost and fair value of investments in preferred stocks and common stocks are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2010				
Preferred stocks	$ 3,017,100	$ 30,000	$ (139,675)	$ 2,907,425
Affiliated common stocks	$ 1,857,065	$ –	$ –	$ 1,857,065
Unaffiliated common stocks	$ 3,072,212	$ 573,705	$ (91,508)	$ 3,554,409
Total Common stocks	$ 4,929,277	$ 573,705	$ (91,508)	$ 5,411,474
At December 31, 2009				
Preferred stocks	$ 2,009,600	$ 17,500	$ (245,400)	$ 1,781,700
Common stocks	$ 3,578,496	$ 260,760	$ (271,882)	$ 3,567,374

2. Investments (continued)

The following table shows gross unrealized losses and fair values of preferred and common stocks, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2010						
Stocks:						
Preferred stocks	$ 1,877,425	$ (139,675)	$ –	$ –	$ 1,877,425	$ (139,675)
Common stocks	68,838	(1,794)	2,706,106	(89,714)	2,774,944	(91,508)
Total	$ 2,085,938	$ (141,469)	$ 2,706,106	$ (89,714)	$ 4,792,044	$ (231,183)
December 31, 2009						
Stocks:						
Preferred stocks	$ –	$ –	$ 1,264,200	$ (245,400)	$ 1,264,200	$ (245,400)
Common stocks	1,274,950	(79,984)	776,062	(191,898)	2,051,012	(271,882)
Total	$ 1,274,950	$ (79,984)	$ 2,040,262	$ (437,298)	$ 3,315,212	$ (517,282)

Mortgage Loans: During 2010, the minimum and maximum lending rates for mortgage loans were 6.625% and 7.25%, respectively. At the issuance of a loan, the percentage of loan to value on any one loan does not exceed 75%. Fire insurance is required on all properties covered by mortgage loans at least equal to the excess of each loan over the maximum loan that would be permitted by law on the land without the buildings. At December 31, 2010 and 2009, the Company held no mortgages with interest overdue beyond 180 days. There was no nonadmitted interest or principal at December 31, 2010 and 2009.

At December 31, 2010 and 2009, taxes, assessments and amounts advanced not included in the mortgage loan total were $13,642 and $21,573, respectively. At December 31, 2010, none of the Company's investments in mortgage loans were subject to prior liens.

The Company's investments in mortgage loans all involve commercial real estate. At December 31, 2010, all such mortgages involve properties located in the states of Texas, Arizona, Utah, New Mexico, Colorado and Nevada. Such investments consist of first mortgage liens on completed income-producing properties. At December 31, 2010, the mortgage outstanding on any individual property did not exceed $4,000,000.

2. Investments (continued)

The total recorded investment in restructured loans at December 31, 2010 and 2009, was $2,842,220 and $4,339,848, respectively. There were no realized capital losses related to these loans. There were no contractual commitments to extend credit to debtors owing receivables whose terms have been modified in troubled debt restructurings. The Company accrues interest income on impaired loans to the extent deemed collectible and the loan continues to perform under its original or restructured contractual terms. Interest income on nonperforming loans generally is recognized on an accrual basis to the extent deemed collectible.

During 2010, the Company foreclosed on two investment properties in Salt Lake City, Utah and transferred the foreclosed properties to its real estate investments. In addition, the Company established a $100,000 valuation allowance on a third loan.

Real Estate: Properties held for the production of income represent two condominiums purchased for the use of Company employees, two properties adjacent to the Home Office property and three foreclosed properties. Two of the foreclosed properties were added in 2010.

2. Investments (continued)

Net Investment Income: Net investment income consists of the following:

	Years Ended December 31	
	2010	**2009**
Income:		
Bonds	**$ 32,016,355**	$ 31,108,823
Preferred stocks	**163,250**	169,526
Common stocks	**88,399**	59,579
Mortgage loans	**8,411,738**	7,813,421
Real estate[1]	**1,200,638**	963,172
Policy loans	**4,806,882**	4,742,875
Short-term investments and cash	**12,271**	201,472
Other	**12,819**	5,247
Total investment income	**46,712,352**	45,064,115
Expenses:		
Real estate operating and maintenance	**1,180,184**	894,885
Real estate taxes	**235,656**	180,996
Depreciation	**358,886**	340,151
Other	**1,178,610**	1,119,842
Total investment expenses	**2,953,336**	2,535,874
Net investment income	**$ 43,759,016**	$ 42,528,241

[1]Real estate includes $674,745 in 2010 and $633,842 in 2009 for the Company's occupancy of its own building.

2. Investments (continued)

Realized Capital Gains (Losses): Realized capital gains (losses) are reported net of federal income taxes and amounts transferred to the IMR as follows:

	2010	2009
Realized capital gains (losses)	**$ 3,166,159**	$ (4,959,080)
Less amount transferred to IMR (net of related taxes of $1,150,227 in 2010 and $352,797 in 2009)	**2,232,794**	684,840
	933,365	(5,643,920)
Less federal income tax (benefit) expense on realized capital (losses) gains	**(499,422)**	(413,572)
Net realized capital gains (losses)	**$ 1,432,787**	$ (5,230,348)

Securities Lending: The Company has suspended securities lending since the fourth quarter of 2008.

Asset Impairments – Other-Than-Temporary: Management regularly reviews the value of the Company's investments. If the value of any investment falls below its cost basis, the decline is analyzed to determine whether it is an other-than-temporary decline in value. To make this determination for each security, the following is considered:

- How long and by how much the fair value has been below its cost;
- The financial condition and near-term prospects of the issuer of the security, including any specific events that may affect its operations or earnings potential;
- Management's intent to hold the security long enough for it to recover its value;
- Any downgrades of the security by a rating agency;
- Any reduction or elimination of dividends, or nonpayment of scheduled interest payments; and
- The impact interest rates have had on the value of the security.

2. Investments (continued)

Bonds: During 2010, the Company recorded losses of $448,903 on two loan-backed bonds considered to be impaired. A loss of $6,740,363 was recorded on five bonds in 2009.

Loan Backed Securities: The Company held one Collateralized Debt Obligations for which the present value of the cash flows expected to be collected is less than the amortized cost basis of the security.

None of the bonds are held with the intent to sell nor with the inability or lack of intent to retain the investment for a period of time sufficient to recover the amortized cost basis.

Held securities with a recognized other-than-temporary impairment, as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities:

Description	Pre-OTTI Amortized Cost Basis	Current Year OTTI Realized	Fair Value	Post-OTTI Amortized Cost Basis
ALESCO Pref Fdg, Ltd.	$ 645,750	$ 290,029	$ 102,637	$ 355,721

The following bonds have fair values below the amortized cost of the bonds for which an interest-related impairment remains as of December 31, 2010. Other-than-temporary impairments have been recognized for non-interest-related declines. All of the bonds have been in a continuous unrealized loss positions for more than 12 months.

Description	a. Unrealized Loss	b. Fair Value
ALESCO Pref FDG. Ltd.	$ 253,084	$ 102,637
Trapeza CDO LLC	189,070	92,205
Totals	$ 442,154	$ 194,842

2. Investments (continued)

The Company reviewed the cash flows of impaired loan-backed bonds and determined that the present values of the cash flows for one bond was less than the amortized cost of the bond. Based on this determination and the fact that the Company had no intent to sell the bond and did not lack the ability to hold the bond until the cash flows were received, the Company impaired the bond to the present value of the projected cash flows. The Company considers the probable return of principal in a bond, the ability of the Company to hold the bond until the fair value can reach the amortized book value, and whether the borrower has filed bankruptcy in concluding that a bond should be other-than-temporarily impaired.

There were no bonds held by the Company where it was not practicable to estimate fair value. All bonds and stocks that have a fair value below 80% of amortized book value are reviewed quarterly.

Stocks: No common stocks were impaired during 2010. During 2009, the Company recorded a realized loss of $171,108 on two common stocks that were considered to be impaired.

Mortgages: During 2010 and 2009, the Company had no mortgage loans that were considered to be other-than-temporarily impaired.

Real Estate: During 2010, the Company foreclosed on two mortgage loans considered to be adequately collateralized. The properties were classified as held for investment as of December 31, 2010.

Market Segment Concentrations

The Company has $105,431,161 in corporate bonds of banks, insurance and finance related corporations. In the event of a severe market event in this segment, the Company could lose a material amount in these investments. At year-end, there was a net unrealized gain of $3,832,905 on this exposure to the financial industry.

3. Fair Values

The fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties. The fair value of a liability is the amount at which the liability could be incurred or settled in a current transaction between willing parties.

3. Fair Values (continued)

Fair values are based on quoted market prices when available. If quoted market prices are not available for the specific security, then fair values are estimated by using pricing models utilized by an independent pricing service to ascertain the fair values. Fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality (matrix pricing). In instances where there is little or no market activity for the same or similar instruments, we estimate fair value using methods, models and assumptions that management believes market participants would use to determine a current transaction price. These valuation techniques involve some level of management estimation and judgment which becomes significant with increasingly complex instruments or pricing models. Where appropriate, adjustments are included to reflect the risk inherent in a particular methodology, model or input used.

Our financial assets and liabilities carried at fair value have been classified, for disclosure purposes, based on a hierarchy defined by SSAP 100. SSAP 100 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows.

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Included in various investment related line items in the financial statements are certain financial instruments carried at fair value. Other financial instruments are periodically measured at fair value, such as certain bonds and preferred stock when carried at the lower of cost or fair value. As of December 31, 2010, the Company's investments reported at fair value were $194,842 in Level 3 and $3,554,409 of common stocks in Level 1.

3. Fair Values (continued)

There were no significant transfers between Levels during 2010.

The table below includes a rollforward for assets classified within the Level 3 hierarchy.

	Bonds Industrial and Miscellaneous
Assets at fair value, January 1, 2010	$ 208,032
Transfers into Level 3	–
Transfers out of Level 3	–
Total realized losses included in net income	(36,970)
Other than temporary impairment recognized	(448,903)
Total unrealized (losses) gain included in surplus	(31,359)
Purchases, issuances and settlements (net):	
Purchases	–
Sales	(100)
Payment-in-kind dividends	504,142
Assets at fair value, December 31, 2010	$ 194,842

We classify our investment in certain debt securities as Level 3 securities. The fair value of the bonds is valued using unobservable inputs since independent pricing information is not available for these securities.

As of December 31, 2010, the reported fair value of the Company's investment in level 3, NAIC rated 6, Collateralized Debt obligations, (CDO's), were $194,842. This consists of two bonds backed by the preferred stock of banks, insurance companies and REITS. Both are mezzanine tranches. To value these securities, the Company uses discounted projected cash flows. The cash flows from the CDO's are obtained from Morgan Keegan through Intex. The cash flows are then valued based on current defaults and deferrals at an interest approximately 10% above the current 10 year US Treasury. The bonds are then carried at the present value of the cash flows at that discount level.

3. Fair Values (continued)

Other methods and assumptions used by the Company in estimating the fair value disclosures for financial instruments in the accompanying financial statements are as follows:

Cash, Short-Term Investments, and Receivables for Securities: The carrying amounts reported in the accompanying statutory-basis balance sheets for these financial instruments approximate their fair values due to the short-term nature of such instruments.

Policy Loans: The carrying amounts reported in the accompanying statutory-basis balance sheets for these financial instruments approximate their fair values.

Investment Securities: The fair values for fixed-maturity securities are based on unit prices prescribed by the SVO or, in the absence of SVO unit prices or when amortized cost is used by the SVO as the unit price, quoted market prices by other third-party organizations. The fair value of mortgage-backed securities is based on quoted market prices by third-party organizations. The fair values for equity securities are based on fair values prescribed by the SVO.

Mortgage Loans: The fair values for mortgage loans are estimated using weighted average maturity analyses, using interest rates currently being offered for similar loans to borrowers with similar credit ratings. Loans with similar characteristics are aggregated for purposes of the calculations.

Investment Contracts: The fair values for the Company's liabilities under investment-type insurance contracts are estimated using discounted cash flow calculations, based on interest rates currently being offered for similar contracts with maturities consistent with those remaining for the contracts being valued.

3. Fair Values (continued)

The carrying amounts and fair values of the Company's financial instruments at December 31 were as follows:

	2010		2009	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Bonds	**$ 536,497,047**	**$ 557,077,638**	$ 531,859,636	$ 531,592,613
Preferred stocks	**3,017,100**	**2,907,425**	2,009,600	1,781,700
Common stocks	**5,411,474**	**5,411,474**	3,567,374	3,567,374
Mortgage loans	**123,670,619**	**120,030,271**	127,023,286	129,801,285
Policy loans	**73,657,571**	**73,657,571**	74,344,102	74,344,102
Short-term investments	**21,856,434**	**21,856,434**	12,006,665	12,006,665
Cash	**5,015,061**	**5,015,061**	4,057,942	4,057,942
Receivables for securities	**19,688**	**19,688**	19,688	19,688

The carrying amounts and fair values of the Company's liabilities for investment-type insurance contracts at December 31 were as follows:

	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Individual annuities	$ 82,149,687	$ 81,416,013	$ 77,515,431	$ 76,967,396
Supplemental contracts not involving life contingencies	18,700,186	19,293,804	17,953,287	18,421,449

The fair values for the Company's insurance contracts other than investment contracts are not required to be disclosed. However, the fair values of liabilities under all insurance contracts are taken into consideration in the Company's overall management of interest rate risk, such that the Company's exposure to changing interest rates is minimized through the matching of investment maturities with amounts due under insurance contracts.

4. Reinsurance

Certain premiums and benefits are assumed from and ceded to other insurance companies under various reinsurance agreements. The ceded reinsurance agreements provide the Company with increased capacity to write larger risks. The Company remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations.

Amounts payable or recoverable for reinsurance on policy and contract liabilities are not subject to periodic or maximum limits. The Company has $1,569,909 of amounts recoverable on paid losses and commissions and expense allowances due from a single reinsurer. This amount does not exceed 3% of the Company's total surplus at December 31, 2010.

The Company has entered into a reinsurance agreement in which the reinsurer may unilaterally cancel any reinsurance for reasons other than nonpayment of premiums or other similar credits. The total amount of reinsurance credits taken for this agreement at December 31, 2010 and 2009 was $21,026,318 and $21,080,081, respectively.

The Company does not have any reinsurance agreements in effect in which the amount of losses paid or accrued through December 31, 2010, would result in a payment to the reinsurer of amounts that, in the aggregate and allowing for offset of mutual credits from other insurance agreements with the same reinsurer, exceed the total direct premiums collected under the reinsured policies.

The amounts related to the Company's ceded and assumed reinsurance arrangements for life insurance are summarized as follows:

	Ceded to Other Companies	Assumed From Other Companies
2010		
Premiums for the year ended December 31	**$ 21,638,131**	**$ 613,684**
Benefits paid or provided for the year ended December 31	**14,311,469**	**591,742**
Credit taken against policy and contract liabilities at December 31	**37,175,176**	–
2009		
Premiums for the year ended December 31	$ 17,654,198	$ 1,184,541
Benefits paid or provided for the year ended December 31	10,744,259	1,054,561
Credit taken against policy and contract liabilities at December 31	35,994,560	–

5. Retrospectively Rated Contracts

In October 2001, the Company became the group carrier for the MBA, a nonprofit association of military and Civil Service personnel. Group term life and health policies were issued to the MBA. These policies can be terminated on anniversary with notice. Members of the MBA field of membership are eligible to apply for group term life coverage or group TRICARE supplement insurance. Life coverage is individually underwritten. Coverage from the prior carrier was continued in the new group policies. The contract with the MBA requires that the MBA maintain a premium stabilization fund (PSF) with the Company. The group is experience-rated, and the PSF will increase or decrease depending on the experience for the year. Interest is credited at the end of each fiscal year. A refund to members is considered annually and is paid at various levels when considered appropriate. The PSF level is currently in excess of a reserve that would be required for group term life; as such, no additional reserves are held. The PSF is held as a deposit reserve. Claim reserves are held separately for both life and health claims.

The Company estimates accrued retrospective premium adjustments for its group association life and health insurance business using the refund calculation specified in the agreement with the association and records them as an adjustment to earned premium. The amount of net premiums collected by the Company at December 31, 2010, that are subject to retrospective rating features was $5,261,274 in group life and $1,410,627 in group health. The net premiums represent 99% of the group life and 100% of the group health premiums collected. No other net premiums are subject to retrospective rating features.

The full balance of retrospective premium adjustments is admitted and considered collectible.

6. Federal Income Taxes

Income before federal income taxes differs from taxable income principally due to the differences in timing for recognizing accrual of market discounts on bonds, deferred compensation, and policyholder dividends; dividends-received tax deductions; policy acquisition costs; interest maintenance reserve; and differences in reserves for policy and contract liabilities for tax and financial reporting purposes.

6. Federal Income Taxes (continued)

The components of the net deferred tax assets (DTAs) and deferred tax liabilities (DTLs) for the year ended December 31 are as follows:

	2010			2009		
	Ordinary	**Capital**	**Total**	**Ordinary**	**Capital**	**Total**
Gross deferred tax asset	**$ 18,816,919**	**$ 2,902,609**	**$ 21,719,528**	$ 19,180,692	$ 4,589,195	$ 23,769,887
Statutory valuation allowance	**–**	**–**	**–**	–	–	–
Adjusted gross deferred tax asset	**18,816,919**	**2,902,609**	**21,719,528**	19,180,692	4,589,195	23,769,887
Deferred tax liability	**3,958,858**	**196,767**	**4,155,625**	4,270,524	33,831	4,304,355
Net deferred tax asset	**14,858,061**	**2,705,842**	**17,563,903**	14,910,168	4,555,364	19,465,532
Deferred tax asset nonadmitted	**3,277,822**	**2,705,842**	**5,983,664**	3,151,370	4,555,364	7,706,734
Net admitted deferred tax asset	**$ 11,580,239**	**$ –**	**$ 11,580,239**	$ 11,758,798	$ –	$ 11,758,798
Increase (decrease) in deferred tax asset non-admitted			**$ (1,723,070)**			$ (2,863,458)

The Company has elected to admit deferred tax assets pursuant to paragraph 10e of SSAP10R.

The Company's admitted adjusted gross deferred tax assets under SSAP 10R paragraphs 10a,b,c and SSAP 10R paragraph 10e are as follows:

	2010			2009		
	10a,b,c	**10e**	**Difference**	**10a,b,c**	**10e**	**Difference**
Ordinary	**$ 12,407,556**	**$ 15,539,097**	**$ 3,131,541**	$ 12,854,970	$ 16,029,322	$ 3,174,352
Capital	**196,767**	**196,767**	**–**	33,831	33,831	–
Total	**$ 12,604,323**	**$ 15,735,864**	**$ 3,131,541**	$ 12,888,801	$ 16,063,153	$ 3,174,352

6. Federal Income Taxes (continued)

The Company's admitted adjusted gross deferred tax assets under SSAP10R are as follows:

	2010			2009		
	Ordinary	Capital	Total	Ordinary	Capital	Total
Paragraphs 10a, 10b and 10c:						
Federal tax paid in carryback years (10a)	$ 6,346,865	$ -	$ 6,346,865	$ 7,821,364	$	$ 7,821,364
Lesser of:						
Deferred taxes expected to be realized within 1 year (10bi)	2,101,833	-	2,101,833	763,082	-	763,082
10% of statutory capital of previously filed statement (10bii)						
Amount of gross DTA's that can be offset against DTL's (10c)	3,958,858	196,767	4,155,625	4,270,524	33,831	4,304,355
Admitted deferred tax asset - SSAP 10R paragraphs 10a, 10b, and 10c	$ 12,407,556	$ 196,767	$ 12,604,323	$ 12,854,970	$ 33,831	$ 12,888,801
Paragraphs 10e:						
Federal tax paid in carryback years (10ei)	$ 6,346,865	$ -	$ 6,346,865	$ 7,821,364	$ -	$ 7,821,364
Lesser of:						
Deferred taxes expected to be realized within 3 years (10eii(a))	5,233,374	-	5,233,374	3,937,434	-	3,937,434
15% of statutory capital of previously filed statement (10eii(b))						
Amount of gross DTA's that can be offset against DTL's (10eiii)	3,958,858	196,767	4,155,625	4,270,524	33,831	4,304,355
Admitted deferred tax asset - SSAP 10R paragraph 10e	$ 15,539,097	$ 196,767	$ 15,735,864	$ 16,029,322	$ 33,831	$ 16,063,153
The risk-based capital level for the test in paragraph 10(d) is						
Total adjusted capital in the risk-based capital calculation			$ 109,075,435			$ 102,065,470
Authorized control level of risk-based capital			9,263,306			8,286,378
Applicable % for application of SSAP 10R			1178%			1232%

The impact of SSAP 10R is as follows:

	2010			2009		
	Ordinary	Capital	Total	Ordinary	Capital	Total
SSAP 10R , paragraph 10a, 10b, 10c						
a. Admitted deferred tax assets	$ 12,407,556	$ 196,767	$ 12,604,323	$ 12,854,970	$ 33,831	$ 12,888,802
b. Admitted assets			$ 818,066,491			$ 798,712,714
c. Statutory surplus			$ 88,916,528			$ 84,613,940
d. Total adjusted Capital from DTAs			$ 12,604,323			$ 12,888,802
Increase due to SSAP 10R, paragraph 10e.						
e. Admitted deferred tax assets	$ 3,131,541	$ -	$ 3,131,541	$ 3,174,352	$ -	$ 3,174,352
f. Admitted assets	$ 3,131,541	$ -	$ 3,131,541	$ 3,174,352	$ -	$ 3,174,352
g. Statutory surplus	$ 3,131,541	$ -	$ 3,131,541	$ 3,174,352	$ -	$ 3,174,352

At December 31, 2010, tax planning strategies did not impact adjusted gross deferred tax assets or net admitted deferred tax assets.

6. Federal Income Taxes (continued)

There were no unrecognized deferred tax liabilities as of December 31, 2010 and 2009.

The major components of the deferred tax amounts are as follows:

	2010	2009	Change
Deferred tax assets-ordinary:			
Reserves	$ **7,511,602**	$ 7,869,534	$ (357,932)
Proxy DAC	**4,615,724**	4,577,488	38,236
Dividends apportioned for payment	**2,278,000**	2,278,000	–
Accrued deferred compensation	**1,798,982**	1,762,426	36,556
Postretirement benefits and other general expenses	**1,207,911**	1,150,410	57,501
Other	**1,404,700**	1,542,834	(138,134)
Total deferred tax assets	**18,816,919**	19,180,692	(363,773)
Deferred tax assets nonadmitted	**3,277,822**	3,151,370	126,452
Admitted ordinary deferred tax assets	**15,539,097**	16,029,322	(490,225)
Capital:			
Premium bonds	**141,098**	113,377	27,721
Other than temporary impairments	**2,577,178**	4,331,780	(1,754,602)
Unrealized capital losses	**184,333**	144,038	40,295
Subtototal deferred tax assets	**2,902,609**	4,589,195	(1,686,586)
Nonadmitted deferred tax assets	**2,705,842**	4,555,364	(1,849,522)
Admitted capital deferred tax assets	**196,767**	33,831	162,936
Total admitted deferred tax assets	$ **15,735,864**	$ 16,063,153	$ (327,289)
Deferred tax liabilities:			
Ordinary:			
Depreciable assets	$ **34,599**	$ 55,288	$ (20,689)
Deferred and uncollected premiums	**3,110,836**	3,180,196	(69,360)
Market discount	**637,981**	640,415	(2,434)
Reserve change	**48,656**	54,442	(5,786)
Other	**126,786**	340,183	(213,397)
Subtotal ordinary deferred tax liabilities	**3,958,858**	4,270,524	(311,666)
Capital:			
Unrealized capital gains	**172,440**	–	172,440
Real estate	**24,327**	33,831	(9,504)
Subtotal capital deferred tax liabilities	**196,767**	33,831	162,936
Total deferred tax liabilities	$ **4,155,625**	$ 4,304,355	$ (148,730)

6. Federal Income Taxes (continued)

Current income taxes incurred consist of the following major components:

	2010	2009	Change
Ordinary:			
Total gross deferred tax assets	**$ 21,719,528**	$ 23,769,887	$ (2,050,359)
Total gross deferred tax liabilities	**4,155,625**	4,304,355	(148,730)
Net deferred tax asset (including unrealized capital gains)	**$ 17,563,903**	$ 19,465,532	(1,901,629)
Deferred tax on change in net unrealized capital gains			132,146
Change in net deferred income tax (excluding unrealized capital gains)			$ (1,769,483)

Current income taxes incurred consist of the following major components:

	2010	2009	Change
Federal income tax on operations	**$ 2,298,500**	$ 1,456,122	$ 842,378
Prior year over/under accrual	**(363,878)**	460,674	(824,552)
Federal income tax on operations incurred	**1,934,622**	1,916,796	17,826
Federal income tax on net realized capital gains (losses)	**(499,422)**	(413,572)	(85,850)
Current federal income tax incurred (benefit)	**$ 1,435,200**	$ 1,503,224	$ (68,024)

Reconciliation of Federal Income Tax Rate to Actual Effective Rate

The significant items causing a difference between the statutory federal income tax rate and the Company's effective income tax rate are as follows:

6. Federal Income Taxes (continued)

	2010	Effective Tax Rate	2009	Effective Tax Rate
Provision computed at statutory rate	**$ 3,711,580**	**34%**	$ 958,267	34%
Amortization of interest maintenance reserve	**$ (353,197)**	**(3.24)%**	$ (236,943)	(8.41)%
Non deductible items	**9,035**	**0.08%**	10,071	0.36%
Change in non admitted assets	**(143,982)**	**(1.32)%**	136,723	4.85%
Prior year true up	**(11,144)**	**(0.10)%**	(9,085)	(0.32)%
Other	**(7,608)**	**(0.07)%**	3,264	0.12%
Total effective tax	**$ 3,204,684**	**29.35%**	$ 862,297	30.59%
Federal and foreign income taxes incurred	**$ 1,435,200**	**13.15%**	$ 1,503,224	53.34%
Change in net deferred income taxes	**1,769,484**	**16.21%**	(640,927)	(22.74)%
Total statutory income taxes	**$ 3,204,684**	**29.36%**	$ 862,297	30.59%

The Company does not have any operating loss or tax credit carryforwards available for tax purposes. Federal taxes available for recovery in the event of the carryback of future operations loss deductions are as follows:

	Ordinary	Capital	Total
2010	$ 2,298,500	$ –	$ 2,298,500
2009	$ 1,456,122	$ –	$ 1,456,122
2008	$ 2,592,243	$ 60,039	$ 2,652,282

The Company does not have any deposits admitted under Section 6603 of the IRS Code.

6. Federal Income Taxes (continued)

Consolidated Return:

The Company's Federal Income Tax return is consolidated with its wholly owned subsidiary, Texas Directors Life Insurance Company effective November 1, 2010. The method of allocation is subject to written agreement with the wholly owned subsidiary. The method of allocation between the companies is based upon separate return calculations with current credit for net losses. Inter-company tax balances are settled annually within 90 days after the federal income tax return is completed and filed. The agreement is on file with the Texas Department of Insurance.

7. Surplus

Unassigned surplus funds were earned by the participating policyholders. There are no restrictions on the unassigned surplus.

Life/health insurance companies are subject to certain risk-based capital (RBC) requirements as specified by the NAIC. Under those requirements, the amount of surplus to be maintained by a life/health insurance company is to be determined based on the various risk factors related to it. At December 31, 2010 and 2009, the Company exceeded the RBC requirements.

The main components of the change in nonadmitted assets are as follows:

	2010	2009	Change
Furniture and equipment	**$ 132,555**	$ 291,845	$ (159,290)
Nonoperating software	**549,809**	510,114	39,695
Miscellaneous receivables and deposits	**508,698**	479,592	29,106
Agent balances	**2,130,318**	1,674,334	455,984
Policy loans and investment income due	**68,042**	10,061	57,981
Deferred tax assets	**5,983,664**	7,706,734	(1,723,070)
	$ 9,373,086	$ 10,672,680	1,299,594
Change as result of SSAP 10R adoption			(42,811)
			$ 1,342,405

7. Surplus (continued)

The Company elected to admit deferred tax assets pursuant to paragraph 10.e of SSAP 10R. The additional amount admitted and reported as special surplus funds was $3,151,541 and $3,174,352 at year-end 2010 and 2009, respectively.

8. Leases

The Company leases office equipment under various noncancelable operating lease agreements that expire at various intervals through 2015. Rental expense was approximately $236,000 and $240,000 during 2010 and 2009, respectively. At January 1, 2011, future minimum payments under noncancelable leases are as follows (in thousands):

2011	$	212
2012		197
2013		141
2014		52
2015		16
	$	618

9. Commitments and Contingencies

The Company is named as a defendant in various legal actions arising principally from claims made under life insurance policies. Those actions are considered by the Company in estimating the policy and contract liabilities. The Company's management believes that the resolution of those actions will not have a material effect on the Company's financial position or results of operations.

10. Annuity Reserves

At December 31, 2010 and 2009, the Company's annuity reserves and deposit fund liabilities that were subject to discretionary withdrawal (with adjustment), subject to discretionary withdrawal (without adjustment) and not subject to discretionary withdrawal provisions are summarized as follows:

	At December 31, 2010	
	Amount	**Percent**
Subject to discretionary withdrawal (with adjustment):		
(1) With market value adjustment	$ –	–%
(2) At book value less current surrender charge of 5% or more	16,673,722	9.62
(3) At market value	–	–
(4) Total with adjustment or at market value	16,673,722	9.62
(5) At book value without adjustment (minimal or no charge or adjustment)	112,686,154	64.98
Not subject to discretionary withdrawal	44,043,321	25.40
Total gross	173,403,197	100.00%
Reinsurance ceded	18,844,495	
Total (net)	$ 154,558,702	

10. Annuity Reserves (continued)

	At December 31, 2009	
	Amount	Percent
Subject to discretionary withdrawal (with adjustment):		
(1) With market value adjustment	$ –	–%
(2) At book value less current surrender charge of 5% or more	12,191,908	7.26
(3) At market value	–	–
(4) Total with adjustment or at market value	12,191,908	7.26
(5) At book value without adjustment (minimal or no charge or adjustment)	111,444,540	66.38
Not subject to discretionary withdrawal	44,245,556	26.36
Total gross	167,882,004	100.00%
Reinsurance ceded	18,573,193	
Total (net)	$ 149,308,811	

11. Life Premium and Annuity Considerations Deferred and Uncollected

Deferred and uncollected life insurance premiums and annuity considerations at December 31, 2010 and 2009, were as follows:

Type	Gross	Net of Loading
At December 31, 2010:		
Ordinary life new business	**$ 1,103,664**	**$ 225,662**
Ordinary life renewal	**10,196,372**	**8,575,324**
Individual annuity	**987**	**873**
Group life	**439,177**	**439,177**
Total	**$ 11,740,200**	**$ 9,241,036**
At December 31, 2009:		
Ordinary life new business	$ 928,509	$ 183,126
Ordinary life renewal	10,472,941	8,854,448
Individual annuity	987	872
Group life	439,394	439,394
Total	$ 11,841,831	$ 9,477,840

12. Employee Benefits

Company employees are covered by a qualified defined contribution (Section 401(k)) plan sponsored by the Company. Assets are held under various elective separate investment accounts by the Massachusetts Mutual Life Insurance Company (Springfield, Massachusetts).

Matching contributions are made at 62.5% on participants' contributions of up to 6%. The Company's contributions to the plan were $180,725 and $184,069 for 2010 and 2009, respectively. Additional contributions in the amount of $191,625 and $184,290 for 2010 and 2009, respectively, (representing 3% of total compensation of all eligible) were made to the retirement plan. At December 31, 2010, the fair value of plan assets was $13,687,226. Any liabilities for this plan are reflected on the financial statements of the Massachusetts Mutual Life Insurance Company.

The Company provides certain life insurance and health care benefits for retired employees. Substantially all employees may become eligible for these benefits if they reach retirement age while working for the Company. Retirees may elect certain prepaid health care benefit plans. Medical coverage may require retiree contributions. The Company's policy is to make payments to these plans sufficient to provide for benefit payments required under the plans.

Life insurance benefits, generally amounting to annual earnings at retirement decreasing uniformly over 15 years to 25% of the entire amount for life thereafter, are provided under a retired lives reserve. The retired lives reserve was $589,417 at December 31, 2010, and $571,376 at December 31, 2009.

The estimated unfunded accumulated postretirement health care benefit obligations, unrecognized transition obligation and accrued postretirement health care benefit liability for the Company were as follows:

	December 31	
	2010	**2009**
Actuarial present value of health care benefit obligations:		
Retirees	$ **4,558,925**	$ 4,437,754
Fully eligible and vested plan participants	**2,942,352**	2,833,791
Accumulated postretirement health care benefit obligation for fully vested participants	$ **7,501,277**	$ 7,271,545
Actuarial present value of health care benefit obligation for nonvested employees	$ **3,957,777**	$ 2,886,827
Unrecognized transition obligation	$ **174,072**	$ 217,592
Accrued postretirement health care benefit liability	$ **2,795,567**	$ 2,636,204

12. Employee Benefits (continued)

The weighted average discount rate used in determining the actuarial present value of the postretirement health care benefit obligation was 5.43% in 2010 and 5.97% in 2009.

For measurement purposes, a 9% annual rate of increase in the per capita cost of covered health care benefits was assumed for the year following the date of the valuation, and that rate was assumed to decrease gradually to 5.5% in 2015 and remain at that level. A 1.0% increase in the assumed annual rate of increase in the per capita cost of health care benefits results in an increase in the accumulated postretirement benefit obligation and postretirement benefit expense. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the postretirement benefit obligation as of December 31, 2010, by $874,355 and the estimated eligibility cost and interest cost components of net periodic postretirement benefit cost by $42,251.

Postretirement benefit cost for 2010 was $609,623 and for 2009 was $1,100,754, including amortization of the transition obligation plus the expected cost of health care benefits for newly eligible or vested employees, the expected cost of life insurance benefits for eligible employees and interest cost.

It has been determined that the Company's prescription drug benefit is actuarially equivalent to Medicare Part D under the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) and will therefore qualify for the federal subsidy. The postretirement benefit obligation and net periodic benefit cost reflect amounts associated with the subsidy.

For the year ended December 31, 2010, the effect of the Act was a $58,290 reduction in the net postretirement benefit cost for the subsidy related to benefits attributed to former employees. The Act also had the following effects on the net postretirement benefit cost; a $10,421 decrease as a result of an actuarial gain and a $47,869 decrease to the interest cost. Note that there was no impact to the eligibility cost since it was $0 for 2010.

In March 2010, the Patient Protection and Affordable Care Act (PPACA) was enacted. One of the key aspects of PPACA was the removal of the tax free status of the Retiree Drug Subsidy (RDS) beginning in 2013. Since the Company has not recognized a deferred tax expense, there are not necessary adjustments due to PPACA.

12. Employee Benefits (continued)

Expected 2010 gross benefit payments were $446,247 and actual gross benefit payments were $496,699. The subsidy was $42,801 during 2010 for the 2008 through 2010 plan years. Of this amount $7,326 had already been reflected as a receivable for 2008 resulting in a net subsidy payment of $35,565 for 2010. Note, no receivable subsidy amounts had been reflected for 2009.

Supplemental Retirement Plans

The Company has nonqualified deferred compensation agreements with certain employees and agents. Benefits under the agreements with the home-office employees vest immediately. Benefits under agent agreements have a graded vesting dependent on various factors. The Company records nonvested balances as a nonadmitted asset. The liability for these agreements was $4,872,905 and $4,704,486 at December 31, 2010 and 2009, respectively. The nonvested balance at December 31, 2010, was $59,101. The expense for these agreements amounted to $287,742 and $289,711 in 2010 and 2009, respectively.

The Company has accrued for compensated absences/vacation pay in accordance with SSAP No. 11, *Postemployment Benefits and Compensated Absences*. A liability of $833,480 is recorded in salaries and wages general expense.

13. Other

The Company is a member of the Federal Home Loan Bank (FHLB) of Dallas. Through its membership, the Company has available a $30,000,000 line of credit and has issued no funding agreements to the FHLB of Dallas. The Company has no advances for cash to use in an investment spread strategy. The Company will apply SSAP No. 52 *Deposit-Type Contracts* accounting treatment to funds utilized in an investment spread strategy. The Company has not utilized funds for operations, and any funds obtained from the FHLB for use in general operations will be accounted for as liabilities related to the agreement with the FHLB of Dallas consistent with SSAP No. 15, *Debt and Holding Company Obligations*.

14. Subsequent Events

The date to which events occurring after December 31, 2010, have been evaluated for possible adjustment to the financial statements or disclosure is May 26, 2011, which is the date on which the financial statements were available to be issued.

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Financial Statements – Statutory-Basis

Government Personnel Mutual Life Insurance Company
Years Ended December 31, 2009 and 2008
With Report of Independent Auditors

Ernst & Young LLP

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Financial Statements – Statutory-Basis

Years Ended December 31, 2009 and 2008

Contents

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Report of Independent Auditors

The Board of Directors
Government Personnel Mutual Life Insurance Company

We have audited the accompanying statutory-basis balance sheets of Government Personnel Mutual Life Insurance Company as of December 31, 2009 and 2008, and the related statutory-basis statements of income, changes in surplus, and cash flow 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Company presents its financial statements in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and accounting principles also are described in Note 1. The effects on the financial statements of these variances are not reasonably determinable but are presumed to be material.

In our opinion, because of the effects of the matter described in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of Government Personnel Mutual Life Insurance Company at December 31, 2009 and 2008, or the results of its operations or its cash flows for the years then ended.

However, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Government Personnel Mutual Life Insurance Company at December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended, in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance.

As discussed in Note 1 to the financial statements, effective December 31, 2009 the Company changed its method for accounting for income taxes with the adoption of Statement of Statutory Accounting Principles (SSAP) No. 10R, *Income Taxes – Revised, A Temporary Replacement of SSAP No. 10.*

Ernst + Young LLP

May 24, 2010

Government Personnel Mutual Life Insurance Company

Balance Sheets – Statutory-Basis

	December 31	
	2009	**2008**
Admitted assets		
Cash and invested assets:		
Bonds	**$ 531,859,636**	$ 500,709,201
Preferred stocks	**2,009,600**	3,052,805
Common stocks	**3,567,374**	2,128,138
Mortgage loans	**127,023,286**	122,398,492
Real estate, less accumulated depreciation (2009 – $1,190,063; 2008 – $849,912):		
Properties occupied by the Company	**7,158,242**	7,380,157
Properties held for the production of income	**6,635,643**	3,434,985
Policy loans	**74,344,102**	73,150,353
Short-term investments	**12,006,665**	36,988,264
Cash and cash equivalents	**4,057,942**	7,904,584
Receivable for securities	**19,688**	82,799
Total cash and invested assets	**768,682,178**	757,229,778
Deferred premiums, less loading (2009 – $2,363,990; 2008 – $2,411,764)	**8,777,115**	9,075,545
Uncollected premiums	**828,964**	780,996
Federal tax recoverable, including net deferred tax asset (2009 – $11,758,799; 2008 – $8,383,635)	**12,172,371**	8,638,635
Accrued investment income	**8,437,621**	8,100,417
Electronic data processing equipment, less accumulated depreciation (2009 – $1,118,391; 2008 – $1,329,417)	**115,711**	147,600
Amounts due from reinsurers	**2,268,871**	2,506,125
Other admitted assets	**604,235**	674,306
Total admitted assets	**$ 801,887,066**	$ 787,153,402

Government Personnel Mutual Life Insurance Company

Balance Sheets – Statutory-Basis (continued)

	December 31	
	2009	**2008**
Liabilities and surplus		
Liabilities:		
Policy and contract liabilities:		
Life and annuity reserves	**$ 607,575,087**	$ 596,329,688
Accident and health reserves	**573,104**	636,574
Deposit-type contracts	**60,784,248**	60,680,375
Dividends and coupons payable	**6,707,225**	6,653,225
Unpaid claims	**7,450,726**	8,402,582
Other	**525,787**	1,071,512
Total policy and contract liabilities	**683,616,177**	673,773,956
Benefits for employees	**4,854,486**	6,203,531
Accounts payable and accrued expenses	**5,538,201**	5,028,129
Unearned investment income	**2,229,485**	2,177,670
Asset valuation reserve	**10,927,178**	10,368,530
Interest maintenance reserve	**4,490,451**	4,502,501
Other	**2,442,796**	1,539,947
Total liabilities	**714,098,774**	703,594,264
Surplus:		
Surplus guarantee fund	**400,000**	400,000
Special surplus funds	**3,174,352**	–
Unassigned surplus	**84,213,940**	83,159,138
Total surplus	**87,788,292**	83,559,138
Total liabilities and surplus	**$ 801,887,066**	$ 787,153,402

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Income – Statutory-Basis

	Years Ended December 31 2009	2008
Premiums and other revenues:		
Premium on life, annuity and accident and health policies	$ 54,957,813	$ 52,662,679
Consideration for supplementary contracts with life contingencies	257,423	673,901
Net investment income	42,528,241	44,002,427
Amortization of the interest maintenance reserve	696,890	590,957
Commissions and expense allowances on reinsurance ceded	4,531,021	4,384,119
Miscellaneous income	99,796	58,592
Total premiums and other revenues	103,071,184	102,372,675
Benefits paid or provided:		
Death benefits	27,005,673	26,481,309
Annuity benefits	4,739,123	9,279,333
Surrender benefits	15,477,270	16,964,566
Interest and adjustments on policy or deposit-type contract funds	2,706,753	2,732,908
Payments from supplementary contracts with life contingencies	1,228,638	1,391,289
Other benefits	1,546,051	1,911,151
Increase in policy reserves	11,181,929	4,728,441
Total benefits paid or provided	63,885,437	63,488,997
Insurance expenses:		
Commissions	5,908,383	6,666,233
General expenses	17,301,277	17,139,101
Insurance taxes, licenses, and fees	1,494,548	1,445,032
Total insurance expenses	24,704,208	25,250,366
Total benefits paid or provided and insurance expenses	88,589,645	88,739,363
Gain from operations before dividends to policyholders, income taxes, and net realized capital losses	14,481,539	13,633,312
Dividends to policyholders	(6,704,029)	(6,655,833)
Gain from operations before income taxes and net realized capital losses	7,777,510	6,977,479
Federal income taxes	1,916,796	2,669,867
Gain from operations before net realized capital losses	5,860,714	4,307,612
Net realized capital losses, net of federal income tax (benefit) expense (2009 – $(766,369); 2008 – $4,729), and net of amounts transferred to IMR	(5,230,348)	(7,445,930)
Net income (loss)	$ 630,366	$ (3,138,318)

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Changes in Surplus – Statutory-Basis

	Years Ended December 31	
	2009	**2008**
Surplus at beginning of year	**$ 83,559,138**	$ 87,957,371
Net income (loss)	**630,366**	(3,138,318)
Change in net unrealized capital gain (loss)	**250,839**	(871,718)
Change in net deferred tax	**640,927**	3,401,783
Change in nonadmitted assets	**91,233**	(4,713,127)
Change in liability for reinsurance in unauthorized companies	**85**	(41)
Change in asset valuation reserve	**(558,648)**	923,188
Additional admitted deferred tax asset under SSAP 10R	**3,174,352**	–
Net increase (decrease)	**4,229,154**	(4,398,233)
Surplus at end of year	**$ 87,788,292**	$ 83,559,138

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Cash Flow – Statutory-Basis

	Years Ended December 31	
	2009	2008
Operating activities:		
Premiums collected net of reinsurance	$ **55,435,080**	$ 53,882,505
Net investment income	**43,050,621**	42,566,584
Miscellaneous income	**4,567,708**	4,521,546
Total	**103,053,409**	100,970,635
Benefits paid	**51,494,102**	54,469,638
Commissions, expenses paid and aggregate write-ins for deductions	**24,275,033**	24,207,450
Dividends paid to policyholders	**6,650,029**	6,603,833
Federal income taxes paid, net of tax on capital gains	**1,620,000**	2,669,084
Total	**84,039,164**	87,950,005
Net cash provided by operating activities	**19,014,245**	13,020,630
Investing activities:		
Proceeds from investments sold, matured or repaid:		
Bonds	**103,903,389**	120,363,738
Stocks	**1,755,088**	1,220,022
Mortgage loans	**15,972,805**	18,802,894
Other proceeds	**63,111**	786,473
Total investment proceeds	**121,694,393**	141,173,127
Cost of investments acquired:		
Bonds	**139,636,431**	88,777,974
Stocks	**1,970,265**	2,779,187
Mortgage loans	**20,462,500**	33,480,000
Real estate	**3,588,754**	2,027,479
Miscellaneous applications	–	391,091
Total investments acquired	**165,657,950**	127,455,731
Net increase in policy loans	**1,199,810**	1,316,113
Net cash (used in) provided by investing activities	**(45,163,367)**	12,401,283
Financing and miscellaneous activities:		
Net deposits on deposit-type contract funds	**(2,226,743)**	(2,590,774)
Other cash provided (applied)	**(452,376)**	(245,521)
Net cash (used in) miscellaneous activities	**(2,679,119)**	(2,836,295)
Net change in cash and short-term investments	**(28,828,241)**	22,585,618
Cash, cash equivalents, and short-term investments:		
At beginning of year	**44,892,848**	22,307,230
At end of year	$ **16,064,607**	$ 44,892,848

See accompanying notes.

1. Nature of Operations and Significant Accounting Policies

Government Personnel Mutual Life Insurance Company (the Company) is domiciled in the state of Texas. The Company is a mutual life insurance organization specializing in the armed forces, civil service, and final expense markets. Coverages are also available to the middle-to-upper-income general civilian market.

Operations are conducted primarily on personal producing and managing general agent plans through approximately 1,400 general and soliciting agents. The Company is licensed in 48 states and the District of Columbia. Its primary markets are the states of Texas, South Carolina, Florida, Virginia, Georgia and North Carolina. The Company is also accredited to solicit sales at some overseas military installations. The Company offers a portfolio of the usual forms of individual permanent, term, flexible premium universal life, and annuity policies, all without a war clause. Life insurance and annuity plans are available to United States military personnel and Civil Service employees through a federal allotment plan. Automatic payment plans are available to the civilian populace. A significant part of new business is issued in the Senior Final Expense market. The Company is the underwriter for the group association coverages for members of the Military Benefit Association (MBA). The Company derives substantially all of its direct group life and group accident and health business from the group policy issued to the MBA.

Basis of Presentation

The Company's financial statements are prepared in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, whose practices may differ from U.S. generally accepted accounting principles. The more significant variances from GAAP are as follows:

Investments: Investments in bonds are reported at amortized cost or fair value based on their National Association of Insurance Commissioners (NAIC) rating; for 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 surplus for those designated as available-for-sale. Fair value for statutory purposes is based on the price published by the Securities Valuation Office of the NAIC (SVO), if available, whereas fair value for GAAP is based on quoted market prices.

1. Nature of Operations and Significant Accounting Policies (continued)

All single-class and multi-class mortgage-backed/asset-backed securities (e.g., CMOs) 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. For GAAP purposes, all securities, purchased or retained, that represent beneficial interests in securitized assets (e.g., CMO, CBO, CDO, CLO, MBS, and ABS securities), 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. If high credit quality securities are adjusted, the retrospective method is used.

Real estate owned and occupied by the Company is included in investments rather than reported as an operating asset, as under GAAP. Investment income and operating expenses for statutory reporting include rent for the Company's occupancy of those properties.

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 are charged or credited directly to unassigned surplus rather than included as a component of earnings, as would be required under GAAP.

Changes in investment admitted asset carrying amounts are credited or charged directly to unassigned surplus.

Valuation Reserves: Under a formula prescribed by the NAIC, the Company defers the portion of realized capital gains and losses on sales of fixed-income investments attributable to changes in the general level of interest rates and amortizes those deferrals over the remaining period to maturity based on groupings of individual securities sold in five-year bands. That net deferral is reported as the interest maintenance reserve (IMR) in

1. Nature of Operations and Significant Accounting Policies (continued)

the accompanying balance sheets. Realized capital gains and losses are reported in income, net of federal income tax and transfers to the IMR. Under GAAP, realized capital gains and losses would be reported in the income statement on a pretax basis in the period that the assets giving rise to the gains or losses are sold.

The asset valuation reserve (AVR) provides a valuation allowance for invested assets. The AVR is determined by an NAIC-prescribed formula, with changes reflected directly to unassigned surplus; AVR is not recognized for GAAP.

Policy Acquisition Costs: 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.

Nonadmitted Assets: Certain assets designated as "nonadmitted," principally agents' balances, furniture and equipment, and other assets not specifically identified as an admitted asset within the *NAIC Accounting Practices and Procedures Manual*, are excluded from the accompanying balance sheets and charged directly to unassigned surplus. Under GAAP, such assets are included in the balance sheet to the extent that those assets are not impaired.

Universal Life and Annuity Policies: Revenues for universal life and annuity policies with mortality or morbidity risk consist of the entire premium received, and benefits incurred represent the total of death benefits paid, surrender benefits paid and the change in policy reserves. Proceeds received for annuity policies without mortality or morbidity risk 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 account values.

1. Nature of Operations and Significant Accounting Policies (continued)

Benefit Reserves: Certain policy reserves are calculated based on statutorily required interest and mortality assumptions rather than on estimated expected experience or actual account balances, as would be required under GAAP.

Reinsurance: Policy and contract liabilities ceded to reinsurers have been reported as reductions of the related reserves rather than as assets, as would be required under GAAP. Commissions allowed by reinsurers on business ceded are reported as income when incurred rather than being deferred and amortized with deferred policy acquisition costs, as would be required under GAAP. In addition, liability for reinsurance balances has been provided for unsecured policy reserves ceded to reinsurers not authorized to assume such business. Changes to the liability are credited or charged directly to unassigned surplus. Under GAAP, an allowance for amounts deemed uncollectible would be established through a charge to earnings.

Employee Benefits: For purposes of calculating the Company's postretirement and postemployment benefit obligations, only vested participants and current retirees are included in the valuation. Under GAAP, active participants not currently eligible would also be included.

Deferred Income Taxes: Under SSAP No. 10, deferred tax assets (DTAs) 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 balance sheet date or 10% of surplus excluding any net deferred tax assets, and EDP equipment and operating software, 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. Effective December 31, 2009, a Temporary Replacement of SSAP No. 10 SSAP No. 10R modified the computation of admitted deferred taxes. If a company's risk-based capital level is above a certain threshold, the prescribed time frame for expected realization of DTAs is three years and the prescribed percentage of surplus is 15%. Also beginning in 2009, only adjusted gross DTAs that are more likely than not to be realized are considered in determining admitted DTAs. The character (capital or ordinary) is required to be considered in the admitted asset determination. Deferred taxes do not include amounts for state taxes. Under GAAP, state income 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.

1. Nature of Operations and Significant Accounting Policies (continued)

Policyholder Dividends: Policyholder dividends are recognized when declared rather than over the term of the related policies. Dividends are determined annually by the Company's Board of Directors. Individual ordinary life participating premium approximates 84% of the Company's ordinary life insurance collected premiums.

The effects of the foregoing variances from GAAP on the accompanying statutory-basis financial statements have not been determined, but are presumed to be material.

Other significant accounting practices are as follows:

Investments

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

Bonds are stated at amortized cost or, for certain bonds, at fair value as determined by the SVO, with related unrealized capital gains/losses reported in unassigned surplus, net of federal income tax.

Bonds not backed by other loans are stated at amortized cost using the interest method. Loan-backed bonds and structured securities are valued at amortized cost using the interest method including anticipated prepayments. Prepayment assumptions are obtained from broker dealer survey values 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.

Redeemable preferred stocks are reported at cost or amortized cost as determined by the SVO.

Common stocks are reported at fair value as determined by the SVO, and the related unrealized capital gains or (losses) are reported in unassigned surplus, net of federal income taxes.

There are no restrictions on common or preferred stock.

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.

1. Nature of Operations and Significant Accounting Policies (continued)

Cash equivalents are short-term highly liquid investments with original maturities of three months or less at time of acquisition and are principally stated at amortized cost.

Mortgage loans are reported at unpaid principal balances, less an allowance for impairment as needed. 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, the impairment is other-than-temporary; the mortgage loan is written down to a realizable value and a realized loss is recognized.

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, with depreciation calculated on a straight-line basis over the estimated useful lives of the properties.

Policy loans are reported at their unpaid principal balance.

Realized capital gains and losses are determined using the specific identification basis. Changes in admitted asset carrying amounts of bonds, mortgage loans, policy loans, common and preferred stocks are credited or charged directly to unassigned surplus.

Market Segment Concentrations

The Company has $126,357,062 in corporate bonds of banks, insurance and finance related corporations. In the event of a severe market event in this segment, the Company could lose a material amount in these investments. At year-end, there was an unrealized loss of $4,789,024 on this exposure to the financial industry.

Furniture and Equipment

The Company's electronic data processing equipment and operating software are reported at cost, less accumulated depreciation. Depreciation is provided in amounts sufficient to charge the cost of electronic processing equipment and operating software to operations over the lesser of their estimated service lives or three years on a straight-line basis. Nonoperating software is depreciated on a straight-line basis over the lesser of its useful life or five years. Other furniture and equipment are depreciated on a straight-line basis over the lesser of their estimated service lives or five years. Depreciation and amortization expense charged to operations was $386,583 for 2009 and $391,878 for 2008.

1. Nature of Operations and Significant Accounting Policies (continued)

Premiums

Life and accident and health premiums are recognized as revenue when due. Premiums for annuity policies with mortality and morbidity risk are also recognized as revenue when due. Premiums received for annuity policies without mortality or morbidity risk and for group annuity contracts are recorded using deposit accounting.

Benefit Reserves

Life, annuity, and accident and health benefit reserves are developed by actuarial methods and are determined based on published tables using statutorily specified interest rates and valuation methods that will provide, in the aggregate, reserves that are greater than the minimum required by the Texas Department of Insurance.

The Company waives deduction of deferred fractional premiums upon the death of insureds and refunds any premium beyond the month of death. Surrender values on policies do not exceed the corresponding benefit reserves. Extra premiums are charged for substandard lives plus the gross premium for the true age. The mean reserve method is used to adjust the calculated terminal reserve to the appropriate reserve at December 31. Mean reserves are determined by computing the regular mean reserve for the plan at the true age and holding, in addition, one-half of the extra premium charge for the year. An asset is recorded for deferred premiums net of loading to adjust the reserve for modal premium payments. Additional reserves are established when the results of cash flow testing under various interest rate scenarios indicate the need for such reserves. There has been no need for such reserves.

As of December 31, 2009 and 2008, reserves of $1,643,030 and $2,049,210, respectively, were recorded on in-force amounts of $106,445,424 and $144,164,059, respectively, for which gross premiums are less than the net premiums according to the standard of valuation required by the Texas Department of Insurance.

The tabular interest, tabular cost less actual reserve released and tabular cost have been determined by formula. For determination of tabular interest on funds not involving life contingencies, the tabular interest is actual interest credited or due on the accounts for the valuation year.

1. Nature of Operations and Significant Accounting Policies (continued)

Deposit-Type Contracts

Deposit-type contracts consist primarily of dividend accumulations, premium deposits, and supplemental contracts not involving life contingencies and annuities certain. Premium deposits relate primarily to the MBA group business. Deposit-type contracts are increased and decreased according to the deposits and withdrawals, respectively, of the applicable policyholders, as well as by retrospectively rated credits and debits for favorable and unfavorable, respectively, underwriting and investment experience of the MBA business.

Unpaid Claims

The liability for unpaid policy and contract claims represents the estimate of the ultimate net cost of all reported and unreported claims incurred through year-end. The liability is estimated using individual case-basis valuations and Company history. Those estimates are subject to the effects of trends in claim severity and frequency. Although considerable variability is inherent in such estimates, management believes that the reserve for unpaid claims is adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

Reinsurance

Reinsurance premiums and benefits paid or provided are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Guaranty Fund Assessments

Guaranty fund assessments are accrued when the Company receives notice or other information that a reasonably estimable amount is or is likely to be payable to a guaranty fund.

Use of Estimates

The preparation of statutory-basis financial statements requires management to make estimates and assumptions that affect amounts reported in the 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.

1. Nature of Operations and Significant Accounting Policies (continued)

Reclassifications

If necessary, certain 2008 amounts in the Company's statutory-basis financial statements have been reclassified to conform to the 2009 financial statement presentation.

2. Investments

Bonds: The amortized cost and the fair value of investments in bonds are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2009				
U.S. Government and agencies	$ 85,791,050	$ 2,536,285	$ (866,411)	$ 87,460,924
State and political subdivisions	69,974,183	472,428	(4,283,039)	66,163,572
Corporate securities	349,042,070	13,100,113	(12,418,692)	349,723,491
Mortgage-backed securities	27,052,333	1,246,764	(54,471)	28,244,626
Total bonds	$ 531,859,636	$ 17,355,590	$ (17,622,613)	$ 531,592,613
At December 31, 2008				
U.S. Government and agencies	$ 97,244,124	$ 5,534,838	$ (337,809)	$ 102,441,153
State and political subdivisions	25,981,931	118,769	(2,843,729)	23,256,971
Corporate securities	350,159,714	4,574,502	(49,933,166)	304,801,050
Mortgage-backed securities	27,323,432	808,200	(189,162)	27,942,470
Total bonds	$ 500,709,201	$ 11,036,309	$ (53,303,866)	$ 458,441,644

The following table shows gross unrealized losses and fair values of fixed maturities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

2. Investments (continued)

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2009						
U.S. Government and agencies	$ 35,606,309	$ (760,023)	$ 3,801,860	$ (106,388)	$ 39,408,169	$ (866,411)
State and political subdivisions	37,662,771	(1,708,148)	16,654,349	(2,574,891)	54,317,120	(4,283,039)
Corporate securities	6,913,655	(110,057)	111,177,051	(12,308,635)	118,090,706	(12,418,692)
Mortgage-backed securities	448,279	(314)	913,330	(54,157)	1,361,609	(54,471)
Total bonds	$ 80,631,014	$ (2,578,542)	$ 132,546,590	$ (15,044,071)	$ 213,177,604	$ (17,622,613)
December 31, 2008						
U.S. Government and agencies	$ 9,353,675	$ (117,222)	$ 6,627,214	$ (220,587)	$ 15,980,889	$ (337,809)
State and political subdivisions	10,994,480	(1,230,097)	6,297,567	(1,613,632)	17,292,047	(2,843,729)
Corporate securities	93,152,898	(12,116,380)	129,459,475	(37,816,786)	222,612,373	(49,933,166)
Mortgage-backed securities	–	–	773,680	(189,162)	773,680	(189,162)
Total bonds	$ 113,501,053	$ (13,463,699)	$ 143,157,936	$ (39,840,167)	$ 256,658,989	$ (53,303,866)

A summary of the amortized cost and fair value of the Company's investments in bonds at December 31, 2009 by contractual maturity, is as follows:

	Amortized Cost	Fair Value
Years to maturity:		
One or less	$ 17,590,691	$ 18,033,328
After one through five	126,594,843	132,040,152
After five through ten	121,822,947	123,685,722
After ten	238,798,822	229,588,785
Mortgage-backed securities	27,052,333	28,244,626
Total	$ 531,859,636	$ 531,592,613

2. Investments (continued)

The actual maturities may differ from the contractual maturities in the foregoing table because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from sales of investments in bonds during 2009 and 2008 were $16,127,960 and $41,978,071, respectively; gross gains of $1,539,818 and $1,320,359 and gross losses of $31,439 and $270,945 were realized on those sales, respectively.

At December 31, 2009, bonds with an admitted asset value of $7,151,425 were on deposit with state insurance departments to satisfy regulatory requirements.

Stocks: Unrealized gains and losses on investments in common stocks are reported directly in unassigned surplus and do not affect operations.

The cost and fair value of investments in preferred stocks and common stocks are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2009				
Preferred stocks	**$ 2,009,600**	**$ 17,500**	**$ (245,400)**	**$ 1,781,700**
Common stocks	**$ 3,578,496**	**$ 260,760**	**$ (271,882)**	**$ 3,567,374**
At December 31, 2008				
Preferred stocks	$ 3,052,805	$ –	$ (1,047,905)	$ 2,004,900
Common stocks	$ 2,451,838	$ 119,674	$ (443,374)	$ 2,128,138

2. Investments (continued)

The following table shows gross unrealized losses and fair values of preferred and common stocks, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	Less than 12 Months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2009						
Stocks:						
Preferred stocks	$ –	$ –	$ 1,264,200	$ (245,400)	$ 1,264,200	$ (245,400)
Common stocks	1,274,950	(79,984)	776,062	(191,898)	2,051,012	(271,882)
Total	$ 1,274,950	$ (79,984)	$ 2,040,262	$ (437,298)	$ 3,315,212	$ (517,282)
December 31, 2008						
Stocks:						
Preferred stocks	$ 1,576,100	$ (976,705)	$ 428,800	$ (71,200)	$ 2,004,900	$ (1,047,905)
Common stocks	1,243,480	(443,374)	–	–	1,243,480	(443,374)
Total	$ 2,819,850	$ (1,420,079)	$ 428,800	$ (71,200)	$ 3,248,380	$ (1,491,279)

Mortgage Loans: During 2009, the minimum and maximum lending rates for mortgage loans were 6.625% and 7.5%, respectively. At the issuance of a loan, the percentage of loan to value on any one loan does not exceed 75%. Fire insurance is required on all properties covered by mortgage loans at least equal to the excess of each loan over the maximum loan that would be permitted by law on the land without the buildings. At December 31, 2009 and 2008, the Company held one mortgage with a carrying value of $0 and $3,456,556, respectively, with interest overdue beyond 180 days. There was $0 and $508,034 in nonadmitted interest or principal at December 31, 2009 and 2008. The Company foreclosed on this mortgage during 2009.

At December 31, 2009 and 2008, taxes, assessments and amounts advanced not included in the mortgage loan total were $21,573 and $28,151, respectively. At December 31, 2009, none of the Company's investments in mortgage loans were subject to prior liens.

2. Investments (continued)

The Company's investments in mortgage loans all involve commercial real estate. At December 31, 2009, all such mortgages involve properties located in the states of Texas, Arizona, Utah, New Mexico, Colorado and Nevada. Such investments consist of first mortgage liens on completed income-producing properties; at December 31, 2009, the mortgage outstanding on any individual property did not exceed $4,000,000.

The total recorded investment in restructured loans at December 31, 2009 and 2008, was $4,339,848 and $4,356,972, respectively. There were no realized capital losses related to these loans. There were no contractual commitments to extend credit to debtors owing receivables whose terms have been modified in troubled debt restructurings. The Company accrues interest income on impaired loans to the extent deemed collectible and the loan continues to perform under its original or restructured contractual terms. Interest income on nonperforming loans generally is recognized on an accrual basis to the extent deemed collectible.

The Company held no impaired mortgages at any time during 2008 and recorded no income on impaired mortgages during that year.

Real Estate: Properties held for the production of income represent two condominiums purchased for the use of Company employees, two properties adjacent to the Home Office property and one foreclosed property.

During 2008, the Company added one investment property to its real estate investments. The property is adjacent to the Home Office Building and expands the Company's holdings to the entire corner of Starcrest and Loop 410.

The property acquired through foreclosure in 2009 was initially classified as held-for-sale. Upon review of the existing market conditions, the Company chose to hold and improve the property and has reclassified the holding as investment property.

2. Investments (continued)

Net Investment Income: Net investment income consists of the following:

	Years Ended December 31	
	2009	**2008**
Income:		
Bonds	**$ 31,108,823**	$ 31,307,075
Preferred stocks	**169,526**	590,638
Common stocks	**59,579**	150,428
Mortgage loans	**7,813,421**	8,015,668
Real estate[1]	**963,172**	787,470
Policy loans	**4,742,875**	4,603,398
Short-term investments and cash	**201,472**	517,261
Other	**5,247**	272,098
Total investment income	**45,064,115**	46,244,036
Expenses:		
Real estate operating and maintenance	**894,885**	760,503
Real estate taxes	**180,996**	115,091
Depreciation	**340,151**	265,098
Other	**1,119,842**	1,100,917
Total investment expenses	**2,535,874**	2,241,609
Net investment income	**$ 42,528,241**	$ 44,002,427

[1]Real estate: Includes $633,842 in 2009 and $637,341 in 2008 for the Company's occupancy of its own building.

2. Investments (continued)

Realized Capital Gains (Losses): Realized capital gains (losses) are reported net of federal income taxes and amounts transferred to the IMR as follows:

	2009	2008
Realized capital losses	**$ (4,959,080)**	$ (6,304,842)
Less amount transferred to IMR (net of related taxes of $352,797 in 2009 and $386,362 in 2008)	**684,840**	749,997
	(5,643,920)	(7,054,839)
Less federal income tax (benefit) expense on realized capital (losses) gains	**(413,572)**	391,091
Net realized capital losses	**$ (5,230,348)**	$ (7,445,930)

Securities Lending: To realize additional income, the Company has in place a Securities Lending Agreement with Frost National Bank. The agreement allows Frost National Bank to lend the securities of the Company in a manner that is transparent to the Company. Frost National Bank performs all of the functions involved in lending securities and pays the Company 60% of all earnings made by Frost National Bank. The amount earned from securities lending during 2009 and 2008 was $0 and $107,387, respectively. Under the agreement, the Company establishes the limits on the amount that Frost National Bank may lend in total, not to exceed 40% of assets. The Company has full control of its assets and may sell any bond without prior approval from Frost National Bank. Frost National Bank posts a sell to the Company, whether the loaned security has been returned to it or not, and indemnifies the Company against any loss arising from the Securities Lending Program. The Company suspended the Securities Lending Agreement during the fourth quarter of 2008 and had no securities loaned at year-end 2008 nor at any time during 2009.

Asset Impairments – Other-Than-Temporary: Management regularly reviews the value of the Company's investments. If the value of any investment falls below its cost basis, the decline is analyzed to determine whether it is an other-than-temporary decline in value. To make this determination for each security, the following is considered:

- How long and by how much the fair value has been below its cost;
- The financial condition and near-term prospects of the issuer of the security, including any specific events that may affect its operations or earnings potential;

2. Investments (continued)

- Management's intent to hold the security long enough for it to recover its value;
- Any downgrades of the security by a rating agency;
- Any reduction or elimination of dividends, or nonpayment of scheduled interest payments; and
- The impact interest rates have had on the value of the security.

Bonds: During 2009, the Company recorded losses of $6,740,363 on five bonds considered to be impaired. Details of those that are loan-backed securities are shown below. A loss of $7,246,981 was recorded on four bonds in 2008.

Loan Backed Securities: The Company held three Collateralized Debt Obligations for which the present value of the cash flows expected to be collected is less than the amortized cost basis of the security.

None of the bonds are held with the intent to sell nor with the inability or lack of intent to retain the investment for a period of time sufficient to recover the amortized cost basis.

Held securities with a recognized other-than-temporary impairment, as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities:

Description	**a. Pre-OTTI amortized cost basis**	**b. Current year OTTI realized**	**c. Fair Value**	**d. Post-OTTI amortized cost basis**
ALESCO Pref Fdg,Ltd.	$ 1,016,500	$ 457,425	$ 169,756	$ 559,075
ALESCO Pref Fdg,Ltd.	2,000,000	1,983,200	16,800	16,800
Trapeza CDO LLC	2,147,970	2,105,019	21,476	42,556
Totals	$ 5,164,470	$ 4,545,644	$ 208,032	$ 618,431

2. Investments (continued)

The following bonds have fair values below the amortized cost of the bonds for which an interest-related impairment remains. Other-than-temporary impairments have been recognized for non-interest-related declines. All of the bonds have been in a continuous unrealized loss positions for more than 12 months.

Description	a. Unrealized Loss	b. Fair Value
ALESCO Pref FDG. Ltd.	$ 389,320	$ 169,756
Trapeza CDO LLC	21,476	21,476
Totals	$ 410,796	$ 191,232

The Company reviewed the cash flows of impaired loan-backed bonds and determined that the present values of the cash flows were less than the amortized cost of the bonds. Based on this determination and the fact that the Company had no intent to sell the bonds and did not lack the ability to hold the bonds until the cash flows were received, the Company impaired the bonds to the present value of the projected cash flows. The Company considers the probable return of principal in a bond, the ability of the Company to hold the bond until the fair value can reach the amortized book value, and whether the borrower has filed bankruptcy in concluding that a bond should be other-than-temporarily impaired.

There were no bonds held by the Company where it was not practicable to estimate fair value. All bonds and stocks that have a fair value below 80% of amortized book value are reviewed quarterly.

Stocks: Two common stocks were impaired during 2009. The stocks have seen significant declines in value in 2009 because of the subprime crisis and the recession. The Company recorded a realized loss of $171,108 based on the fair value obtained from the NAIC SVO and verified to the fair value obtained from Frost National Bank.

During 2008, a realized loss of $208,130 was recorded for six common stocks that were considered to be impaired.

Mortgages: During 2009 and 2008, the Company had no mortgage loans that were considered to be other-than-temporarily impaired.

2. Investments (continued)

Real Estate: During 2009, the Company foreclosed on a mortgage loan considered to be adequately collateralized. Subsequent to foreclosure, an impairment of $269,860 was recorded on the property, which was classified as investment property.

3. Fair Values

The following methods and assumptions were used by the Company in estimating the fair value disclosures for financial instruments in the accompanying financial statements:

Cash, Short-Term Investments, Policy Loans, and Receivables for Securities: The carrying amounts reported in the accompanying statutory-basis balance sheets for these financial instruments approximate their fair values.

Investment Securities: The fair values for fixed-maturity securities are based on unit prices prescribed by the SVO or, in the absence of SVO unit prices or when amortized cost is used by the SVO as the unit price, quoted market prices by other third-party organizations. The fair value of mortgage-backed securities is based on quoted market prices by third-party organizations. The fair values for equity securities are based on fair values prescribed by the SVO.

Mortgage Loans: The fair values for mortgage loans are estimated using weighted average maturity analyses, using interest rates currently being offered for similar loans to borrowers with similar credit ratings. Loans with similar characteristics are aggregated for purposes of the calculations.

Investment Contracts: The fair values for the Company's liabilities under investment-type insurance contracts are estimated using discounted cash flow calculations, based on interest rates currently being offered for similar contracts with maturities consistent with those remaining for the contracts being valued.

3. Fair Values (continued)

The carrying amounts and fair values of the Company's financial instruments at December 31 were as follows:

	2009		2008	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Bonds	**$ 531,859,636**	**$ 531,592,613**	$ 500,709,201	$ 458,441,644
Preferred stocks	**2,009,600**	**1,781,700**	3,052,805	2,004,900
Common stocks	**3,567,374**	**3,567,374**	2,128,138	2,128,138
Mortgage loans	**127,023,286**	**129,801,285**	122,398,492	125,624,917
Policy loans	**74,344,102**	**74,344,102**	73,150,353	73,150,353
Short-term investments	**12,006,665**	**12,006,665**	36,988,264	36,988,264
Cash	**4,057,942**	**4,057,942**	6,905,662	6,905,662
Cash equivalents	–	–	998,922	998,922
Receivables for securities	**19,688**	**19,688**	82,799	82,799

The carrying amounts and fair values of the Company's liabilities for investment-type insurance contracts at December 31 were as follows:

	2009		2008	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Individual annuities	$ 77,515,431	$ 76,967,396	$ 73,835,043	$ 73,444,094
Supplemental contracts not involving life contingencies	17,953,287	18,421,449	18,360,318	18,907,061

The fair values for the Company's insurance contracts other than investment contracts are not required to be disclosed. However, the fair values of liabilities under all insurance contracts are taken into consideration in the Company's overall management of interest rate risk, such that the Company's exposure to changing interest rates is minimized through the matching of investment maturities with amounts due under insurance contracts.

4. Reinsurance

Certain premiums and benefits are assumed from and ceded to other insurance companies under various reinsurance agreements. The ceded reinsurance agreements provide the Company with increased capacity to write larger risks. The Company remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations.

Amounts payable or recoverable for reinsurance on policy and contract liabilities are not subject to periodic or maximum limits. The Company has $1,319,745 of amounts recoverable on paid losses and commissions and expense allowances due from a single reinsurer. This amount does not exceed 3% of the Company's total surplus at December 31, 2009.

The Company has entered into a reinsurance agreement in which the reinsurer may unilaterally cancel any reinsurance for reasons other than nonpayment of premiums or other similar credits. The total amount of reinsurance credits taken for this agreement at December 31, 2009 and 2008 was $21,080,081 and $19,191,819, respectively.

The Company does not have any reinsurance agreements in effect in which the amount of losses paid or accrued through December 31, 2009, would result in a payment to the reinsurer of amounts that, in the aggregate and allowing for offset of mutual credits from other insurance agreements with the same reinsurer, exceed the total direct premiums collected under the reinsured policies.

4. Reinsurance (continued)

The amounts related to the Company's ceded and assumed reinsurance arrangements for life insurance are summarized as follows:

	Ceded to Other Companies	Assumed From Other Companies
2009		
Premiums for the year ended December 31	**$ 17,654,198**	**$ 1,184,541**
Benefits paid or provided for the year ended December 31	**10,744,259**	**1,054,561**
Credit taken against policy and contract liabilities at December 31	**35,994,560**	–
2008		
Premiums for the year ended December 31	$ 18,132,932	$ 1,940,435
Benefits paid or provided for the year ended December 31	13,132,765	1,509,615
Credit taken against policy and contract liabilities at December 31	32,707,836	–

During 2004 and 2005, the Company entered into agreements with two insurance companies for the co-insurance of three blocks of business. The form of the agreement is 100% indemnity co-insurance, with formal assumption to be accomplished after state approvals are secured. During 2006, the Company began the process of assumption of the business by submitting requests for approval to selected states. The Company has completed the assumption reinsurance for numerous states as approval was received. Assumption reinsurance of the business will continue as approval is received from other states and policyholders.

At December 31, 2008, the Company entered into an agreement to reinsure 35% of an in-force block of policies on a yearly renewable term basis and 26.5% of another in-force block on a co-insurance basis. The transaction covered 7,060 policies with $79,585,842 of insurance in force and $928,659 in reserves as of that date.

5. Retrospectively Rated Contracts

In October 2001, the Company became the group carrier for the MBA, a nonprofit association of military and Civil Service personnel. Group term life and health policies were issued to the MBA. These policies can be terminated on anniversary with notice. Members of the MBA field of membership are eligible to apply for group term life coverage or group TRICARE supplement insurance. Life coverage is individually underwritten. Coverage from the prior carrier was continued in the new group policies. The contract with the MBA requires that the MBA maintain a premium stabilization fund (PSF) with the Company. The group is experience-rated, and the PSF will increase or decrease depending on the experience for the year. Interest is credited at the end of each fiscal year. A refund to members is considered annually and is paid at various levels when considered appropriate. The PSF level is currently well in excess of a reserve that would be required for group term life, as such, no additional reserves are held. The PSF is held as a deposit reserve. Claim reserves are held separately for both life and health claims.

The Company estimates accrued retrospective premium adjustments for its group association life and health insurance business using the refund calculation specified in the agreement with the association and records them as an adjustment to earned premium. The amount of net premiums collected by the Company at December 31, 2009, that are subject to retrospective rating features was $5,265,247 in group life and $1,205,451 in group health. The net premiums represent 99% of the group life and 100% of the group health premiums collected. No other net premiums are subject to retrospective rating features.

The full balance of retrospective premium adjustments is admitted and considered collectible.

6. Federal Income Taxes

Income before federal income taxes differs from taxable income principally due to the differences in timing for recognizing accrual of market discounts on bonds, deferred compensation, and policyholder dividends; dividends-received tax deductions; policy acquisition costs; interest maintenance reserve; and differences in reserves for policy and contract liabilities for tax and financial reporting purposes.

6. Federal Income Taxes (continued)

The components of the net deferred tax assets (DTAs) and deferred tax liabilities (DTLs) for the year ended December 31 are as follows:

	2009 Ordinary	2009 Capital	2009 Total	2008 Total
Gross deferred tax asset	$ 19,180,692	$ 4,589,195	$ 23,769,887	$ 23,366,341
Adjusted gross deferred tax asset	19,180,692	4,589,195	23,769,887	23,366,341
Deferred tax liability	4,270,524	33,831	4,304,355	4,412,515
Net deferred tax asset (liability)	14,910,168	4,555,364	19,465,532	18,953,826
Nonadmitted deferred tax asset	3,151,370	4,555,364	7,706,734	10,570,191
Net deferred tax asset admitted	$ 11,758,798	$ –	$ 11,758,798	$ 8,383,635
Increase (decrease) in deferred tax asset nonadmitted			$ (2,863,457)	$ 3,925,910

The Company has elected to admit deferred tax assets pursuant to paragraph 10.e of SSAP 10R. The financial statements for December 31, 2009, reflect the first time SSAP 10R has been utilized.

6. Federal Income Taxes (continued)

The Company's admitted adjusted gross deferred tax assets under both SSAP 10 and SSAP 10R are as follows:

	SSAP 10	SSAP 10R	Difference
Ordinary	$ 12,854,970	$ 16,029,322	$ 3,174,352
Capital	33,831	33,831	–
Total	$ 12,888,801	$ 16,063,153	$ 3,174,352

The admitted deferred tax asset is comprised of the following:

SSAP 10	Ordinary	Capital	Total
Federal tax paid in carryback years (10.a)	$ 7,821,364	$ –	$ 7,821,364
Lesser of:			
Deferred taxes expected to be realized within 1 year (10.b.i)	763,082	–	763,082
10% of statutory capital of previously filed statement (10.b.ii)			
Amount of gross DTA's that can be offset against DTL's (10.c)	4,270,524	33,831	4,304,355
Admitted deferred tax asset – SSAP 10	$ 12,854,970	$ 33,831	$ 12,888,801

SSAP 10R	Ordinary	Capital	Total
Federal tax paid in carryback years (10.e.i)	$ 7,821,364	$ –	$ 7,821,364
Lesser of:			
Deferred taxes expected to be realized within 3 years (10.e.ii(a))	3,937,434	–	3,937,434
15% of statutory capital of previously filed statement (10.e.ii(b))			
Amount of gross DTA's that can be offset against DTL's (10.e.iii)	4,270,524	33,831	4,304,355
Admitted deferred tax asset – SSAP 10R	$ 16,029,322	$ 33,831	$ 16,063,153

6. Federal Income Taxes (continued)

The risk-based capital level for the test in paragraph 10.d of SSAP 10R is based on the following:

	SSAP 10	SSAP 10R	Difference
Admitted deferred tax assets	$ 12,888,801	$ 16,063,153	$ 3,174,352
Admitted assets	798,712,714	801,887,066	3,174,352
Statutory surplus	84,613,940	87,788,292	3,174,352
Total adjusted capital in the risk-based capital calculation	$ 102,065,470		
Authorized control level of risk-based capital	$ 8,286,378		
Applicable % for application of SSAP 10R	1232%		

Unrecognized deferred tax liabilities: None

Current income taxes incurred consist of the following major components:

	2009	2008
Federal income tax on operations	**$ 1,916,796**	$ 2,669,867
Federal income tax on net Realized capital gains/(losses)	**(413,572)**	391,091
Current federal income taxes incurred (benefit)	**$ 1,503,224**	$ 3,060,958

6. Federal Income Taxes (continued)

The major components of the deferred tax amounts are as follows:

	2009	2008
Deferred tax assets:		
Reserves	$ 7,869,534	$ 8,326,772
Proxy DAC	4,577,488	4,699,115
Dividends Apportioned for Payment	2,278,000	2,261,000
Accrued Deferred Compensation	1,762,426	2,240,138
Other-Than-Temporary Impairments	4,331,780	3,080,494
Unrealized Capital Losses	144,038	273,258
Postretirement benefits and other general expenses	1,150,410	959,618
Other	1,656,211	1,525,946
Total deferred tax assets	23,769,887	$23,366,341
Deferred tax assets nonadmitted	7,706,733	10,570,191
Admitted deferred tax assets	16,063,154	12,796,150
Deferred tax liabilities:		
Depreciable assets	89,119	124,489
Deferred and Uncollected Premiums	3,180,196	3,260,630
Market discount	640,415	859,679
Reserve change	54,442	59,289
Other	340,183	108,428
Total deferred tax liabilities	4,304,355	4,412,515
Net admitted deferred tax assets	$ 11,758,799	$ 8,383,635

6. Federal Income Taxes (continued)

The change in net deferred income taxes is comprised of the following:

	2009	2008	Change
Total gross deferred tax assets	$ **23,769,887**	$ 23,366,340	$ 403,547
Total gross deferred tax liabilities	**4,304,355**	4,412,515	(108,160)
Net deferred tax asset (including unrealized capital gains)	**19,465,532**	18,953,8265	511,707
Deferred tax on change in net unrealized capital gains			129,220
Change in net deferred income tax (excluding unrealized capital gains)			$ 640,927

Reconciliation of Federal Income Tax Rate to Actual Effective Rate

The significant items causing a difference between the statutory federal income tax rate and the Company's effective income tax rate are as follows:

	2009	Effective Tax Rate
Provision computed at statutory rate	$ **958,267**	34.00%
Amortization of Interest Maintenance Reserve	**(236,943)**	(8.41)%
Nondeductible items	**10,071**	0.36%
Change in Nonadmitted Assets	**136,723**	4.85%
Prior Year True-Up	**(9,085)**	(0.32)%
Other	**3,262**	0.12%
Total effective tax	$ **862,297**	30.6%
Federal and foreign income taxes incurred	**$ 1,503,224**	53.34%
Change in net deferred income taxes	**(640,927)**	(22.74)%
Total statutory income taxes	$ **862,297**	30.6%

6. Federal Income Taxes (continued)

The Company does not have any operating loss or tax credit carryforwards available for tax purposes. Federal taxes available for recovery in the event of the carryback of future operations loss deductions are as follows:

	Ordinary	Capital	Total
2009	$ 1,802,802	$ –	$ 1,802,802
2008	$ 2,592,243	$ 350,620	$ 2,942,863
2007	$ 3,426,319	$ –	$ 3,426,319

7. Surplus

Unassigned surplus funds were earned by the participating policyholders. There are no restrictions on the unassigned surplus.

Life/health insurance companies are subject to certain risk-based capital (RBC) requirements as specified by the NAIC. Under those requirements, the amount of surplus to be maintained by a life/health insurance company is to be determined based on the various risk factors related to it. At December 31, 2009 and 2008, the Company exceeded the RBC requirements.

The main components of the change in nonadmitted assets are as follows:

	2009	2008	Change
Furniture and equipment	$ **291,845**	$ 454,389	$ (162,544)
Nonoperating software	**510,114**	589,702	(79,588)
Miscellaneous receivables and deposits	**479,592**	505,595	(26,003)
Agent balances	**1,674,334**	1,306,354	367,980
Policy loans and investment income due	**10,061**	512,034	(501,973)
Deferred tax assets	**7,706,734**	10,570,191	(2,863,457)
	$ **10,672,680**	$ 13,938,265	(3,265,585)
Change as result of SSAP 10R adoption			3,174,352
			$ 91,233

7. Surplus (continued)

The Company elected to admit deferred tax assets pursuant to paragraph 10.e of SSAP 10R in the amount of $3,174,352. The financial statements for December 31, 2009, reflect the first time SSAP 10R has been utilized.

8. Leases

The Company leases office equipment under various noncancelable operating lease agreements that expire at various intervals through 2014. Rental expense was approximately $240,000 and $227,700 during 2009 and 2008, respectively. At January 1, 2010, future minimum payments under noncancelable leases are as follows (in thousands):

2010	$	117
2011		102
2012		94
2013		65
2014		14
	$	392

9. Commitments and Contingencies

The Company is named as a defendant in various legal actions arising principally from claims made under life insurance policies. Those actions are considered by the Company in estimating the policy and contract liabilities. The Company's management believes that the resolution of those actions will not have a material effect on the Company's financial position or results of operations.

10. Annuity Reserves

At December 31, 2009 and 2008, the Company's annuity reserves and deposit fund liabilities that were subject to discretionary withdrawal (with adjustment), subject to discretionary withdrawal (without adjustment) and not subject to discretionary withdrawal provisions are summarized as follows:

	At December 31, 2009	
	Amount	Percent
Subject to discretionary withdrawal (with adjustment):		
(1) With market value adjustment	$ –	–%
(2) At book value less current surrender charge of 5% or more	12,191,908	7.26
(3) At market value	–	–
(4) Total with adjustment or at market value	12,191,908	7.26
(5) At book value without adjustment (minimal or no charge or adjustment)	111,444,540	66.38
Not subject to discretionary withdrawal	44,245,556	26.36
Total gross	167,882,004	100.00%
Reinsurance ceded	18,573,193	
Total (net)	$ 149,308,811	

	At December 31, 2008	
	Amount	Percent
Subject to discretionary withdrawal (with adjustment):		
(1) With market value adjustment	$ –	–%
(2) At book value less current surrender charge of 5% or more	10,145,287	6.27
(3) At market value	–	–
(4) Total with adjustment or at market value	10,145,287	6.27
(5) At book value without adjustment (minimal or no charge or adjustment)	110,035,993	68.03
Not subject to discretionary withdrawal	41,562,547	25.70
Total gross	161,743,827	100.00%
Reinsurance ceded	16,120,212	
Total (net)	$ 145,623,615	

11. Life Premium and Annuity Considerations Deferred and Uncollected

Deferred and uncollected life insurance premiums and annuity considerations at December 31, 2009 and 2008, were as follows:

Type	Gross	Net of Loading
At December 31, 2009:		
Ordinary life new business	**$ 928,509**	**$ 183,126**
Ordinary life renewal	**10,472,941**	**8,854,448**
Individual annuity	**987**	**872**
Group life	**439,394**	**439,394**
Total	**$ 11,841,831**	**$ 9,477,840**
At December 31, 2008:		
Ordinary life new business	$ 750,960	$ 201,089
Ordinary life renewal	10,961,942	9,100,186
Individual annuity	1,009	872
Group life	443,218	443,218
Total	$ 12,157,129	$ 9,745,365

12. Employee Benefits

Company employees are covered by a qualified defined contribution (Section 401(k)) plan sponsored by the Company. Assets are held under various elective separate investment accounts by the Massachusetts Mutual Life Insurance Company (Springfield, Massachusetts).

Matching contributions are made at 62.5% on participants' contributions of up to 6%. The Company's contributions to the plan were $184,069 and $175,137 for 2009 and 2008, respectively. Additional contributions in the amount of $184,290 and $177,603 for 2009 and 2008, respectively, (representing 3% of total compensation of all eligible) were made to the retirement plan. At December 31, 2009, the fair value of plan assets was $12,218,696. Any liabilities for this plan are reflected on the financial statements of the Massachusetts Mutual Life Insurance Company.

12. Employee Benefits (continued)

The Company provides certain life insurance and health care benefits for retired employees. Substantially all employees may become eligible for these benefits if they reach retirement age while working for the Company. Retirees may elect certain prepaid health care benefit plans. Medical coverage may require retiree contributions. The Company's policy is to make payments to these plans sufficient to provide for benefit payments required under the plans.

Life insurance benefits, generally amounting to annual earnings at retirement decreasing uniformly over 15 years to 25% of the entire amount for life thereafter, are provided under a retired lives reserve. The retired lives reserve was $571,376 at December 31, 2009, and $612,018 at December 31, 2008.

The estimated unfunded accumulated postretirement health care benefit obligations, unrecognized transition obligation and accrued postretirement health care benefit liability for the Company were as follows:

	December 31	
	2009	**2008**
Actuarial present value of health care benefit obligations:		
Retirees	**$ 4,437,754**	$ 3,670,493
Fully eligible and vested plan participants	**2,833,791**	2,156,161
Accumulated postretirement health care benefit obligation for fully vested participants	**$ 7,271,545**	$ 5,826,654
Actuarial present value of health care benefit obligation for nonvested employees	**$ 2,886,827**	$ 2,809,053
Unrecognized transition obligation	**$ 217,592**	$ 261,112
Accrued postretirement health care benefit liability	**$ 2,636,204**	$ 2,004,521

The weighted average discount rate used in determining the actuarial present value of the postretirement health care benefit obligation was 5.97% in 2009 and 6.12% in 2008.

12. Employee Benefits (continued)

For measurement purposes, a 10% annual rate of increase in the per capita cost of covered health care benefits was assumed for the year following the date of the valuation, and that rate was assumed to decrease gradually to 5.5% in 2015 and remain at that level. A 1.0% increase in the assumed annual rate of increase in the per capita cost of health care benefits results in an increase in the accumulated postretirement benefit obligation and postretirement benefit expense. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the postretirement benefit obligation as of December 31, 2009, by $785,503 and the estimated eligibility cost and interest cost components of net periodic postretirement benefit cost by $112,548.

Postretirement benefit cost for 2009 was $1,100,754 and for 2008 was $730,469, including amortization of the transition obligation plus the expected cost of health care benefits for newly eligible or vested employees, the expected cost of life insurance benefits for eligible employees and interest cost.

It has been determined that the Company's prescription drug benefit is actuarially equivalent to Medicare Part D under the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) and will therefore qualify for the federal subsidy. The postretirement benefit obligation and net periodic benefit cost reflect amounts associated with the subsidy.

For the year ended December 31, 2009, the effect of the Act was a $159,256 reduction in the net postretirement benefit cost for the subsidy related to benefits attributed to former employees. The Act also had the following effects on the net postretirement benefit cost; a $45,245 decrease as a result of an actuarial gain; a $67,779 decrease to the current period service cost due to the subsidy; and a $46,232 decrease to the interest cost.

Expected 2009 gross benefit payments were $494,046 and actual gross benefit payments were $484,939. The subsidy was $9,539 for 2009 and was expected to be $33,030.

Supplemental Retirement Plans

The Company has nonqualified deferred compensation agreements with certain employees and agents. Benefits under the agreements with the home-office employees vest immediately. Benefits under agent agreements have a graded vesting dependent on various factors. The Company records nonvested balances as a nonadmitted asset. The liability for these agreements

12. Employee Benefits (continued)

was $4,704,486 and $6,053,531 at December 31, 2009 and 2008, respectively. The nonvested balance at December 31, 2009, was 78,266. The expense for these agreements amounted to $289,711 and $525,211 in 2009 and 2008, respectively.

The company has accrued for compensated absences/vacation pay in accordance with SSAP No. 11, *Postemployment Benefits and Compensated Absences*. A liability of $766,619 is recorded in salaries and wages general expense.

During 2006, the company recognized a cost of $360,000, payable over time, for the unique contractual postemployment wage continuation of a long-tenured ex-employee. The remaining liability as of December 31, 2009 was $22,500.

13. Other

The Company has available a $30,000,000 line of credit from the Federal Home Loan Bank of Dallas. No amounts have been drawn since its inception and no debt was outstanding at December 31, 2009.

14. Subsequent Events

The date to which events occurring after December 31, 2009, have been evaluated for possible adjustment to the financial statements or disclosure is May 24, 2010, which is the date on which the financial statements were available to be issued.

The Company is in the process of entering the Medicare Supplement market and has received approval of policy forms in multiple states. The majority of the business, up to 90%, will be reinsured. Effective January 1, 2010, the Company entered into an agreement with an experienced company in the Medicare Supplement market to administer the business. Products were released for sale in approved states in April 2010, with policy effective dates beginning in June of 2010.

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Financial Statements – Statutory-Basis

Government Personnel Mutual Life Insurance Company
Years Ended December 31, 2008 and 2007
With Report of Independent Auditors

Ernst & Young LLP

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Contents

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Report of Independent Auditors

The Board of Directors
Government Personnel Mutual
Life Insurance Company

We have audited the accompanying statutory-basis balance sheets of Government Personnel Mutual Life Insurance Company as of December 31, 2008 and 2007, and the related statutory-basis statements of income, changes in surplus, and cash flow 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Company presents its financial statements in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and accounting principles also are described in Note 1. The effects on the financial statements of these variances are not reasonably determinable but are presumed to be material.

In our opinion, because of the effects of the matter described in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of Government Personnel Mutual Life Insurance Company at December 31, 2008 and 2007, or the results of its operations or its cash flows for the years then ended.

However, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Government Personnel Mutual Life Insurance Company at December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance.

Ernst + Young LLP

May 13, 2009

Government Personnel Mutual Life Insurance Company

Balance Sheets – Statutory-Basis

	December 31	
	2008	**2007**
Admitted assets		
Cash and invested assets:		
Bonds, including securities loaned (2008 – \$0; 2007 – \$95,787,556)	**\$ 495,209,481**	\$ 533,452,918
Preferred stocks	**8,552,525**	7,084,320
Common stocks	**2,128,138**	3,034,563
Mortgage loans	**122,398,492**	107,498,957
Real estate, less accumulated depreciation (2008 – \$849,912; 2007 – \$584,813):		
Properties occupied by the Company	**7,380,157**	7,606,802
Properties held for the production of income	**3,434,985**	1,445,960
Policy loans	**73,150,353**	71,827,803
Short-term investments	**36,988,264**	19,887,317
Cash and cash equivalents	**7,904,584**	2,419,913
Receivables for securities	**82,799**	869,271
Total cash and invested assets	**757,229,778**	755,127,824
Deferred premiums, less loading (2008 – \$2,411,764; 2007 – \$2,377,632)	**9,075,545**	9,544,424
Uncollected premiums	**780,996**	850,956
Federal tax recoverable, including net deferred tax asset (2008 – \$8,383,635; 2007 – \$8,458,694)	**8,638,635**	8,714,477
Accrued investment income	**8,100,417**	7,966,883
Electronic data processing equipment, less accumulated depreciation (2008 – \$1,329,417; 2007 – \$1,302,683)	**147,600**	78,227
Amounts due from reinsurers	**2,506,125**	3,552,165
Other admitted assets	**674,306**	763,842
Total admitted assets	**\$ 787,153,402**	\$ 786,598,798

Government Personnel Mutual Life Insurance Company

Balance Sheets – Statutory-Basis (continued)

	December 31	
	2008	**2007**
Liabilities and surplus		
Liabilities:		
Policy and contract liabilities:		
Life and annuity reserves	**$ 596,329,688**	$ 591,549,063
Accident and health reserves	**636,574**	688,758
Deposit-type contracts	**60,680,375**	60,927,715
Dividends and coupons payable	**6,653,225**	6,601,225
Unpaid claims	**8,402,582**	7,642,948
Other	**1,071,512**	793,454
Total policy and contract liabilities	**673,773,956**	668,203,163
Benefits for employees	**6,203,531**	6,004,630
Accounts payable and accrued expenses	**5,028,129**	5,094,663
Unearned investment income	**2,177,670**	2,121,386
Asset valuation reserve	**10,368,530**	11,291,718
Interest maintenance reserve	**4,502,501**	4,343,461
Other	**1,539,947**	1,582,406
Total liabilities	**703,594,264**	698,641,427
Surplus:		
Surplus guarantee fund	**400,000**	400,000
Unassigned surplus	**83,159,138**	87,557,371
Total surplus	**83,559,138**	87,957,371
Total liabilities and surplus	**$ 787,153,402**	$ 786,598,798

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Income – Statutory-Basis

	Years Ended December 31 2008	2007
Premiums and other revenues:		
Premium on life, annuity and accident and health policies	$ 52,662,679	$ 54,124,687
Considerations for supplemental contracts with life contingencies	673,901	704,184
Net investment income	44,002,427	42,387,627
Amortization of the interest maintenance reserve	590,957	447,188
Commissions and expense allowances on reinsurance ceded	4,384,119	4,706,623
Miscellaneous income	58,592	131,983
Total premiums and other revenues	102,372,675	102,502,292
Benefits paid or provided:		
Death benefits	26,481,309	25,570,881
Annuity benefits	9,279,333	9,366,038
Surrender benefits	16,964,566	15,105,199
Interest and adjustments on policy or deposit-type contract funds	2,732,908	2,889,283
Payments from supplemental contracts with life contingencies	1,391,289	1,239,234
Other benefits	1,911,151	1,638,427
Increase in policy reserves	4,728,441	7,880,951
Total benefits paid or provided	63,488,997	63,690,013
Insurance expenses:		
Commissions	6,666,233	5,991,702
General expenses	17,139,101	15,518,575
Insurance taxes, licenses and fees	1,445,032	1,324,857
Total insurance expenses	25,250,366	22,835,134
Total benefits paid or provided and insurance expenses	88,739,363	86,525,147
Gain from operations before dividends to policyholders, income taxes and net realized capital gains	13,633,312	15,977,145
Dividends to policyholders	(6,655,833)	(6,561,553)
Gain from operations before income taxes and net realized capital gains	6,977,479	9,415,592
Federal income taxes	2,669,867	3,018,640
Gain from operations before net realized capital gains	4,307,612	6,396,952
Net realized capital losses, net of federal income tax expense (2008 – $4,729; 2007 – $75,597) and net of amounts transferred to IMR	(7,445,930)	(1,262,726)
Net (loss) income	$ (3,138,318)	$ 5,134,226

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Changes in Surplus – Statutory-Basis

	Years Ended December 31	
	2008	**2007**
Surplus at beginning of year	**$ 87,957,371**	$ 84,522,790
Net (loss) income	**(3,138,318)**	5,134,226
Change in net unrealized capital loss	**(871,718)**	(489,242)
Change in net deferred tax	**3,401,783**	477,784
Change in nonadmitted assets	**(4,713,127)**	(483,196)
Change in liability for reinsurance in unauthorized companies	**(41)**	(53)
Change in asset valuation reserve	**923,188**	(1,204,938)
Net (decrease) increase	**(4,398,233)**	3,434,581
Surplus at end of year	**$ 83,559,138**	$ 87,957,371

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Cash Flow – Statutory-Basis

	Years Ended December 31	
	2008	2007
Operating activities		
Premiums collected, net of reinsurance	$ 53,882,505	$ 55,280,351
Net investment income	42,566,584	42,860,248
Miscellaneous income	4,521,546	4,765,602
Total	100,970,635	102,906,201
Benefits paid	54,469,638	54,632,352
Commissions, expenses paid and aggregate write-ins for deductions	24,207,450	22,874,168
Dividends paid to policyholders	6,603,833	6,486,553
Federal income taxes paid, net of tax on capital gains	2,669,084	3,459,973
Total	87,950,005	87,453,046
Net cash provided by operating activities	13,020,630	15,453,155
Investing activities		
Proceeds from investments sold, matured or repaid:		
Bonds	120,363,738	62,272,083
Stocks	1,220,022	5,045,921
Mortgage loans	18,802,894	17,391,170
Other proceeds	786,473	273,026
Total investment proceeds	141,173,127	84,982,200
Cost of investments acquired:		
Bonds	88,777,974	55,327,541
Stocks	2,779,187	8,889,717
Mortgage loans	33,480,000	22,887,408
Real estate	2,027,479	653,754
Miscellaneous applications	391,091	80,027
Total investments acquired	127,455,731	87,838,447
Net increase in policy loans	1,316,113	1,243,408
Net cash provided by (used in) investing activities	12,401,283	(4,099,655)
Financing and miscellaneous activities		
Net deposits on deposit-type contract funds	(2,590,774)	(3,239,280)
Other cash (applied) provided	(245,521)	327,206
Net cash used in financing and miscellaneous activities	(2,836,295)	(2,912,074)
Net change in cash and short-term investments	22,585,618	8,441,426
Cash, cash equivalents and short-term investments		
At beginning of year	22,307,230	13,865,804
At end of year	$ 44,892,848	$ 22,307,230

See accompanying notes.

1. Nature of Operations and Significant Accounting Policies

Government Personnel Mutual Life Insurance Company (Company) is domiciled in the state of Texas. The Company is a mutual life insurance organization specializing in the armed forces, civil service markets and final expense markets. Coverages are also available to the middle to upper-income general civilian market.

Operations are conducted primarily on personal producing and managing general agent plans through approximately 1,400 general and soliciting agents. The Company is licensed in 48 states and the District of Columbia. Its primary markets are the states of Texas, California, Florida and Virginia. The Company is also accredited to solicit sales at some overseas military installations. The Company offers a portfolio of the usual forms of individual permanent, term, flexible premium universal life and annuity policies, all without a war clause. Life insurance and annuity plans are available to United States military personnel and civil service employees through a federal allotment plan. Automatic payment plans are available to the civilian populace. The Company is the underwriter for the group association coverages for members of the Military Benefit Association (MBA). The Company derives substantially all of its direct group life and group accident and health business from the group policy issued to the MBA.

Basis of Presentation

The Company's financial statements are prepared in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, whose practices may differ from U.S. generally accepted accounting principles (GAAP). The more significant variances from GAAP are as follows:

Investments: Investments in bonds are reported at amortized cost or fair value based on their National Association of Insurance Commissioners (NAIC) rating; for 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 surplus for those designated as available-for-sale. Fair value for statutory purposes is based on the price published by the Securities Valuation Office of the NAIC (SVO), if available, whereas fair value for GAAP is based on quoted market prices.

1. Nature of Operations and Significant Accounting Policies (continued)

All single class and multi-class mortgage-backed/asset-backed securities (e.g., CMOs) 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. For GAAP purposes, all securities, purchased or retained, that represent beneficial interests in securitized assets (e.g., CMO, CBO, CDO, CLO, MBS and ABS securities), 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. If high credit quality securities are adjusted, the retrospective method is used.

Real estate owned and occupied by the Company is included in investments rather than reported as an operating asset as under GAAP. Investment income and operating expenses for statutory reporting include rent for the Company's occupancy of those properties.

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 are charged or credited directly to unassigned surplus rather than included as a component of earnings as would be required under GAAP.

Changes in investment nonadmitted asset carrying amounts are credited or charged directly to unassigned surplus.

Valuation Reserves: Under a formula prescribed by the NAIC, the Company defers the portion of realized capital gains and losses on sales of fixed income investments attributable to changes in the general level of interest rates and amortizes those deferrals over the remaining period to maturity based on groupings of individual securities sold in five-year bands. That net deferral is reported as the interest maintenance reserve (IMR) in the

1. Nature of Operations and Significant Accounting Policies (continued)

accompanying balance sheets. Realized capital gains and losses are reported in income, net of federal income tax and transfers to the IMR. Under GAAP, realized capital gains and losses would be reported in the income statement on a pretax basis in the period that the assets giving rise to the gains or losses are sold.

The asset valuation reserve (AVR) provides a valuation allowance for invested assets. The AVR is determined by an NAIC prescribed formula with changes reflected directly to unassigned surplus; AVR is not recognized for GAAP.

Policy Acquisition Costs: 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.

Nonadmitted Assets: Certain assets designated as "nonadmitted," principally agents' balances, furniture and equipment, and other assets not specifically identified as an admitted asset within the NAIC *Accounting Practices and Procedures Manual*, are excluded from the accompanying balance sheets and charged directly to unassigned surplus. Under GAAP, such assets are included in the balance sheet to the extent that those assets are not impaired.

Universal Life and Annuity Policies: Revenues for universal life and annuity policies with mortality or morbidity risk consist of the entire premium received and benefits incurred represent the total of death benefits paid, surrender benefits paid, and the change in policy reserves. Proceeds received for annuity policies without mortality or morbidity risk 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 account values.

1. Nature of Operations and Significant Accounting Policies (continued)

Benefit Reserves: Certain policy reserves are calculated based on statutorily required interest and mortality assumptions rather than on estimated expected experience or actual account balances as would be required under GAAP.

Reinsurance: Policy and contract liabilities ceded to reinsurers have been reported as reductions of the related reserves rather than as assets as would be required under GAAP. Commissions allowed by reinsurers on business ceded are reported as income when incurred rather than being deferred and amortized with deferred policy acquisition costs as would be required under GAAP. In addition, liability for reinsurance balances has been provided for unsecured policy reserves ceded to reinsurers not authorized to assume such business. Changes to the liability are credited or charged directly to unassigned surplus. Under GAAP, an allowance for amounts deemed uncollectible would be established through a charge to earnings.

Employee Benefits: For purposes of calculating the Company's postretirement and postemployment benefit obligations, only vested participants and current retirees are included in the valuation. Under GAAP, active participants not currently eligible would also be included.

Deferred Income Taxes: 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 balance sheet date or 10% of surplus excluding any net deferred tax assets, and EDP equipment and operating software, 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. Deferred taxes do not include amounts for state taxes. Under GAAP, state income 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.

Policyholder Dividends: Policyholder dividends are recognized when declared rather than over the term of the related policies. Dividends are determined annually by the Company's Board of Directors. Individual ordinary life participating premium approximates 84% of the Company's ordinary life insurance collected premiums.

1. Nature of Operations and Significant Accounting Policies (continued)

The effects of the foregoing variances from GAAP on the accompanying statutory-basis financial statements have not been determined, but are presumed to be material.

Other significant accounting practices are as follows:

Investments

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

Bonds are stated at amortized cost or, for certain bonds, at fair value as determined by the SVO and as validated through an independent pricing service, with related unrealized capital gains/losses reported in unassigned surplus, net of federal income tax.

Bonds not backed by other loans are stated at amortized cost using the interest method. Loan-backed bonds and structured securities are valued at amortized cost using the interest method including anticipated prepayments. Prepayment assumptions are obtained from broker dealer survey values 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.

Redeemable preferred stocks are reported at cost or amortized cost as determined by the SVO.

Common stocks are reported at fair value as determined by the SVO and are based on quoted market prices, and the related unrealized capital gains or (losses) are reported in unassigned surplus, net of federal income taxes.

There are no restrictions on common or preferred stock.

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.

Cash equivalents are short-term highly liquid investments with original maturities of three months or less at time of acquisition and are principally stated at amortized cost.

1. Nature of Operations and Significant Accounting Policies (continued)

Mortgage loans are reported at unpaid principal balances, less an allowance for impairment as needed. 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, the impairment is other than temporary; the mortgage loan is written down to a realizable value and a realized loss is recognized.

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, with depreciation calculated on a straight-line basis over the estimated useful lives of the properties.

Policy loans are reported at their unpaid principal balance.

Realized capital gains and losses are determined using the specific identification basis. Changes in admitted asset carrying amounts of bonds, mortgage loans, policy loans, common and preferred stocks are credited or charged directly to unassigned surplus.

Market segment concentrations

The Company has $104,128,072 in corporate bonds of banks, insurance and finance-related corporations. In the event of a severe market event in this segment, the Company could lose a material amount in these investments. At year-end, there was an unrealized loss of $13,639,372 on this exposure to the financial industry.

Furniture and Equipment

The Company's electronic data processing equipment and operating software are reported at cost, less accumulated depreciation. Depreciation is provided in amounts sufficient to charge the cost of electronic processing equipment and operating software to operations over the lesser of their estimated service lives or three years on a straight-line basis. Nonoperating software is depreciated on a straight-line basis over the lesser of its useful life or five years. Other furniture and equipment are depreciated on a straight-line basis over the lesser of their estimated service lives or five years. Depreciation and amortization expense charged to operations was $391,878 for 2008 and $444,886 for 2007.

1. Nature of Operations and Significant Accounting Policies (continued)

Premiums

Life and accident and health premiums are recognized as revenue when due. Premiums for annuity policies with mortality and morbidity risk are also recognized as revenue when due. Premiums received for annuity policies without mortality or morbidity risk and for group annuity contracts are recorded using deposit accounting.

Benefit Reserves

Life, annuity and accident and health benefit reserves are developed by actuarial methods and are determined based on published tables using statutorily specified interest rates and valuation methods that will provide, in the aggregate, reserves that are greater than the minimum required by the Texas Department of Insurance.

The Company waives deduction of deferred fractional premiums upon the death of insureds and refunds any premium beyond the month of death. Surrender values on policies do not exceed the corresponding benefit reserves. Extra premiums are charged for substandard lives plus the gross premium for the true age. The mean reserve method is used to adjust the calculated terminal reserve to the appropriate reserve at December 31. Mean reserves are determined by computing the regular mean reserve for the plan at the true age and holding, in addition, one-half of the extra premium charge for the year. An asset is recorded for deferred premiums net of loading to adjust the reserve for modal premium payments. Additional reserves are established when the results of cash flow testing under various interest rate scenarios indicate the need for such reserves. There has been no need for such reserves.

As of December 31, 2008 and 2007, reserves of $2,049,210 and $2,591,533, respectively, were recorded on in-force amounts of $144,164,059 and $179,566,021, respectively, for which gross premiums are less than the net premiums according to the standard of valuation required by the Texas Department of Insurance.

The tabular interest, tabular cost less actual reserve released and tabular cost have been determined by formula. For determination of tabular interest on funds not involving life contingencies, the tabular interest is actual interest credited or due on the accounts for the valuation year.

1. Nature of Operations and Significant Accounting Policies (continued)

Deposit-Type Contracts

Deposit-type contracts consist primarily of dividend accumulations, premium deposits and supplemental contracts not involving life contingencies and annuities certain. Premium deposits relate primarily to the MBA group business. Deposit-type contracts are increased and decreased according to the deposits and withdrawals, respectively, of the applicable policyholders, as well as by retrospectively rated credits and debits for favorable and unfavorable, respectively, underwriting and investment experience of the MBA business.

Unpaid Claims

The liability for unpaid policy and contract claims represents the estimate of the ultimate net cost of all reported and unreported claims incurred through year-end. The liability is estimated using individual case-basis valuations and Company history. Those estimates are subject to the effects of trends in claim severity and frequency. Although considerable variability is inherent in such estimates, management believes that the reserve for unpaid claims is adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

Reinsurance

Reinsurance premiums and benefits paid or provided are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Guaranty Fund Assessments

Guaranty fund assessments are accrued when the Company receives notice or other information that a reasonably estimable amount is or is likely to be payable to a guaranty fund.

Use of Estimates

The preparation of statutory-basis financial statements requires management to make estimates and assumptions that affect amounts reported in the 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.

1. Nature of Operations and Significant Accounting Policies (continued)

Reclassifications

If necessary, certain 2007 amounts in the Company's statutory-basis financial statements have been reclassified to conform to the 2008 financial statement presentation.

2. Investments

Bonds: The amortized cost and the fair value of investments in bonds are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2008				
U.S. Government and agencies	$ 97,244,124	$ 5,534,838	$ (337,809)	$ 102,441,153
State and political subdivisions	25,981,931	118,769	(2,843,729)	23,256,971
Corporate securities	344,659,994	4,574,502	(47,788,616)	301,445,880
Mortgage-backed securities	27,323,432	808,200	(189,162)	27,942,470
Total bonds	$ 495,209,481	$ 11,036,309	$ (51,159,316)	$ 455,086,474
At December 31, 2007				
U.S. Government and agencies	$ 149,223,745	$ 2,677,895	$ (613,854)	$ 151,287,786
State and political subdivisions	18,953,466	281,007	(145,287)	19,089,186
Corporate securities	339,603,992	6,957,957	(11,436,780)	335,125,169
Mortgage-backed securities	25,671,715	330,991	(876,664)	25,126,042
Total bonds	$ 533,452,918	$ 10,247,850	$ (13,072,585)	$ 530,628,183

The following table shows gross unrealized losses and fair values of fixed maturities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2008						
U.S. Government and agencies	$ 9,353,675	$ (117,222)	$ 6,627,214	$ (220,587)	$ 15,980,889	$ (337,809)
State and political subdivisions	10,994,480	(1,230,097)	6,297,567	(1,613,632)	17,292,047	(2,843,729)
Corporate securities	91,564,498	(11,204,780)	127,692,705	(36,583,832)	219,257,203	(47,788,612)
Mortgage-backed securities	–	–	773,680	(189,162)	773,680	(189,162)
Total bonds	$ 111,912,653	$(12,552,099)	$ 141,391,166	$(38,607,213)	$ 253,303,819	$(51,159,312)

2. Investments (continued)

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2007						
U.S. Government and agencies	$ 5,329,300	$ (245,814)	$ 29,327,088	$ (368,040)	$ 34,656,388	$ (613,854)
State and political subdivisions	5,149,104	(119,498)	2,484,775	(25,789)	7,633,879	(145,287)
Corporate securities	52,162,814	(3,476,077)	152,618,799	(7,960,703)	204,781,613	(11,436,780)
Mortgage-backed securities	2,921,440	(26,164)	9,437,601	(850,500)	12,359,041	(876,664)
Total bonds	$ 65,562,658	$ (3,867,553)	$ 193,868,263	$ (9,205,032)	$ 259,430,921	$(13,072,585)

A summary of the amortized cost and fair value of the Company's investments in bonds at December 31, 2008, by contractual maturity, is as follows:

	Amortized Cost	Fair Value
Years to maturity:		
One or less	$ 8,964,189	$ 9,035,934
After one through five	107,502,889	99,615,070
After five through ten	129,640,753	117,751,331
After ten	221,778,218	200,741,669
Mortgage-backed securities	27,323,432	27,942,470
Total	$ 495,209,481	$ 455,086,474

The actual maturities may differ from the contractual maturities in the foregoing table because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from sales of investments in bonds during 2008 and 2007 were $41,978,071 and $35,220,793, respectively; gross gains of $1,320,359 and $177,055 and gross losses of $270,945 and $406,662 were realized on those sales, respectively.

At December 31, 2008, bonds with an admitted asset value of $7,071,447 were on deposit with state insurance departments to satisfy regulatory requirements.

2. Investments (continued)

Stocks: Unrealized gains and losses on investments in common stocks are reported directly in unassigned surplus and do not affect operations.

The cost and fair value of investments in preferred stocks and common stocks are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2008				
Preferred stocks	$ 8,552,525	$ –	$ (3,192,455)	$ 5,360,070
Common stocks	$ 2,451,838	$ 119,674	$ (443,374)	$ 2,128,138
At December 31, 2007				
Preferred stocks	$ 7,084,320	$ 24,800	$ (726,520)	$ 6,382,600
Common stocks	$ 2,517,477	$ 537,532	$ (20,446)	$ 3,034,563

The following table shows gross unrealized losses and fair values of preferred and common stocks, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2008						
Stocks:						
Preferred stocks	$ 3,164,500	$(1,888,305)	$ 2,195,570	$(1,304,150)	$ 5,360,070	$(3,192,455)
Common stocks	1,243,480	(443,374)	–	–	1,243,480	(443,374)
Total	$ 4,407,980	$(2,331,679)	$ 2,195,570	$(1,304,150)	$ 6,603,550	$(3,635,829)
December 31, 2007						
Stocks:						
Preferred stocks	$ 3,837,800	$ (671,520)	$ 445,000	$ (55,000)	$ 4,282,800	$ (726,520)
Common stocks	413,705	(20,446)	–	–	413,705	(20,446)
Total	$ 4,251,505	$ (691,966)	$ 445,000	$ (55,000)	$ 4,696,505	$ (746,966)

2. Investments (continued)

Mortgage Loans: During 2008, the minimum and maximum lending rates for mortgage loans were 6.125% and 7.0%, respectively. At the issuance of a loan, the percentage of loan to value on any one loan does not exceed 75%. Fire insurance is required on all properties covered by mortgage loans at least equal to the excess of each loan over the maximum loan that would be permitted by law on the land without the buildings. At December 31, 2008 and 2007, the Company held one mortgage with a carrying value of $3,456,556 and $3,234,126, respectively, with interest overdue beyond 180 days. There was $508,034 and $0 in nonadmitted interest or principal at December 31, 2008 and 2007, respectively.

At December 31, 2008 and 2007, taxes, assessments and amounts advanced not included in the mortgage loan total were $28,151 and $27,452, respectively. At December 31, 2008, none of the Company's investments in mortgage loans were subject to prior liens.

The Company's investments in mortgage loans all involve commercial real estate. At December 31, 2008, all such mortgages involve properties located in the states of Texas, Arizona, Utah or New Mexico. Such investments consist of first mortgage liens on completed income-producing properties at December 31, 2008; the mortgage outstanding on any individual property did not exceed $4,000,000.

The total recorded investment in troubled restructured loans at December 31, 2008 and 2007, was $4,356,972 and $4,434,253, respectively. There were no realized capital losses related to these loans. There were no contractual commitments to extend credit to debtors owing receivables whose terms have been modified in troubled debt restructurings. The Company accrues interest income on impaired loans to the extent deemed collectible and the loan continues to perform under its original or restructured contractual terms. Interest income on nonperforming loans generally is recognized on an accrual basis to the extent deemed collectible.

The Company held no impaired mortgages at any time during 2008 and 2007 and recorded no income on impaired mortgages during the year.

Real Estate: Properties held for the production of income represent two condominiums purchased for the use of Company employees and two properties adjacent to the Home Office property.

During 2008, the Company added one investment property to its real estate investments. The property is adjacent to the Home Office Building and expands the Company's holdings to the entire corner of Starcrest and Loop 410.

2. Investments (continued)

Net Investment Income: Net investment income consists of the following:

	Years Ended December 31	
	2008	**2007**
Income:		
Bonds	**$ 31,307,075**	$ 31,134,956
Preferred stocks	**590,638**	192,216
Common stocks	**150,428**	196,689
Mortgage loans	**8,015,668**	7,467,179
Real estate [(1)]	**787,470**	772,019
Policy loans	**4,603,398**	4,486,365
Short-term investments and cash	**517,261**	906,466
Other	**272,098**	80,741
Total investment income	**46,244,036**	45,236,631
Expenses:		
Real estate operating and maintenance	**760,503**	702,530
Real estate taxes	**115,091**	131,271
Depreciation	**265,098**	254,935
Other	**1,100,917**	1,760,268
Total investment expenses	**2,241,609**	2,849,004
Net investment income	**$ 44,002,427**	$ 42,387,627

[(1)] Real estate: Includes $637,341 in 2008 and $638,172 in 2007 for the Company's occupancy of its own building.

Realized Capital Gains (Losses): Realized capital gains (losses) are reported net of federal income taxes and amounts transferred to the IMR as follows:

	2008	**2007**
Realized capital losses	**$ (6,304,842)**	$ (1,174,100)
Less amount transferred to IMR (net of related taxes of $386,362 in 2008 and $4,430 in 2007)	**749,997**	8,599
	(7,054,839)	(1,182,699)
Less federal income tax expense on realized capital gains	**391,091**	80,027
Net realized capital losses	**$ (7,445,930)**	$ (1,262,726)

2. Investments (continued)

Securities Lending: The Company has in place a Securities Lending Agreement with Frost National Bank. The Company suspended the Securities Lending Agreement during the fourth quarter of 2008 and had no securities loaned at year-end. If reactivated, the agreement allows Frost National Bank to lend the securities of the Company in a manner that is transparent to the Company. Frost National Bank performs all of the functions involved in lending securities and pays the Company 60% of all earnings made by Frost National Bank. The amount earned from securities lending during 2008 and 2007 was $107,387 and $79,596, respectively. Under the agreement, the Company establishes the limits on the amount that Frost National Bank may lend in total, not to exceed 40% of assets. The Company has full control of its assets and may sell any bond without prior approval from Frost National Bank. Frost National Bank posts a sell to the Company, whether the loaned security has been returned to them or not, and indemnifies the Company against any loss arising from the Securities Lending Program.

Asset Impairments – Other-Than-Temporary: Management regularly reviews the value of the Company's investments. If the value of any investment falls below its cost basis, the decline is analyzed to determine whether it is an other-than-temporary decline in value. To make this determination for each security, the following is considered:

- How long and by how much the fair value has been below its cost;
- The financial condition and near-term prospects of the issuer of the security, including any specific events that may affect its operations or earnings potential;
- Management's intent to hold the security long enough for it to recover its value;
- Any downgrades of the security by a rating agency;
- Any reduction or elimination of dividends, or nonpayment of scheduled interest payments; and
- The impact interest rates have had on the value of the security.

Bonds: During 2008, the Company recorded losses of $7,246,981 on four bonds considered to be impaired. A loss of $1,052,328 was recorded on one bond in 2007.

2. Investments (continued)

Stocks: Six common stocks were impaired during 2008. The stocks have seen significant declines in value in 2008 because of the sub-prime crisis and the recession. The Company recorded a realized loss of $208,130 based on the fair value obtained from the NAIC SVO and verified to the fair value obtained from Frost National Bank.

During 2007, a realized loss of $357,145 was recorded for two common stocks that were considered to be impaired.

Mortgages: During 2008 and 2007, the Company had no mortgage loans that were considered to be other than temporarily impaired.

3. Fair Values

The following methods and assumptions were used by the Company in estimating the fair value disclosures for financial instruments in the accompanying financial statements:

> *Cash, Short-Term Investments, Policy Loans, and Receivables for Securities*: The carrying amounts reported in the accompanying statutory-basis balance sheets for these financial instruments approximate their fair values.
>
> *Investment Securities*: The fair values for fixed maturity securities are based on unit prices prescribed by the SVO or, in the absence of SVO unit prices or when amortized cost is used by the SVO as the unit price, quoted market prices by other third-party organizations. The fair value of mortgage-backed securities is based on quoted market prices by third party organizations. The fair values for equity securities are based on fair values prescribed by the SVO. The SVO prices do not differ materially from quoted market prices or prices obtained from an independent pricing service.
>
> *Mortgage Loans*: The fair values for mortgage loans are estimated using weighted-average maturity analyses, using interest rates currently being offered for similar loans to borrowers with similar credit ratings. Loans with similar characteristics are aggregated for purposes of the calculations.
>
> *Investment Contracts*: The fair values for the Company's liabilities under investment-type insurance contracts are estimated using discounted cash flow calculations, based on interest rates currently being offered for similar contracts with maturities consistent with those remaining for the contracts being valued.

3. Fair Values (continued)

The carrying amounts and fair values of the Company's financial instruments at December 31 were as follows:

	2008		2007	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Bonds	**$ 495,209,481**	**$ 455,086,474**	$ 533,452,918	$ 530,628,183
Preferred stock	**8,552,525**	**5,360,070**	7,084,320	6,382,600
Common stocks	**2,128,138**	**2,128,138**	3,034,563	3,034,563
Mortgage loans	**122,398,492**	**125,624,917**	107,498,957	108,184,800
Policy loans	**73,150,353**	**73,150,353**	71,827,803	71,827,803
Short-term investments	**36,988,264**	**36,988,264**	19,887,317	19,887,317
Cash	**6,905,662**	**6,905,662**	2,419,913	2,419,913
Cash equivalents	**998,922**	**998,922**	–	–
Receivables for securities	**82,799**	**82,799**	869,271	869,271

The carrying amounts and fair values of the Company's liabilities for investment-type insurance contracts at December 31 were as follows:

	2008		2007	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Individual annuities	**$ 73,835,043**	**$ 73,444,094**	$ 78,087,694	$ 76,815,786
Supplemental contracts not involving life contingencies	**18,360,318**	**18,907,061**	19,112,848	19,532,283

The fair values for the Company's insurance contracts other than investment contracts are not required to be disclosed. However, the fair values of liabilities under all insurance contracts are taken into consideration in the Company's overall management of interest rate risk, such that the Company's exposure to changing interest rates is minimized through the matching of investment maturities with amounts due under insurance contracts.

4. Reinsurance

Certain premiums and benefits are assumed from and ceded to other insurance companies under various reinsurance agreements. The ceded reinsurance agreements provide the Company with increased capacity to write larger risks. The Company remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations.

Amounts payable or recoverable for reinsurance on policy and contract liabilities are not subject to periodic or maximum limits. The Company has $1,359,795 of amounts recoverable on paid losses and commissions and expense allowances due from a single reinsurer. This amount does not exceed 3% of the Company's total surplus at December 31, 2008.

The Company has entered into a reinsurance agreement in which the reinsurer may unilaterally cancel any reinsurance for reasons other than nonpayment of premiums or other similar credits. The total amount of reinsurance credits taken for this agreement at December 31, 2008 and 2007, was $19,191,819 and $17,432,412, respectively.

The Company does not have any reinsurance agreements in effect in which the amount of losses paid or accrued through December 31, 2008, would result in a payment to the reinsurer of amounts that, in the aggregate and allowing for offset of mutual credits from other insurance agreements with the same reinsurer, exceed the total direct premiums collected under the reinsured policies.

The amounts related to the Company's ceded and assumed reinsurance arrangements for life insurance are summarized as follows:

	Ceded to Other Companies	Assumed From Other Companies
2008		
Premiums for the year ended December 31	**$ 18,132,932**	**$ 1,940,435**
Benefits paid or provided for the year ended December 31	**13,132,765**	**1,509,615**
Credit taken against policy and contract liabilities at December 31	**32,707,836**	–

4. Reinsurance (continued)

	Ceded to Other Companies	Assumed From Other Companies
2007		
Premiums for the year ended December 31	$ 20,164,206	$ 2,441,980
Benefits paid or provided for the year ended December 31	14,780,422	2,636,168
Credit taken against policy and contract liabilities at December 31	29,408,135	–

During 2004 and 2005, the Company entered into agreements with two insurance companies for the coinsurance of three blocks of business. The form of the agreement is 100% indemnity coinsurance with formal assumption to be accomplished after state approvals are secured. During 2006, the Company began the process of assumption of the business by submitting requests for approval to selected states. The Company has completed the assumption reinsurance for numerous states as approval was received. Assumption reinsurance of the business will continue as approval is received from other states and policyholders.

At December 31, the Company entered into an agreement to reinsure 35% of an in-force block of policies on a yearly renewable-term basis and 26.5% of another in-force block on a coinsurance basis. The transaction covers 7,060 policies with $79,585,842 of insurance in force and $928,659 in reserves.

5. Retrospectively Rated Contracts

In October 2001, the Company became the group carrier for the MBA, a nonprofit association of military and civil service personnel. Group term life and health policies were issued to the MBA. These policies can be terminated on anniversary with notice. Members of the MBA field of membership are eligible to apply for group term life coverage or group TRICARE supplement insurance. Life coverage is individually underwritten. Coverage from the prior carrier was continued in the new group policies. The contract with the MBA requires that the MBA maintain a premium stabilization fund (PSF) with the Company. The group is experience rated and the PSF will increase or decrease depending on the experience for the year. Interest is credited at the

5. Retrospectively Rated Contracts (continued)

end of each fiscal year. A refund to members is considered annually and is paid at various levels when considered appropriate. The PSF level is currently well in excess of a reserve that would be required for group term life, as such, no additional reserves are held. The PSF is held as a deposit reserve. Claim reserves are held separately for both life and health claims.

The Company estimates accrued retrospective premium adjustments for its group association life and health insurance business using the refund calculation specified in the agreement with the association and records them as an adjustment to earned premium. The amount of net premiums collected by the Company at December 31, 2008, that are subject to retrospective rating features was $5,329,670 in group life and $955,684 in group health. The net premiums represent 99% of the group life and 100% of the group health premiums collected. No other net premiums are subject to retrospective rating features.

The full balance of retrospective premium adjustments is admitted and considered collectible.

6. Federal Income Taxes

Income before federal income taxes differs from taxable income principally due to the differences in timing for recognizing accrual of market discounts on bonds, deferred compensation and policyholder dividends; dividends-received tax deductions; policy acquisition costs; interest maintenance reserve; and differences in reserves for policy and contract liabilities for tax and financial reporting purposes.

The components of incurred tax expense and the change in deferred tax assets (DTAs) and deferred tax liabilities (DTLs) for the year ended December 31 are as follows:

	2008	2007
Current income tax expense, operations	**$ 2,669,867**	$ 3,018,640
Income tax expense on net realized capital gains/losses before transfers to IMR	**391,091**	80,027
Change in gross DTAs	**(3,443,046)**	(537,950)
Change in DTLs	**(407,804)**	(191,869)
Income tax on net unrealized capital losses	**449,067**	252,035
Net change in deferred taxes	**(3,401,783)**	(477,784)
Total income taxes incurred	**$ (340,825)**	$ 2,620,883

6. Federal Income Taxes (continued)

The Company's income tax expense and change in deferred taxes differ from the amount obtained by applying the federal statutory rates of 34% for the years ended December 31, 2008 and 2007, to gain from operations before income taxes and net realized capital losses for the following reasons:

	2008	2007
Federal income tax expense at 34%	**$ 2,372,343**	$ 3,201,301
Net capital gains	**391,091**	80,027
Other-than-temporary impairments	**(2,534,738)**	(479,220)
Amortization of IMR	**(200,925)**	(152,044)
Change in nonadmitted assets	**(267,654)**	(95,518)
Other	**(100,942)**	66,337
Total income taxes incurred	**$ (340,825)**	$ 2,620,883

Deferred tax assets and liabilities at December 31 are summarized and reconciled to amounts shown on the accompanying balance sheets as follows:

	2008	2007
Gross DTAs	**$ 23,366,341**	$ 19,923,294
Gross DTLs	**(4,412,515)**	(4,820,319)
Deferred tax assets nonadmitted	**(10,570,191)**	(6,644,281)
Net deferred tax assets	**8,383,635**	8,458,694
Federal tax recoverable due to overpayment or carryback	**255,000**	255,783
Federal tax recoverable and net deferred tax asset	**$ 8,638,635**	$ 8,714,477
Increase in deferred tax assets nonadmitted	**$ 3,925,910**	$ 202,262

6. Federal Income Taxes (continued)

The main components of the deferred tax amounts are as follows:

	2008	2007
DTA		
Reserves	$ 8,326,772	$ 8,571,954
Deferred acquisition charges	4,699,115	4,535,819
Dividends apportioned for payment	2,261,000	2,244,000
Accrued deferred compensation	2,240,138	1,990,574
Other	5,839,316	2,580,947
Total DTAs	23,366,341	19,923,294
DTAs nonadmitted	10,570,191	6,644,281
Total admitted DTA	12,796,150	13,279,013
DTL		
Bonds	859,679	1,196,661
Depreciable assets	124,489	111,670
Deferred and uncollected premiums	3,260,630	3,429,083
Reserve change	59,289	76,423
Other	108,428	6,482
Total DTLs	4,412,515	4,820,319
Net DTA	$ 8,383,635	$ 8,458,694

The Company does not have any operating loss or tax credit carryforwards available for tax purposes. Federal income taxes incurred that will be available for recoupment in the event of future net losses are approximately $2,995,000 for 2008, $3,691,000 for 2007, and $2,462,000 for 2006.

7. Surplus

Unassigned surplus funds were earned by the participating policyholders. There are no restrictions on the unassigned surplus.

Life/health insurance companies are subject to certain risk-based capital (RBC) requirements as specified by the NAIC. Under those requirements, the amount of surplus to be maintained by a life/health insurance company is to be determined based on the various risk factors related to it. At December 31, 2008 and 2007, the Company exceeded the RBC requirements.

7. Surplus (continued)

The main components of the change in nonadmitted assets are as follows:

	2008	2007	Change
Nonadmitted assets			
Furniture and equipment	$ **454,389**	$ 556,593	$ (102,204)
Nonoperating software	**589,702**	485,447	104,255
Miscellaneous receivables and deposits	**505,595**	445,633	59,962
Agent balances	**1,306,354**	1,082,746	223,608
Policy loans and investment income due	**512,034**	10,438	501,596
Deferred tax assets	**10,570,191**	6,644,281	3,925,910
	$13,938,265	$ 9,225,138	$ 4,713,127

8. Leases

The Company leases office equipment under various noncancelable operating lease agreements that expire at various intervals through 2011. Rental expense was approximately $227,700 and $235,000 during 2008 and 2007, respectively. At January 1, 2009, future minimum payments under noncancelable leases are as follows (in thousands):

2009	$ 150
2010	85
2011	16
2012	–
2013	–
	$ 251

9. Commitments and Contingencies

The Company is named as a defendant in various legal actions arising principally from claims made under life insurance policies. Those actions are considered by the Company in estimating the policy and contract liabilities. The Company's management believes that the resolution of those actions will not have a material effect on the Company's financial position or results of operations.

10. Annuity Reserves

At December 31, 2008 and 2007, the Company's annuity reserves and deposit fund liabilities that were subject to discretionary withdrawal (with adjustment), subject to discretionary withdrawal (without adjustment) and not subject to discretionary withdrawal provisions are summarized as follows:

	At December 31, 2008	
	Amount	**Percent**
Subject to discretionary withdrawal (with adjustment):		
(1) With market value adjustment	$ –	–%
(2) At book value less current surrender charge of 5% or more	**10,145,287**	**6.27**
(3) At market value	–	–
(4) Total with adjustment or at market value	**10,145,287**	**6.27**
(5) At book value without adjustment (minimal or no charge or adjustment)	**110,035,993**	**68.03**
Not subject to discretionary withdrawal	**41,562,547**	**25.70**
Total gross	**161,743,827**	**100.00%**
Reinsurance ceded	**16,120,212**	
Total (net)	**$ 145,623,615**	

	At December 31, 2007	
	Amount	**Percent**
Subject to discretionary withdrawal (with adjustment):		
(1) With market value adjustment	$ –	–%
(2) At book value less current surrender charge of 5% or more	12,835,932	7.79
(3) At market value	–	–
(4) Total with adjustment or at market value	12,835,932	7.79
(5) At book value without adjustment (minimal or no charge or adjustment)	111,607,130	67.78
Not subject to discretionary withdrawal	40,219,536	24.43
Total gross	164,662,598	100.00%
Reinsurance ceded	14,526,851	
Total (net)	$ 150,135,747	

11. Life Premium and Annuity Considerations Deferred and Uncollected

Deferred and uncollected life insurance premiums and annuity considerations at December 31, 2008 and 2007, were as follows:

Type	Gross	Net of Loading
At December 31, 2008:		
Ordinary life new business	**$ 750,960**	**$ 201,089**
Ordinary life renewal	**10,961,942**	**9,100,186**
Individual annuity	**1,009**	**872**
Group life	**443,218**	**443,218**
Total	**$ 12,157,129**	**$ 9,745,365**
At December 31, 2007:		
Ordinary life new business	$ 735,630	$ 221,212
Ordinary life renewal	11,445,443	9,583,848
Individual annuity	2,763	1,143
Group life	448,330	448,330
Total	$ 12,632,166	$ 10,254,533

12. Employee Benefits

Company employees are covered by a qualified defined contribution (Section 401(k)) plan sponsored by the Company. Assets are held under various elective separate investment accounts by the Massachusetts Mutual Life Insurance Company (Springfield, Massachusetts).

Matching contributions are made at 62.5% on participants' contributions of up to 6%. The Company's contributions to the plan were $175,137 and $164,408 for 2008 and 2007, respectively. Additional contributions in the amount of $177,603 and $168,013 for 2008 and 2007, respectively (representing 3% of total compensation of all eligible) were made to the retirement plan. At December 31, 2008, the fair value of plan assets was $10,563,184. Any liabilities for this plan are reflected on the financial statements of the Massachusetts Mutual Life Insurance Company.

12. Employee Benefits (continued)

The Company provides certain life insurance and health care benefits for retired employees. Substantially all employees may become eligible for these benefits, if they reach retirement age while working for the Company. Retirees may elect certain prepaid health care benefit plans. Medical coverage may require retiree contributions. The Company's policy is to make payments to these plans sufficient to provide for benefit payments required under the plans.

Life insurance benefits, generally amounting to annual earnings at retirement decreasing uniformly over 15 years to 25% of the entire amount for life thereafter, are provided under a retired lives reserve. The retired lives reserve was $612,018 at December 31, 2008, and $627,528 at December 31, 2007.

The estimated unfunded accumulated postretirement health care benefit obligations, unrecognized transition obligation and accrued postretirement health care benefit liability for the Company were as follows:

	December 31	
	2008	**2007**
Actuarial present value of health care benefit obligations:		
Retirees	**$ 3,670,493**	$ 3,190,612
Fully eligible and vested plan participants	**2,156,161**	2,013,680
Accumulated postretirement health care benefit obligation for fully vested participants	**$ 5,826,654**	$ 5,204,292
Actuarial present value of health care benefit obligation for nonvested employees	**$ 2,809,053**	$ 2,449,381
Unrecognized transition obligation	**$ 261,112**	$ 304,632
Accrued postretirement health care benefit liability	**$ 2,004,521**	$ 1,780,883

The weighted-average discount rate used in determining the actuarial present value of the postretirement health care benefit obligation was 6.12 % in 2008 and 6.25 % in 2007.

12. Employee Benefits (continued)

For measurement purposes, a 10% annual rate of increase in the per capita cost of covered health care benefits was assumed for the year following the date of the valuation, and that rate was assumed to decrease gradually to 5.5 % in 2014 and remain at that level. A 1% increase in the assumed annual rate of increase in the per capita cost of health care benefits results in an increase in the accumulated postretirement benefit obligation and postretirement benefit expense. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the postretirement benefit obligation as of December 31, 2008, by $643,167 and the estimated eligibility cost and interest cost components of net periodic postretirement benefit cost by $73,803.

Postretirement benefit cost for 2008 was $730,469 and for 2007 was $411,253, including amortization of the transition obligation, plus the expected cost of health care benefits for newly eligible or vested employees, the expected cost of life insurance benefits for eligible employees and interest cost.

It has been determined that the Company's prescription drug benefit is actuarially equivalent to Medicare Part D under the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) and will therefore qualify for the federal subsidy. The postretirement benefit obligation and net periodic benefit cost reflect amounts associated with the subsidy. For the year ended December 31, 2008, the effect of the Act was a $104,831 reduction in the net postretirement benefit cost for the subsidy related to benefits attributed to former employees. The Act also had the following effects on the net postretirement benefit cost: a $20,056 decrease as a result of an actuarial gain; a $30,943 decrease to the current period service cost due to the subsidy; and a $53,832 decrease to the interest cost.

Expected 2008 gross benefit payments were $434,662 and actual gross benefit payments were $520,300. The subsidy was $28,944 for 2008 and was expected to be $30,042.

Supplemental Retirement Plans

The Company has nonqualified deferred compensation agreements with certain employees and agents. Benefits under the agreements with the home-office employees vest immediately. Benefits under agent agreements have a graded vesting dependent on various factors. The Company records nonvested balances as a nonadmitted asset. The liability for these agreements was $6,053,531 and $5,854,630 at December 31, 2008 and 2007, respectively. The nonvested balance at December 31, 2008, was $112,880. The expense for these agreements amounted to $525,211 and $490,815 in 2008 and 2007, respectively.

12. Employee Benefits (continued)

The Company has accrued for compensated absences/vacation pay in accordance with Statements of Statutory Accounting Principles No. 11, *Postemployment Benefits and Compensated Absences*. A liability of $740,943 is recorded in salaries and wages general expense.

During 2006, the Company recognized a cost of $360,000, payable over time, for the unique contractual postemployment wage continuation of a long tenured ex-employee. The remaining liability as of December 31, 2008, was $112,500.

13. Other

The Company has available a $30,000,000 line of credit from the Federal Home Loan Bank of Dallas. No amounts have been drawn since its inception and no debt was outstanding at December 31, 2008.

14. Subsequent Events

As of March 31, 2009, the Company had approximately $4,800,000 of additional unrealized losses recorded as nonadmitted assets through surplus as a result of investment down grades and changes in NAIC classification.

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Financial Statements – Statutory Basis

Government Personnel Mutual Life Insurance Company
Years Ended December 31, 2007 and 2006

Ernst & Young

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Contents

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Report of Independent Auditors

The Board of Directors
Government Personnel Mutual Life Insurance Company

We have audited the accompanying statutory-basis balance sheets of Government Personnel Mutual Life Insurance Company (the Company) as of December 31, 2007 and 2006, and the related statutory-basis statements of income, changes in surplus and cash flow 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included 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 and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Company presents its financial statements in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and U.S. generally accepted accounting principles and the effects on the accompanying financial statements are described in Note 1. The effects on the financial statements of these variances are not reasonably determinable, but are presumed to be material.

In our opinion, because of the effects of the matter described in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of Government Personnel Mutual Life Insurance Company at December 31, 2007 and 2006, or the results of its operations or its cash flows for the years then ended.

However, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Government Personnel Mutual Life Insurance Company at December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance.

Ernst + Young LLP

May 14, 2008

Government Personnel Mutual Life Insurance Company

Balance Sheets – Statutory Basis

	December 31	
	2007	**2006**
Admitted assets		
Cash and invested assets:		
Bonds, including securities loaned (2007 – $95,787,556; 2006 – $130,492,007)	**$ 533,452,918**	$ 541,810,953
Preferred stocks	**7,084,320**	2,575,000
Common stocks	**3,034,563**	4,517,162
Mortgage loans	**107,498,957**	101,908,972
Real estate, less accumulated depreciation (2007 – $584,813; 2006 – $329,879):		
Properties occupied by the Company	**7,606,802**	7,791,808
Properties held for the production of income	**1,445,960**	862,135
Policy loans	**71,827,803**	70,584,888
Short-term investments	**19,887,317**	13,092,722
Cash	**2,419,913**	773,082
Receivables for securities	**869,271**	1,142,296
Total cash and invested assets	**755,127,824**	745,059,018
Deferred and uncollected premiums, less loading (2007 – $2,377,632; 2006 – $2,122,286)	**10,254,534**	10,738,286
Accident and health premiums due and unpaid	**140,846**	162,350
Federal tax recoverable, including net deferred tax asset (2007 – $8,458,694; 2006 – $7,931,137)	**8,714,477**	7,931,137
Accrued investment income	**7,966,883**	7,976,471
Electronic data processing equipment, less accumulated depreciation (2007 – $1,302,683; 2006 – $1,232,820)	**78,227**	138,408
Reinsurance ceded	**3,552,165**	2,431,625
Other admitted assets	**763,842**	942,877
Total admitted assets	**$ 786,598,798**	$ 775,380,172

Government Personnel Mutual Life Insurance Company

Balance Sheets – Statutory Basis (continued)

	December 31	
	2007	**2006**
Liabilities and surplus		
Liabilities:		
Policy and contract liabilities:		
Life and annuity reserves	**$ 591,549,063**	$ 583,690,353
Accident and health reserves	**688,758**	666,517
Deposit-type contracts	**60,927,715**	61,799,811
Dividends and coupons payable	**6,601,225**	6,526,225
Unpaid claims	**7,642,948**	8,276,277
Other	**793,454**	64,792
Total policy and contract liabilities	**668,203,163**	661,023,975
Benefits for employees	**6,004,630**	5,646,850
Accounts payable and accrued expenses	**5,094,663**	5,536,417
Unearned investment income	**2,121,386**	2,080,660
Federal income taxes payable	**–**	185,550
Asset valuation reserve	**11,291,718**	10,086,780
Interest maintenance reserve	**4,343,461**	4,782,049
Other	**1,582,406**	1,515,101
Total liabilities	**698,641,427**	690,857,382
Surplus:		
Surplus guarantee fund	**400,000**	400,000
Unassigned surplus	**87,557,371**	84,122,790
Total surplus	**87,957,371**	84,522,790
Total liabilities and surplus	**$ 786,598,798**	$ 775,380,172

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Income – Statutory Basis

	Years Ended December 31	
	2007	**2006**
Premiums and other revenues:		
Premium on life, annuity and accident and health policies	**$ 54,124,687**	$ 55,735,738
Considerations for supplemental contracts with life contingencies	**704,184**	545,622
Net investment income	**42,387,627**	41,133,137
Amortization of the interest maintenance reserve	**447,188**	455,044
Commissions and expense allowances on reinsurance ceded	**4,706,623**	4,701,038
Miscellaneous income	**131,983**	171,735
Total premiums and other revenues	**102,502,292**	102,742,314
Benefits paid or provided:		
Death benefits	**25,570,881**	27,007,255
Annuity benefits	**9,366,038**	11,795,469
Surrender benefits	**15,105,199**	14,968,609
Interest and adjustments on policy or deposit-type contract funds	**2,889,283**	2,888,762
Payments from supplemental contracts with life contingencies	**1,239,234**	1,296,546
Other benefits	**1,638,427**	1,404,737
Increase in policy reserves	**7,880,951**	6,607,895
Total benefits paid or provided	**63,690,013**	65,969,273
Insurance expenses:		
Commissions	**5,991,702**	5,780,293
General expenses	**15,518,575**	15,371,462
Insurance taxes, licenses and fees	**1,324,857**	1,579,219
Total insurance expenses	**22,835,134**	22,730,974
Total benefits paid or provided and insurance expenses	**86,525,147**	88,700,247
Gain from operations before dividends to policyholders, income taxes and net realized capital (losses) gains	**15,977,145**	14,042,067
Dividends to policyholders	**(6,561,553)**	(6,424,153)
Gain from operations before income taxes and net realized capital (losses) gains	**9,415,592**	7,617,914
Federal income taxes	**3,018,640**	2,223,080
Gain from operations before net realized capital (losses) gains	**6,396,952**	5,394,834
Net realized capital (losses) gains, net of federal income tax expense (2007 – $75,597; 2006 – $217,506) and net of amounts transferred to IMR	**(1,262,726)**	420,717
Net income	**$ 5,134,226**	$ 5,815,551

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Changes in Surplus – Statutory Basis

	Years Ended December 31	
	2007	**2006**
Surplus at beginning of year	**$ 84,522,790**	$ 79,330,167
Net income	**5,134,226**	5,815,551
Change in net unrealized capital (losses) gains, net of tax	**(489,242)**	279,871
Change in net deferred tax	**477,784**	(353,151)
Change in nonadmitted assets	**(483,196)**	584,376
Change in liability for reinsurance in unauthorized companies	**(53)**	(30)
Change in asset valuation reserve	**(1,204,938)**	(1,126,996)
Other	**–**	(6,998)
Net increase	**3,434,581**	5,192,623
Surplus at end of year	**$ 87,957,371**	$ 84,522,790

See accompanying notes.

Government Personnel Mutual Life Insurance Company

Statements of Cash Flow – Statutory Basis

	Years Ended December 31 2007	2006
Operating activities		
Premiums collected, net of reinsurance	$ 55,280,351	$ 56,601,227
Net investment income	42,860,248	41,968,370
Miscellaneous income	4,765,602	4,758,648
Total	102,906,201	103,328,245
Benefit and loss related payments	54,632,352	57,126,055
Commissions, expenses paid and aggregate write-ins for deductions	22,874,168	22,645,411
Dividends paid to policyholders	6,486,553	6,404,689
Federal and foreign income taxes paid, net of tax on capital (losses) gains	3,459,973	1,775,530
Total	87,453,046	87,951,685
Net cash provided by operating activities	15,453,155	15,376,560
Investing activities		
Proceeds from investments sold, matured or repaid:		
Bonds	62,272,083	64,757,816
Stocks	5,045,921	1,790,933
Mortgage loans	17,391,170	12,932,822
Other proceeds	273,026	–
Total investment proceeds	84,982,200	79,481,571
Cost of investments acquired:		
Bonds	55,327,541	78,308,720
Stocks	8,889,717	1,415,280
Mortgage loans	22,887,408	15,527,500
Real estate	653,754	78,956
Miscellaneous applications	80,027	134,470
Total investments acquired	87,838,447	95,464,926
Net increase in policy loans and premium notes	1,243,408	1,227,586
Net cash used in investing activities	(4,099,655)	(17,210,941)
Financing and miscellaneous activities		
Net deposits on deposit-type contract funds and other insurance	(3,239,280)	(2,580,277)
Other cash provided	327,206	697,211
Net cash used in financing and miscellaneous activities	(2,912,074)	(1,883,066)
Net change in cash and short-term investments	8,441,426	(3,717,447)
Cash and short-term investments at beginning of year	13,865,804	17,583,251
Cash and short-term investments at end of year	$ 22,307,230	$ 13,865,804

See accompanying notes.

1. Nature of Operations and Significant Accounting Policies

Government Personnel Mutual Life Insurance Company (the Company) is domiciled in the state of Texas. The Company is a mutual life insurance organization specializing in the armed forces, civil service markets and final expense markets. Coverages are also available to the middle to upper-income general civilian market.

Operations are conducted primarily on personal producing and managing general agent plans through approximately 1,400 general and soliciting agents. The Company is licensed in 48 states, the territory of Guam and the District of Columbia. Its primary markets are the states of Texas, California, Florida and Virginia. The Company is also accredited to solicit sales at some overseas military installations. The Company offers a portfolio of the usual forms of individual permanent, term, flexible premium universal life and annuity policies, all without a war clause. Life insurance and annuity plans are available to United States military personnel and civil service employees through a federal allotment plan. Automatic payment plans are available to the civilian populace. The Company is the underwriter for the group association coverages for members of the Military Benefit Association (MBA). The Company derives substantially all of its direct group life and group accident and health business from the group policy issued to the MBA.

Basis of Presentation

The Company's financial statements are prepared in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, whose practices may differ from U.S. generally accepted accounting principles (GAAP). The more significant variances from GAAP are as follows:

Investments: Investments in bonds are reported at amortized cost or fair value based on their National Association of Insurance Commissioners (NAIC) rating; for 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 surplus for those designated as available-for-sale. Fair value for statutory purposes is based on the price published by the Securities Valuation Office of the NAIC (SVO), if available, whereas fair value for GAAP is based on quoted market prices.

1. Nature of Operations and Significant Accounting Policies (continued)

All single-class and multi-class mortgage-backed/asset-backed securities (e.g., CMOs) 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. For GAAP purposes, all securities, purchased or retained, that represent beneficial interests in securitized assets (e.g., CMO, CBO, CDO, CLO, MBS and ABS securities), 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. If high credit quality securities are adjusted, the retrospective method is used.

Real estate owned and occupied by the Company is included in investments rather than reported as an operating asset as under GAAP. Investment income and operating expenses for statutory reporting include rent for the Company's occupancy of those properties.

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 are charged or credited directly to unassigned surplus rather than included as a component of earnings as would be required under GAAP.

Changes in investment nonadmitted asset carrying amounts are credited or charged directly to unassigned surplus.

Valuation Reserves: Under a formula prescribed by the NAIC, the Company defers the portion of realized capital gains and losses on sales of fixed income investments attributable to changes in the general level of interest rates and amortizes those deferrals over the remaining period to maturity based on groupings of individual securities sold in five-year bands. That net deferral is reported as the interest maintenance reserve (IMR) in the

1. Nature of Operations and Significant Accounting Policies (continued)

accompanying balance sheets. Realized capital gains and losses are reported in income, net of federal income tax and transfers to the IMR. Under GAAP, realized capital gains and losses would be reported in the income statement on a pretax basis in the period that the assets giving rise to the gains or losses are sold.

The asset valuation reserve (AVR) provides a valuation allowance for invested assets. The AVR is determined by an NAIC prescribed formula with changes reflected directly to unassigned surplus; AVR is not recognized for GAAP.

Policy Acquisition Costs: 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.

Nonadmitted Assets: Certain assets designated as "nonadmitted," principally agents' balances, furniture and equipment and other assets not specifically identified as an admitted asset within the *NAIC Accounting Practices and Procedures Manual*, are excluded from the accompanying balance sheets and charged directly to unassigned surplus. Under GAAP, such assets are included in the balance sheet to the extent that those assets are not impaired.

Universal Life and Annuity Policies: Revenues for universal life and annuity policies with mortality or morbidity risk consist of the entire premium received and benefits incurred represent the total of death benefits paid, surrender benefits paid and the change in policy reserves. Proceeds received for annuity policies without mortality or morbidity risk 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 account values.

1. Nature of Operations and Significant Accounting Policies (continued)

Benefit Reserves: Certain policy reserves are calculated based on statutorily required interest and mortality assumptions rather than on estimated expected experience or actual account balances as would be required under GAAP.

Reinsurance: Policy and contract liabilities ceded to reinsurers have been reported as reductions of the related reserves rather than as assets as would be required under GAAP. Commissions allowed by reinsurers on business ceded are reported as income when incurred rather than being deferred and amortized with deferred policy acquisition costs as would be required under GAAP. In addition, liability for reinsurance balances has been provided for unsecured policy reserves ceded to reinsurers not authorized to assume such business. Changes to the liability are credited or charged directly to unassigned surplus. Under GAAP, an allowance for amounts deemed uncollectible would be established through a charge to earnings.

Employee Benefits: For purposes of calculating the Company's postretirement and postemployment benefit obligations, only vested participants and current retirees are included in the valuation. Under GAAP, active participants not currently eligible would also be included.

Deferred Income Taxes: 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 balance sheet date or 10% of surplus excluding any net deferred tax assets, and EDP equipment and operating software, 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. Deferred taxes do not include amounts for state taxes. Under GAAP, state income 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.

Policyholder Dividends: Policyholder dividends are recognized when declared rather than over the term of the related policies. Dividends are determined annually by the Company's Board of Directors. Individual ordinary life participating premium approximates 87% of the Company's ordinary life insurance collected premiums.

1. Nature of Operations and Significant Accounting Policies (continued)

Statements of Cash Flow: Cash and short-term investments in the statements of cash flow 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.

The effects of the foregoing variances from GAAP on the accompanying statutory-basis financial statements have not been determined, but are presumed to be material.

Other significant accounting practices are as follows:

Investments

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

Bonds are stated at amortized cost or, for certain bonds, at fair value as determined by the SVO, with related unrealized capital gains/losses reported in unassigned surplus, net of federal income tax.

Bonds not backed by other loans are stated at amortized cost using the interest method. Loan-backed bonds and structured securities are valued at amortized cost using the interest method including anticipated prepayments. Prepayment assumptions are obtained from broker dealer survey values 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.

Redeemable preferred stocks are reported at cost or amortized cost as determined by the SVO.

Common stocks are reported at fair value as determined by the SVO, and the related unrealized capital gains/losses are reported in unassigned surplus, net of federal income taxes.

There are no restrictions on common or preferred stock.

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.

1. Nature of Operations and Significant Accounting Policies (continued)

Mortgage loans are reported at unpaid principal balances, less an allowance for impairment as needed. 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, the impairment is other-than-temporary; the mortgage loan is written down to a realizable value and a realized loss is recognized.

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, with depreciation calculated on a straight-line basis over the estimated useful lives of the properties.

Policy loans are reported at their unpaid principal balance.

Realized capital gains and losses are determined using the specific identification basis. Changes in admitted asset carrying amounts of bonds, mortgage loans, policy loans, common and preferred stocks are credited or charged directly to unassigned surplus.

Furniture and Equipment

The Company's electronic data processing equipment and operating software are reported at cost, less accumulated depreciation. Depreciation is provided in amounts sufficient to charge the cost of electronic processing equipment and operating software to operations over the lesser of their estimated service lives or three years on a straight-line basis. Nonoperating software is depreciated on a straight-line basis over the lesser of its useful life or five years. Other furniture and equipment are depreciated on a straight-line basis over the lesser of their estimated service lives or five years. Depreciation and amortization expense charged to operations was $444,886 for 2007 and $529,622 for 2006.

Premiums

Life and accident and health premiums are recognized as revenue when due. Premiums for annuity policies with mortality and morbidity risk are also recognized as revenue when due. Premiums received for annuity policies without mortality or morbidity risk and for group annuity contracts are recorded using deposit accounting.

1. Nature of Operations and Significant Accounting Policies (continued)

Benefit Reserves

Life, annuity and accident and health benefit reserves are developed by actuarial methods and are determined based on published tables using statutorily specified interest rates and valuation methods that will provide, in the aggregate, reserves that are greater than the minimum required by the Texas Department of Insurance.

The Company waives deduction of deferred fractional premiums upon the death of insureds and refunds any premium beyond the month of death. Surrender values on policies do not exceed the corresponding benefit reserves. Extra premiums are charged for substandard lives plus the gross premium for the true age. The mean reserve method is used to adjust the calculated terminal reserve to the appropriate reserve at December 31. Mean reserves are determined by computing the regular mean reserve for the plan at the true age and holding, in addition, one-half of the extra premium charge for the year. An asset is recorded for deferred premiums net of loading to adjust the reserve for modal premium payments. Additional reserves are established when the results of cash flow testing under various interest rate scenarios indicate the need for such reserves. There has been no need for such reserves.

As of December 31, 2007 and 2006, reserves of $2,591,533 and $2,774,221, respectively, were recorded on in-force amounts of $179,566,021 and $194,575,035, respectively, for which gross premiums are less than the net premiums according to the standard of valuation required by the Texas Department of Insurance.

The tabular interest, tabular cost less actual reserve released and tabular cost have been determined by formula. For determination of tabular interest on funds not involving life contingencies, the tabular interest is actual interest credited or due on the accounts for the valuation year.

Deposit-Type Contracts

Deposit-type contracts consist primarily of dividend accumulations, premium deposits and supplemental contracts not involving life contingencies and annuities certain. Premium deposits relate primarily to the MBA group business. Deposit-type contracts are increased and decreased according to the deposits and withdrawals, respectively, of the applicable policyholders, as well as by retrospectively rated credits and debits for favorable and unfavorable, respectively, underwriting and investment experience of the MBA business.

1. Nature of Operations and Significant Accounting Policies (continued)

Unpaid Claims

The liability for unpaid policy and contract claims represents the estimate of the ultimate net cost of all reported and unreported claims incurred through year-end. The liability is estimated using individual case-basis valuations and Company history. Those estimates are subject to the effects of trends in claim severity and frequency. Although considerable variability is inherent in such estimates, management believes that the reserve for unpaid claims is adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

Reinsurance

Reinsurance premiums and benefits paid or provided are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Guaranty Fund Assessments

Guaranty fund assessments are accrued when the Company receives notice or other information that a reasonably estimable amount is or is likely to be payable to a guaranty fund.

Use of Estimates

The preparation of statutory-basis financial statements requires management to make estimates and assumptions that affect amounts reported in the 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.

Reclassifications

Certain 2006 amounts in the Company's statutory-basis financial statements have been reclassified to conform to the 2007 financial statement presentation.

2. Investments

Bonds: The amortized cost and the fair value of investments in bonds are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2007				
U.S. government and agencies	$ 149,223,745	$ 2,677,895	$ (613,854)	$ 151,287,786
State and political subdivisions	18,953,466	281,007	(145,287)	19,089,186
Corporate securities	339,603,992	6,957,957	(11,436,780)	335,125,169
Mortgage-backed securities	25,671,715	330,991	(876,664)	25,126,042
Total bonds	$ 533,452,918	$ 10,247,850	$ (13,072,585)	$ 530,628,183
At December 31, 2006				
U.S. government and agencies	$ 162,988,667	$ 1,188,806	$ (4,151,449)	$ 160,026,024
State and political subdivisions	12,017,177	745,862	(40,649)	12,722,390
Corporate securities	340,059,124	7,691,574	(6,354,632)	341,396,066
Mortgage-backed securities	26,745,985	169,200	(545,389)	26,369,796
Total bonds	$ 541,810,953	$ 9,795,442	$ (11,092,119)	$ 540,514,276

The following table shows gross unrealized losses and fair values of fixed maturities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position. There were five unrated or below investment grade bonds. There were 18 bonds with their fair value below 90% of the amortized cost.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2007						
U.S. government and agencies	$ 5,329,300	$ (245,814)	$ 29,327,088	$ (368,040)	$ 34,656,388	$ (613,854)
State and political subdivisions	5,149,104	(119,498)	2,484,775	(25,789)	7,633,879	(145,287)
Corporate securities	52,162,814	(3,476,077)	152,618,799	(7,960,703)	204,781,613	(11,436,780)
Mortgage-backed securities	2,921,440	(26,164)	9,437,601	(850,500)	12,359,041	(876,664)
Total bonds	$ 65,562,658	$ (3,867,553)	$ 193,868,263	$ (9,205,032)	$ 259,430,921	$ (13,072,585)
December 31, 2006						
U.S. government and agencies	$ 26,293,831	$ (323,370)	$ 117,841,011	$ (3,828,079)	$ 144,134,842	$ (4,151,449)
State and political subdivisions	5,129,235	(40,649)	–	–	5,129,235	(40,649)
Corporate securities	67,916,525	(1,509,898)	124,629,903	(4,844,734)	192,546,428	(6,354,632)
Mortgage-backed securities	4,289,940	(87,941)	13,457,201	(457,448)	17,747,141	(545,389)
Total bonds	$ 103,629,531	$ (1,961,858)	$ 255,928,115	$ (9,130,261)	$ 359,557,646	$ (11,092,119)

2. Investments (continued)

A summary of the amortized cost and fair value of the Company's investments in bonds at December 31, 2007, by contractual maturity, is as follows:

	Amortized Cost	Fair Value
Years to maturity:		
One or less	$ 19,413,035	$ 19,468,009
After one through five	90,876,388	92,810,813
After five through ten	144,573,499	143,538,980
After ten	252,918,281	249,684,339
Mortgage-backed securities	25,671,715	25,126,042
Total	$ 533,452,918	$ 530,628,183

The actual maturities may differ from the contractual maturities in the foregoing table because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from sales of investments in bonds during 2007 and 2006 were $35,220,793 and $45,490,183, respectively; gross gains of $177,055 and $829,488 and gross losses of $406,662 and $982,412 were realized on those sales, respectively.

At December 31, 2007, bonds with an admitted asset value of $7,070,341 were on deposit with state insurance departments to satisfy regulatory requirements.

Stocks: Unrealized gains and losses on investments in common stocks are reported directly in unassigned surplus and do not affect operations. The cost and fair value of investments in preferred stocks and common stocks are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2007				
Preferred stocks	**$ 7,084,320**	**$ 24,800**	**$ (726,520)**	**$ 6,382,600**
Common stocks	**$ 2,517,477**	**$ 537,532**	**$ (20,446)**	**$ 3,034,563**
At December 31, 2006				
Preferred stocks	$ 2,575,000	$ 97,450	$ (16,400)	$ 2,656,050
Common stocks	$ 3,258,801	$ 1,258,361	$ –	$ 4,517,162

2. Investments (continued)

The following table shows gross unrealized losses and fair values of preferred and common stocks, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2007						
Stocks:						
Preferred stocks	$ 3,837,800	$ (671,520)	$ 445,000	$ (55,000)	$ 4,282,800	$ (726,520)
Common stocks	413,705	(20,446)	–	–	413,705	(20,446)
Total	$ 4,251,505	$ (691,966)	$ 445,000	$ (55,000)	$ 4,696,505	$ (746,966)
December 31, 2006						
Stocks:						
Preferred stocks	$ –	$ –	$ 483,600	$ (16,400)	$ 483,600	$ (16,400)
Common stocks	–	–	–	–	–	–
Total	$ –	$ –	$ 483,600	$ (16,400)	$ 483,600	$ (16,400)

Mortgage Loans: During 2007, the minimum and maximum lending rates for mortgage loans were 6.25% and 6.875%, respectively. At the issuance of a loan, the percentage of loan to value on any one loan does not exceed 75%. Fire insurance is required on all properties covered by mortgage loans at least equal to the excess of each loan over the maximum loan that would be permitted by law on the land without the buildings. At December 31, 2007, the Company held one mortgage with a carrying value of $3,234,126 with interest overdue beyond 180 days. None were held at year-end 2006. There was no nonadmitted interest or principal at December 31, 2007 or 2006.

At December 31, 2007 and 2006, taxes, assessments and amounts advanced not included in the mortgage loan total were $27,452 and $48,430, respectively. At December 31, 2007, none of the Company's investments in mortgage loans were subject to prior liens.

The Company's investments in mortgage loans all involve commercial real estate. At December 31, 2007, all such mortgages involve properties located in the states of Texas, Nevada, Arizona, Colorado, Utah or New Mexico. Such investments consist of first mortgage liens on completed income-producing properties; at December 31, 2007, the mortgage outstanding on any individual property did not exceed $3,700,000.

2. Investments (continued)

The total recorded investment in troubled restructured loans at December 31, 2007 and 2006, was $4,434,253 and $5,172,197, respectively. There were no realized capital losses related to these loans. There were no contractual commitments to extend credit to debtors owing receivables whose terms have been modified in troubled debt restructurings. The Company accrues interest income on impaired loans to the extent deemed collectible and the loan continues to perform under its original or restructured contractual terms. Interest income on nonperforming loans generally is recognized on a cash basis.

Real Estate: Properties held for the production of income represent two condominiums purchased for the use of Company employees and a strip center adjacent to the home office property.

During 2007, the Company added one investment property to its real estate investments. The property is adjacent to the home office building and allows the Company access to Starcrest, a major cross street to Loop 410. The Company paid $600,304 for the property.

Net Investment Income: Net investment income consists of the following:

	Years Ended December 31	
	2007	**2006**
Income:		
Bonds	**$ 31,134,956**	$ 29,715,747
Preferred stocks	**192,216**	196,155
Common stocks	**196,689**	229,163
Mortgage loans	**7,467,179**	7,933,418
Real estate [1]	**772,019**	705,426
Policy loans	**4,486,365**	4,345,164
Short-term investments and cash	**906,466**	875,942
Other	**80,741**	57,804
Total investment income	**45,236,631**	44,058,819
Expenses:		
Real estate operating and maintenance	**702,530**	717,500
Real estate taxes	**131,271**	111,768
Depreciation	**254,935**	245,796
Other	**1,760,268**	1,850,618
Total investment expenses	**2,849,004**	2,925,682
Net investment income	**$ 42,387,627**	$ 41,133,137

[1] Real estate: Includes $638,172 in 2007 and $637,902 in 2006 for the Company's occupancy of its own building.

2. Investments (continued)

Realized Capital Gains (Losses): Realized capital gains (losses) are reported net of federal income taxes and amounts transferred to the IMR as follows:

	2007	2006
Realized capital (losses) gains	**$ (1,174,100)**	$ 394,000
Less amount transferred to IMR (net of related taxes of $4,430 in 2007 and $(83,036) in 2006	**8,599**	(161,187)
	(1,182,699)	555,187
Less federal income tax expense on realized capital (losses) gains	**80,027**	134,470
Net realized capital obligations	**$ (1,262,726)**	$ 420,717

Securities Lending: To realize additional income, the Company has entered into a Securities Lending Agreement with Frost National Bank. The agreement allows Frost National Bank to lend the securities of the Company in a manner that is transparent to the Company. Frost National Bank performs all of the functions involved in lending securities and pays the Company 60% of all earnings made by Frost National Bank. As of December 31, 2007, the amount earned from securities lending was $79,596. The Company establishes the limits on the amount that Frost National Bank may lend in total, not to exceed 40% of assets. The Company has full control of its assets and may sell any bond without prior approval from Frost National Bank. Frost National Bank will post a sell to the Company, whether the loaned security has been returned to them or not, and indemnifies the Company against any loss arising from the Securities Lending Program.

Asset Impairments – Other-Than-Temporary: Management regularly reviews the value of the Company's investments. If the value of any investment falls below its cost basis, the decline is analyzed to determine whether it is an other-than-temporary decline in value. To make this determination for each security, the following is considered:

- How long and by how much the fair value has been below its cost;
- The financial condition and near-term prospects of the issuer of the security, including any specific events that may affect its operations or earnings potential;
- Management's intent to hold the security long enough for it to recover its value;

2. Investments (continued)

- Any downgrades of the security by a rating agency;
- Any reduction or elimination of dividends, or nonpayment of scheduled interest payments; and
- The impact interest rates have had on the value of the security.

The Company has no direct exposure to subprime mortgages. The Company has reviewed the positions in the investment portfolio for securities held that have exposure to subprime mortgages and the associated risk from the current credit crisis. Due to the lack of transparency in financial statements of security issuers, it is difficult to completely ascertain the significance of each issuer's exposure to subprime mortgages. Although the Company has experienced some loss in value in investments held, the impact has not been material. 98.4% of bonds are of high quality consisting of Exempt Obligations and NAIC Category 1 and 2 bonds. Because the Company practice is to hold invested assets long term and because the Company had no debt, the exposure to the current reduced liquidity in the financial markets is not considered significant.

Bonds: During 2007, the Company impaired the Alltel 6.80% bond due May 1, 2029. During 2007, the management of that company and two venture capital firms bought all the stock and took the company private. The debt issued to fund the buyout increased outstanding debt to a level that led Moody's, S&P and the other rating services to downgrade the debt to the Caa1 level. This led to a significant decline in the fair value of the bond. Based on the significant decline in value and the probability that it will be some time before the bonds return to a reasonable level, the decision was made to impair the bonds to the fair value at the end of the year. A capital loss of $1,052,328 was recorded. The amortized cost of the bond prior to the recognized loss was $2,802,328. The fair value was obtained from the SVO and was verified to the fair value obtained from Frost National Bank. No bonds were impaired during 2006.

Stocks: Two common stocks were impaired during 2007. The first, Alesco Financial Trust, is a financial Real Estate Investment Trust (REIT) with exposure to Collateralized Debt Obligations with subprime loans. The second was the RMK Multi-Sector High Income fund that also had exposure to Below Investment Grade debt and subprime loans. Due to the sub-prime crises and its impact on these stocks, management believes the decline to be other-than-temporary. Therefore, these stocks were impaired and a realized loss of $357,145 was recorded. The fair value was obtained from the SVO and also verified to the fair value obtained from Frost National Bank.

2. Investments (continued)

During 2006, a realized loss of $1,500 was recorded for one common stock with an amortized cost of $4,180 that was considered to be impaired.

Mortgages: During 2007 and 2006, the Company had no mortgage loans that were considered to be other-than-temporarily impaired.

3. Fair Values

The following methods and assumptions were used by the Company in estimating the fair value disclosures for financial instruments in the accompanying financial statements:

Cash, Short-Term Investments, Policy Loans and Receivables for Securities: The carrying amounts reported in the accompanying statutory-basis balance sheets for these financial instruments approximate their fair values.

Investment Securities: The fair values for fixed maturity securities are based on unit prices prescribed by the SVO or, in the absence of SVO unit prices or when amortized cost is used by the SVO as the unit price, quoted market prices by other third-party organizations. The fair value of mortgage-backed securities is based on quoted market prices by third-party organizations. The fair values for equity securities are based on fair values prescribed by the SVO.

Mortgage Loans: The fair values for mortgage loans are estimated using weighted-average maturity analyses, using interest rates currently being offered for similar loans to borrowers with similar credit ratings. Loans with similar characteristics are aggregated for purposes of the calculations.

Investment Contracts: The fair values for the Company's liabilities under investment-type insurance contracts are estimated using discounted cash flow calculations, based on interest rates currently being offered for similar contracts with maturities consistent with those remaining for the contracts being valued.

3. Fair Values (continued)

The carrying amounts and fair values of the Company's financial instruments at December 31 were as follows:

	2007		2006	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Bonds	**$ 533,452,918**	**$ 530,628,183**	$ 541,810,953	$ 540,514,276
Preferred stock	**7,084,320**	**6,382,600**	2,575,000	2,656,050
Common stocks	**3,034,563**	**3,034,563**	4,517,162	4,517,162
Mortgage loans	**107,498,957**	**108,184,800**	101,908,972	103,722,584
Policy loans	**71,827,803**	**71,827,803**	70,584,888	70,584,888
Short-term investments	**19,887,317**	**19,887,317**	13,092,722	13,092,722
Cash	**2,419,913**	**2,419,913**	773,082	773,082
Receivables for securities	**869,271**	**869,271**	1,142,297	1,142,297

The carrying amounts and fair values of the Company's liabilities for investment-type insurance contracts at December 31 were as follows:

	2007		2006	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Individual annuities	**$ 78,087,694**	**$ 76,815,786**	$ 81,934,505	$ 80,390,771
Supplemental contracts not involving life contingencies	**19,112,848**	**19,532,283**	19,727,712	20,254,526

The fair values for the Company's insurance contracts other than investment contracts are not required to be disclosed. However, the fair values of liabilities under all insurance contracts are taken into consideration in the Company's overall management of interest rate risk, such that the Company's exposure to changing interest rates is minimized through the matching of investment maturities with amounts due under insurance contracts.

4. Reinsurance

Certain premiums and benefits are assumed from and ceded to other insurance companies under various reinsurance agreements. The ceded reinsurance agreements provide the Company with increased capacity to write larger risks. The Company remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations.

Amounts payable or recoverable for reinsurance on policy and contract liabilities are not subject to periodic or maximum limits. The Company has $1,636,562 of amounts recoverable on paid losses and commissions and expense allowances due from a single reinsurer. This amount does not exceed 3% of the Company's total surplus at December 31, 2007.

The Company has entered into a reinsurance agreement in which the reinsurer may unilaterally cancel any reinsurance for reasons other than nonpayment of premiums or other similar credits. The total amount of reinsurance credits taken for this agreement at December 31, 2007 and 2006, was $17,432,412 and $19,278,549, respectively.

The Company does not have any reinsurance agreements in effect in which the amount of losses paid or accrued through December 31, 2007, would result in a payment to the reinsurer of amounts that, in the aggregate and allowing for offset of mutual credits from other insurance agreements with the same reinsurer, exceed the total direct premiums collected under the reinsured policies.

The amounts related to the Company's ceded and assumed reinsurance arrangements for life insurance are summarized as follows:

	Ceded to Other Companies	Assumed From Other Companies
2007		
Premiums for the year ended December 31	$ 20,164,206	$ 2,441,980
Benefits paid or provided for the year ended December 31	14,780,422	2,636,168
Credit taken against policy and contract liabilities at December 31	29,408,135	–

4. Reinsurance (continued)

	Ceded to Other Companies	Assumed From Other Companies
2006		
Premiums for the year ended December 31	$ 21,429,033	$ 8,672,681
Benefits paid or provided for the year ended December 31	16,689,590	5,864,898
Credit taken against policy and contract liabilities at December 31	30,224,747	–

Effective February 28, 2005, the Company entered into a 100% indemnity coinsurance agreement to assume an existing block of ordinary life business. The Company assumed 10,949 policies with $117.7 million of insurance in force and $6.8 million in reserves.

Effective April 1, 2005, the Company entered into a 100% indemnity coinsurance agreement to assume an existing block of single premium life business. The Company assumed 649 policies with $53.7 million of insurance in force and $33 million in reserves.

During 2006, the Company began the process of assumption of the business by submitting requests for approval to selected states. The Company has completed the assumption reinsurance for numerous states as approval was received. Assumption reinsurance of the business will continue as approval is received from other states and policyholders.

5. Retrospectively Rated Contracts

In October 2001, the Company became the group carrier for the MBA, a nonprofit association of military and civil service personnel. Group term life and health policies were issued to the MBA. These policies can be terminated on anniversary with notice. Members of the MBA field of membership are eligible to apply for group term life coverage or group TRICARE supplement insurance. Life coverage is individually underwritten. Coverage from the prior carrier was continued in the new group policies. The contract with the MBA requires that the MBA maintain a premium stabilization fund (PSF) with the Company. The group is experience rated and the PSF will increase or decrease depending on the experience for the year. Interest is credited at the end of each fiscal year. A refund to members is considered annually and is paid at various levels when considered appropriate. The PSF level is currently well in excess of a reserve that would

5. Retrospectively Rated Contracts (continued)

be required for group term life, as such, no additional reserves are held. The PSF is held as a deposit reserve. Claim reserves are held separately for both life and health claims.

The Company estimates accrued retrospective premium adjustments for its group association life and health insurance business using the refund calculation specified in the agreement with the association and records them as an adjustment to earned premium. The amount of net premiums collected by the Company at December 31, 2007, that are subject to retrospective rating features was $5,393,263 in group life and $1,006,913 in group health. The net premiums represent 99% of the group life and 100% of the group health premiums collected. No other net premiums are subject to retrospective rating features.

The full balance of retrospective premium adjustments is admitted and considered collectible.

6. Federal Income Taxes

Income before federal income taxes differs from taxable income principally due to the differences in timing for recognizing accrual of market discounts on bonds, deferred compensation and policyholder dividends; dividends-received tax deductions; policy acquisition costs; interest maintenance reserve; and differences in reserves for policy and contract liabilities for tax and financial reporting purposes.

The components of incurred tax expense and the change in deferred tax assets (DTAs) and deferred tax liabilities (DTLs) for the year ended December 31 are as follows:

	2007	2006
Current income tax expense, operations	**$ 3,018,640**	$ 2,223,080
Income tax expense on net realized capital (losses) gains before transfers to IMR	**80,027**	134,470
Change in gross DTAs	**(537,950)**	(84,572)
Change in DTL	**(191,869)**	581,900
Income tax on net unrealized capital (losses) gains	**252,035**	(144,177)
Net change in deferred taxes	**(477,784)**	353,151
Total income taxes incurred	**$ 2,620,883**	$ 2,710,701

6. Federal Income Taxes (continued)

The Company's income tax expense and change in deferred taxes differ from the amount obtained by applying the federal statutory rates of 34% for the years ended December 31, 2007 and 2006, to gain from operations before income taxes and net realized capital losses for the following reasons:

	2007	2006
Federal income tax expense at 34%	$ 3,201,301	$ 2,590,091
Net capital (losses) gains	80,027	134,470
Other-than-temporary impairments	(479,220)	–
Other	(181,225)	(13,860)
Total income taxes incurred	$ 2,620,883	$ 2,710,701

Deferred tax assets and liabilities at December 31 are summarized and reconciled to amounts shown on the accompanying balance sheets as follows:

	2007	2006
Gross DTAs	$ 19,923,294	$ 19,385,344
Gross DTLs	(4,820,319)	(5,012,188)
Deferred tax assets nonadmitted	(6,644,281)	(6,442,019)
Net deferred tax assets	8,458,694	7,931,137
Federal tax recoverable due to overpayment or carryback	255,783	–
Federal tax recoverable and net deferred tax asset	$ 8,714,477	$ 7,931,137
Increase (decrease) in deferred tax assets nonadmitted	$ 202,262	$ (211,410)

6. Federal Income Taxes (continued)

The main components of the deferred tax amounts are as follows:

	2007	2006
DTA		
Reserves	**$ 8,571,954**	$ 9,624,023
Deferred acquisition charges	**4,535,819**	3,472,458
Dividends apportioned for payment	**2,244,000**	2,218,500
Accrued deferred compensation	**1,990,574**	1,868,929
Other	**2,580,947**	2,201,434
Total DTAs	**$ 19,923,294**	$ 19,385,344
DTAs nonadmitted	**$ 6,644,281**	$ 6,442,019
DTL		
Bonds	**$ 1,196,661**	$ 897,503
Common stock	**–**	355,959
Depreciable assets	**111,670**	90,989
Deferred and uncollected premiums	**3,429,083**	3,586,159
Reserve change	**76,423**	81,524
Other	**6,482**	54
Total DTLs	**$ 4,820,319**	$ 5,012,188

The Company does not have any operating loss or tax credit carryforwards available for tax purposes. Federal income taxes incurred that will be available for recoupment in the event of future net losses are approximately $3,625,000 for 2007, $2,462,000 for 2006 and $1,635,000 for 2005.

When determining its federal income tax expense, the Company uses a number of estimated amounts that may change when the actual tax return is completed.

7. Surplus

Unassigned surplus funds were earned by the participating policyholders. There are no restrictions on the unassigned surplus.

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

8. Leases

The Company leases office equipment under various noncancelable operating lease agreements that expire at various intervals through 2011. Rental expense was approximately $235,000 and $224,300 during 2007 and 2006, respectively. At January 1, 2008, future minimum payments under noncancelable leases are as follows (in thousands):

2008	$ 187
2009	151
2010	86
2011	16
	$ 440

9. Commitments and Contingencies

The Company is named as a defendant in various legal actions arising principally from claims made under life insurance policies. Those actions are considered by the Company in estimating the policy and contract liabilities. The Company's management believes that the resolution of those actions will not have a material effect on the Company's financial position or results of operations.

10. Annuity Reserves

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

	At December 31, 2007	
	Amount	**Percent**
Subject to discretionary withdrawal (with adjustment):		
(1) With market value adjustment	$ –	–%
(2) At book value less current surrender charge of 5% or more	**12,835,932**	**7.79**
(3) At market value	–	–
(4) Total with adjustment or at market value	**12,835,932**	**7.79**
(5) At book value without adjustment (minimal or no charge or adjustment)	**111,607,130**	**67.78**
Not subject to discretionary withdrawal	**40,219,536**	**24.43**
Total gross	**164,662,598**	**100.00%**
Reinsurance ceded	**14,526,851**	
Total (net)	**$ 150,135,747**	

	At December 31, 2006	
	Amount	**Percent**
Subject to discretionary withdrawal (with adjustment):		
(1) With market value adjustment	$ –	–%
(2) At book value less current surrender charge of 5% or more	14,682,294	8.58
(3) At market value	–	–
(4) Total with adjustment or at market value	14,682,294	8.58
(5) At book value without adjustment (minimal or no charge or adjustment)	114,935,466	67.20
Not subject to discretionary withdrawal	41,428,603	24.22
Total gross	171,046,363	100.00%
Reinsurance ceded	16,063,397	
Total (net)	$ 154,982,966	

11. Life Premium and Annuity Considerations Deferred and Uncollected

Deferred and uncollected life insurance premiums and annuity considerations at December 31, 2007 and 2006, were as follows:

Type	Gross	Net of Loading
At December 31, 2007:		
Ordinary life new business	$ 735,630	$ 221,212
Ordinary life renewal	11,445,443	9,583,848
Individual annuity	2,763	1,143
Group life	448,330	448,330
Total	$ 12,632,166	$ 10,254,533
At December 31, 2006:		
Ordinary life new business	$ 595,291	$ 181,105
Ordinary life renewal	11,810,522	10,102,543
Individual annuity	1,079	958
Group life	453,680	453,680
Total	$ 12,860,572	$ 10,738,286

12. Employee Benefits

Company employees are covered by a qualified defined contribution (Section 401(k)) plan sponsored by the Company. Assets are held under various elective separate investment accounts by the Massachusetts Mutual Life Insurance Company (Springfield, Massachusetts).

Matching contributions are made at 62.5% on participants' contributions of up to 6%. The Company's contributions to the plan were $164,408 and $153,496 for 2007 and 2006, respectively. Additional contributions in the amount of $168,013 and $158,892 for 2007 and 2006, respectively (representing 3% of total compensation of all eligible) were made to the retirement plan. At December 31, 2007, the fair value of plan assets was $13,218,944. Any liabilities for this plan are reflected on the financial statements of the Massachusetts Mutual Life Insurance Company.

12. Employee Benefits (continued)

The Company provides certain life insurance and health care benefits for retired employees. Substantially all employees may become eligible for these benefits, if they reach retirement age while working for the Company. Retirees may elect certain prepaid health care benefit plans. Medical coverage may require retiree contributions. The Company's policy is to make payments to these plans sufficient to provide for benefit payments required under the plans.

Life insurance benefits, generally amounting to annual earnings at retirement decreasing uniformly over 15 years to 25% of the entire amount for life thereafter, are provided under a retired lives reserve. The retired lives reserve was $627,528 at December 31, 2007, and $592,098 at December 31, 2006.

The estimated unfunded accumulated postretirement health care benefit obligations, unrecognized transition obligation and accrued postretirement health care benefit liability for the Company were as follows:

	December 31	
	2007	**2006**
Actuarial present value of health care benefit obligations:		
Retirees	**$ 3,190,612**	$ 2,473,626
Fully eligible and vested plan participants	**2,013,680**	1,825,594
Accumulated postretirement health care benefit obligation for fully vested participants	**$ 5,204,292**	$ 4,299,220
Actuarial present value of health care benefit obligation for nonvested employees	**$ 2,449,381**	$ 1,610,315
Unrecognized transition obligation	**$ 304,632**	$ 348,152
Accrued postretirement health care benefit liability	**$ 1,780,883**	$ 1,722,585

The weighted-average discount rate used in determining the actuarial present value of the postretirement health care benefit obligation was 6.25% in 2007 and 5.75% in 2006.

12. Employee Benefits (continued)

For measurement purposes, a 12% annual rate of increase in the per capita cost of covered health care benefits was assumed for the year following the date of the valuation, and that rate was assumed to decrease gradually to 5.5% in 2014 and remain at that level. A 1% increase in the assumed annual rate of increase in the per capita cost of health care benefits results in an increase in the accumulated postretirement benefit obligation and postretirement benefit expense. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the postretirement benefit obligation as of December 31, 2007, by $519,388 and the estimated eligibility cost and interest cost components of net periodic postretirement benefit cost by $27,047.

Postretirement benefit cost for 2007 was $411,253 and for 2006 was $653,322, including amortization of the transition obligation, plus the expected cost of health care benefits for newly eligible or vested employees, the expected cost of life insurance benefits for eligible employees and interest cost.

It has been determined that the Company's prescription drug benefit is actuarially equivalent to Medicare Part D under the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) and will therefore qualify for the federal subsidy. The postretirement benefit obligation and net periodic benefit cost reflect amounts associated with the subsidy.

For the year ended December 31, 2007, the effect of the Act was a $78,025 reduction in the net postretirement benefit cost for the subsidy related to benefits attributed to former employees. The Act also had the following effects on the net postretirement benefit cost; a $25,468 decrease as a result of an actuarial gain; a $-0- decrease to the current period service cost due to the subsidy; and a $52,557 decrease to the interest cost.

Expected 2007 gross benefit payments were $382,899 and actual gross benefit payments were $395,086. The subsidy was $28,638 for 2007 and was expected to be $30,063.

12. Employee Benefits (continued)

Supplemental Retirement Plans

The Company has nonqualified deferred compensation agreements with certain employees and agents. Benefits under the agreements with the home-office employees vest immediately. Benefits under agent agreements have a graded vesting dependent on various factors. The Company records nonvested balances as a nonadmitted asset. The liability for these agreements was $5,854,630 and $5,496,850 at December 31, 2007 and 2006, respectively. The nonvested balance at December 31, 2007, was $115,776. The expense for these agreements amounted to $490,815 and $510,066 in 2007 and 2006, respectively.

The Company has accrued for compensated absences/vacation pay in accordance with Statements of Statutory Accounting Principles No. 11, *Postemployment Benefits and Compensated Absences*. A liability of $753,978 is recorded in salaries and wages general expense.

During 2006, the Company recognized a cost of $360,000, payable over time, for the unique contractual postemployment wage continuation of a long tenured ex-employee. The remaining liability as of December 31, 2007, was $202,500.

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