CITIZENS INC
Form 10-K/A
May 25, 2007

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON D.C. 20549**
**FORM 10-K/A**
**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2006**

Commission file number 1-13004

**CITIZENS, INC.**

(Exact name of registrant as specified in its charter)

| **Colorado** | **84-0755371** |
|---|---|
| (State of incorporation) | (IRS Employer Identification No.) |
| **400 East Anderson Lane, Austin, Texas** | **78752** |
| (Address of principal executive offices) | (Zip Code) |

Registrant s telephone number, including area code: (512) 837-7100

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| **Class A Common Stock** | **New York Stock Exchange** |

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

o Yes þ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

o Yes þ No

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

þ Yes o No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

o Yes þ No

As of the last business day of the registrant s most recently completed second fiscal quarter (June 30, 2006), the aggregate market value of the Class A voting stock held by non-affiliates of the registrant was approximately $170,173,000.

Number of shares of common stock outstanding as of March 1, 2007:
Class A: 40,289,786
Class B: 1,001,714

**DOCUMENTS INCORPORATED BY REFERENCE**

None.

This Annual Report on Form 10-K/A (this Amendment ) is being filed as an amendment to our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 to include information required by Part III of Form 10-K. The information included in Part III was sent to our stockholders on April 30, 2007 as part of our definitive proxy material relating to our 2007 Annual Meeting of Shareholders; however, the definitive proxy material was not filed with the Commission until May 4, 2007. Consequently, we are now providing information required by Part III of Form 10-K. In accordance with the rules of the Securities and Exchange Commission, this Amendment sets forth the complete text of the Annual Report on Form 10-K, as amended. This Amendment does not update the information contained in the original filing to reflect facts or events that may have occurred subsequent to the date of the original filing or subsequent to any periods for which disclosure was otherwise provided in the original filing.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**

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Consent of KPMG LLP
Consent of Ernst & Young LLP
Certification of CEO Pursuant to Section 302
Certification of CFO Pursuant to Section 302
Certification of CEO Pursuant to Section 906
Certification of CFO Pursuant to Section 906

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**
**FORWARD-LOOKING STATEMENTS**

*Certain statements contained in this Annual Report on Form 10-K are not statements of historical fact and constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act (the Act ), including, without limitation, statements specifically identified as forward-looking statements within this document. Many of these statements contain risk factors as well. In addition, certain statements in future filings by the Company with the Securities and Exchange Commission, in press releases, and in oral and written statements made by or with the approval of the Company which are not statements of historical fact constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements, include, but are not limited to: (i) projections of revenues, income or loss, earnings or loss per share, the payment or non-payment of dividends, capital structure, and other financial items, (ii) statements of our plans and objectives by our management or Board of Directors including those relating to products or services, (iii) statements of future economic performance and (iv) statements of assumptions underlying such statements. Words such as believes, anticipates, expects, intends, targeted, may, will and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.*

*Forward-looking statements involve risks and uncertainties, which may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to: (i) the strength of foreign and U.S. economies in general and the strength of the local economies where our policyholders reside; (ii) the effects of and changes in trade, monetary and fiscal policies and laws; (iii) inflation, interest rates, market and monetary fluctuations and volatility; (iv) the timely development of and acceptance of new products and services and perceived overall value of these products and services by existing and potential customers; (v) changes in consumer spending, borrowing and saving habits; (vi) a concentration of business from persons residing in Latin America and the Pacific Rim; (vii) uncertainties in assimilating acquisitions; (viii) the persistency of existing and future insurance policies sold by the Company and its subsidiaries; (ix) the dependence of the Company on its Chairman of the Board; (x) the ability to control expenses; (xi) the effect of changes in laws and regulations (including laws and regulations concerning insurance) with which the Company and its subsidiaries must comply, (xii) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies as well as the Financial Accounting Standards Board, (xiii) changes in the Company s organization and compensation plans; (xiv) the costs and effects of litigation and of unexpected or adverse outcomes in such litigation; and (xv) the success of the Company at managing the risks involved in the foregoing.*

*Such forward-looking statements speak only as of the date on which such statements are made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made to reflect the occurrence of unanticipated events.*

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**

*We make available, free of charge, through our Internet website (**http://www.citizensinc.com**), our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Section 16 reports filed by officers and directors, news releases, and, if applicable, amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after we electronically file such reports with, or furnish such reports to, the Securities and Exchange Commission. We are not including any of the information contained on our website as part of, or incorporating it by reference into, this Annual Report on Form 10-K.*

## PART I

## ITEM 1. Business

### Overview

We are a leading insurance holding company serving the life insurance needs of individuals in the United States and around the world. We pursue a strategy of offering ordinary life insurance products in niche markets where we believe we are able to achieve competitive advantages. Our core operations include:

- the issuance of ordinary life insurance in U.S. Dollar-denominated amounts to foreign nationals through outside marketing consultants, principally in Latin America and the Pacific Rim; and
- offering final expense ordinary life insurance through our home service distribution channel.

We have provided our insurance products internationally since 1975 and domestically since 1969. We believe we are one of the leading writers of U.S. Dollar-denominated ordinary life insurance in the international market. In October 2004, we entered the home service distribution channel through the acquisition of Security Plan Life Insurance Company ( Security Plan ), a significant provider of final expense ordinary life insurance in Louisiana. We also provide ordinary life insurance to middle income individuals in various markets in the Midwest and southern U.S., as well as small face property insurance in Louisiana.

Our objective is to grow our asset base and profitability through:

- building assets through the issuance of cash accumulation and final expense ordinary life insurance products;
- strategic acquisitions of domestic life insurance companies; and
- expanding our distribution channels of ordinary life insurance.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**

We market our products through our network of 3,000 marketing consultants, independent agents and employee agents, and provide underwriting, investment and administrative functions through 170 employees in our executive offices in Austin, Texas and a support center in Donaldsonville, Louisiana.

We were formed in 1969 by our Chairman, Harold E. Riley, who had many years of past experience in international and domestic life insurance before forming our Company. Since then, our business has grown significantly, both internationally and domestically. Revenues rose from $99.9 million in 2004 to $142.1 million in 2005 to $158.1 million in 2006. Since 1987, we have completed and integrated the acquisitions of 14 life insurance companies in the United States. We continue to seek acquisitions of other domestic life insurance companies as well as expand our life insurance business.

During the five years ended December 31, 2006, our assets grew from $326.3 million to $711.2 million, and total stockholders equity increased from $101.8 million to $139.6 million.

We organize and manage our life insurance business through two primary operating business segments, Life Insurance and Home Service Insurance. We exited the Domestic Health segment in 2004.

The following table sets forth certain information regarding our business segments and distribution channels.

| | For the Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | (In thousands) | | | |
| Operating Business Segment and Principal Distribution Channel | Total Revenue | Segment Income (Loss) Before Income Tax | Total Revenue | Segment Income (Loss) Before Income Tax |
| Life Insurance Approximately 2,150 marketing consultants around the world and 525 domestic representatives | $105,747 | $10,803 | $90,649 | $4,715 |
| Home Service Insurance - Approximately 320 employee agents | 51,235 | 3,531 | 49,655 | 5,902 |
| Other Non-Insurance Enterprises | 1,077 | (992) | 1,809 | 1,179 |

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**

Each operating business segment focuses on critical activities close to its target markets and customers, including marketing and customer support, while our centralized administrative staff provides support in key functions. At the corporate level, we stress disciplined underwriting and provide support services, including investment, information technology and other administrative and finance functions. This enables the operating business segments to focus on their target markets and distribution relationships while enjoying cost savings realized by operating these segments together.

**Our Operating Segments**

Our business is comprised of three primary operating business segments:

- Life Insurance;
- Home Service Insurance (which we acquired on October 1, 2004, and as such, all income statement amounts in 2004 are for the last fiscal quarter only); and
- Other Non-insurance Enterprises.

The following summary, representing revenues and pre-tax income from operations and identifiable assets for our segments, is as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| | (In thousands) | | |
| Revenue | | | |
| Life Insurance | $ 105,747 | 90,649 | 86,468 |
| Home Service Insurance | 51,235 | 49,655 | 12,556 |
| Other Non-Insurance Enterprises | 1,077 | 1,809 | 835 |
| Total consolidated revenue | $ 158,059 | 142,113 | 99,859 |
| Premium income | | | |
| Life Insurance | $ 90,479 | 78,592 | 70,117 |
| Home Service Insurance | 38,017 | 37,682 | 9,797 |
| Other Non-Insurance Enterprises | | | |
| Total consolidated premium income | $ 128,496 | 116,274 | 79,914 |
| Net investment income | | | |
| Life Insurance | $ 14,243 | 11,780 | 13,950 |
| Home Service Insurance | 12,232 | 11,573 | 2,876 |
| Other Non-Insurance Enterprises | 500 | 215 | 179 |
| Total consolidated net investment income | $ 26,975 | 23,568 | 17,005 |
| Income (loss) before federal income tax: | | | |
| Life Insurance | $ 10,803 | 4,715 | 5,842 |
| Home Service Insurance | 3,531 | 5,902 | 2,609 |
| Other Non-Insurance Enterprises | (992) | 1,179 | (363) |

| | | | |
|---|---|---|---|
| Total consolidated income before federal income tax | $ 13,342 | 11,796 | 8,088 |

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**

| | December 31, | |
|---|---|---|
| | 2006 | 2005 |
| | (In thousands) | |
| Assets: | | |
| Life Insurance | $ 395,297 | 346,313 |
| Home Service Insurance | 300,368 | 300,693 |
| Other Non-Insurance Enterprises | 15,519 | 14,883 |
| Total consolidated assets | $ 711,184 | 661,889 |

**Life Insurance**

Our Life Insurance segment consists of both international and domestic life insurance policies. The acceptance of applications for U.S. Dollar-denominated ordinary whole life insurance from significant net worth foreign nationals is the foundation upon which we have built our Company. For over the past 30 years, we have participated in the foreign marketplace. We believe positive attributes of our international insurance market include:

- policies are typically larger face amounts than in our U.S operations. resulting in lower underwriting and administrative costs per policy;
- the premiums are paid annually rather than monthly or quarterly, which saves us administrative expenses and accelerates our cash flow;
- persistency is higher than U.S. policies;
- the mortality is as good or better than that experienced in the U.S. because our insureds are in the top income brackets in their countries;
- the marketing consultants from whom applications are received are highly professional;
- we do not advance any commissions relating to this business, so we do not have financial exposure in the event monies are advanced and insurance revenues do not cover the advances; and
- the profit margins are higher for us than for our typical U.S. policies.

Due to our significant experience in this segment, we have implemented numerous policies and procedures to reduce the risks of asset losses. We have no offices, employees or assets outside of the U.S. All of our premiums from outside of the U.S. must be paid in U.S. Dollars through a U.S. financial institution. The policies we issue to foreign nationals are designed to alleviate risks inherent in such markets by containing limitations on benefits for certain causes of death, such as homicide. In addition, we have developed disciplined underwriting criteria over many years, which include background reviews of potential marketing consultants, and thorough medical reviews of applicants, including retention of medical doctors who perform detailed medical examinations, as well as background and reference checks on applicants. Also, we have a claims policy that requires an investigation of substantially all death claims.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**

Through our primary insurance company subsidiary, CICA LIFE Insurance Company of America ( CICA ), we make available ordinary whole life products to significant net worth foreign nationals through contracts with independent marketing organizations and independent marketing consultants. The number of our independent consultants has expanded over the years in this division to approximately 2,150, and the number of countries from which applications are received is increasing. Historically, the majority of our international life business has come from Latin America. However, in 2004 the Pacific Rim began to represent a meaningful and growing source of new business, amounting to $2.6 million of issued and paid annualized premium. Issued and paid annualized premium is a standard non-GAAP tool used by the life insurance industry as a measure of new business issued. Issued and paid annualized premium assumes all new business is issued on an annual mode during the year and is not the same as GAAP earned premiums, which measures the collected and pro-rata premiums for the period. The Company believes issued and paid annualized premium is a measure of distribution productivity and is a leading indicator of future revenue trends. However, revenues are driven by sales in prior periods as well as the current period; therefore, a reconciliation of issued and paid annualized premium is not meaningful or determinable. This increase was also evident in 2005, as issued and paid annualized premiums from this region were $4.1 million, and through 2006, when premiums were $4.2 million. Overall, the Life Insurance segment made up 70.4% of our total premium revenues in 2006 and 67.6% of such revenues in 2005.

The following table sets forth our total yearly percentages of direct collected premiums and annuity deposits from our international life business for the years indicated:

| Country | 2006 | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|
| | | | (Dollars in thousands) | | | |
| Colombia | $ 22,879 | 28.0% | $ 20,572 | 30.1% | $ 18,487 | 31.2% |
| Taiwan | 10,077 | 12.3 | 7,008 | 10.2 | 3,748 | 6.3 |
| Argentina | 8,975 | 11.0 | 8,419 | 12.3 | 8,592 | 14.5 |
| Venezuela | 8,907 | 10.9 | 7,178 | 10.5 | 6,557 | 11.1 |
| Uruguay | 3,092 | 3.8 | 3,202 | 4.7 | 3,527 | 6.0 |
| Other Non-U.S. | 27,818 | 34.0 | 22,065 | 32.2 | 18,303 | 30.9 |
| Total | $ 81,748 | 100.0% | $ 68,444 | 100.0% | $ 59,214 | 100.0% |

The ordinary whole life policies issued by CICA on residents of foreign countries had an average face amount of approximately $52,000 at December 31, 2006. We accept applications for international insurance policies submitted by several outside marketing consulting firms and marketing consultants in markets pursuant to non-exclusive contracts. These persons specialize in marketing life insurance products to foreign nationals and generally have several years of experience marketing life insurance products. The outside firms provide recruitment, training and supervision of their managers and associates in the placement of U.S. Dollar-denominated life insurance products; however, all associates of these firms contract directly with us and receive their compensation directly from us. Accordingly, should the arrangement between any outside marketing consulting firm and us be canceled for any reason, we believe we could continue suitable marketing arrangements with the associates of these outside firms without appreciable loss of present and future sales, as we have done in the past. There is, however, always a risk that

**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**

insurance sales could decrease. Our standard agreement with individual marketing consultants provides that the consultant is the representative of the prospective insured. Our standard contract with outside marketing consulting firms provides that the firm has the responsibility for recruiting and training its associates. These firms guarantee any debts of their associates to us. In consideration for the services rendered, the firms receive a fee on all new policies placed by them or their associates.

Our foreign outside marketing consultants are independent contractors, responsible for their respective expenses, and are compensated based on a percentage of collected premiums. We encourage these consultants to place ordinary whole life insurance. With respect to our contracts with foreign marketing consulting firms, these firms receive overriding first year and renewal commissions on business written by associates under their supervision, and all marketing expenses related thereto, except sales conventions, are borne by these firms.

Our Life Insurance segment is dependent on the non-U.S. markets for a significant percentage of its ongoing and new life insurance premium revenue. As a result, we are subject to potential risks with regard to the continued ability to write this business should adverse events occur in the countries from which we receive applications. For example, even though we do not conduct business in a foreign country and have no assets or employees in any country outside the U.S, a foreign government could take the position that its residents cannot procure insurance through us. While such an event has never occurred, if we were faced with such a situation, we could experience increased lapse rates of our policies. Our policy lapse rate could also increase if funds that flow out of such countries were to become restricted. Based on more than 30 years experience in the marketplace in which we compete, management believes such risks are not significant. We require all premiums to be paid in the U.S. with U.S. Dollars via drafts drawn on banks in the U.S., therefore, we are not subject to foreign regulation or restrictions on fund transfers, nor are we subject to currency devaluation or foreign appropriation. Management also believes that many of the inherent risks in foreign countries, such as political instability, inflation and economic disruptions, tend to improve rather than hurt our business over the long term because these risks encourage individuals to convert assets out of local currencies to the more stable U.S. Dollar.

Our international business grew at a double-digit pace in 2005, and experienced solid growth in 2006. New annualized issued and paid premiums from the international market increased by 17.9% during 2005 compared to 2004 and 9.4% during 2006 compared to 2005. The development of the markets in the Pacific Rim and the expansion of existing markets in Latin America contributed to the growth in international revenues. Overall, issued and paid new annualized premium income for 2006 from the international markets totaled $20.4 million, compared to $18.6 million in 2005 and $15.8 million in 2004. We will continue to emphasize growth in this segment.

The domestic life policies of our Life Insurance segment consists of ordinary whole life, credit life insurance, credit disability insurance, and final expense policies, sold primarily throughout the Midwest and southern U.S. The majority of our domestic life business is the result of acquisitions of U.S. life insurance companies since 1987. We conduct our domestic life business primarily through two operating life insurance subsidiaries.

We seek to serve middle-income American families through the sale of cash accumulation ordinary whole life insurance products. In 2004, we shifted our emphasis to a sales force

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

comprised primarily of part-time, second career sales associates (such as teachers, coaches, community leaders and others in small communities outside of major metropolitan areas). Product sales over the past three years have trended downward, and combined with high lapse rates on existing business, resulted in decreased premium income in 2006 compared to 2005.

Our domestic underwriting policy requires a medical examination of applicants for ordinary insurance in excess of certain prescribed limits. These limits are graduated according to the age of the applicant and the amount of insurance.

The following table sets forth our total yearly direct premiums and annuity deposits from our domestic life and disability premium income by state for the years indicated, including domestic life, domestic health and annuity deposits:

| State | 2006 | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|
| | | | (Dollars in thousands) | | | |
| Texas | $ 7,962 | 39.6% | $ 9,172 | 38.6% | $ 10,212 | 36.9% |
| Kentucky | 2,436 | 12.1 | 2,936 | 12.3 | 4,377 | 15.8 |
| Oklahoma | 2,363 | 11.8 | 3,481 | 14.6 | 4,262 | 15.4 |
| Mississippi | 1,520 | 7.6 | 1,658 | 7.0 | 1,811 | 6.5 |
| Other States | 5,828 | 28.9 | 6,545 | 27.5 | 7,029 | 25.4 |
| Total | $ 20,109 | 100.0% | $ 23,792 | 100.0% | $ 27,691 | 100.0% |

**Home Service Insurance**

On October 1, 2004, following the acquisition of Security Plan Life Insurance Company ( Security Plan ), a new segment, Home Service Insurance, was established.

Security Plan, which has conducted its operations since 1948, focuses on the life insurance needs of the lower income market, principally in Louisiana. Its policies, which are predominantly ordinary whole life products, provide a means of funding individuals final expenses, primarily consisting of funeral and other burial costs. The policies are sold and serviced through the home service marketing distribution system utilizing employee-agents who work on a route system to collect premiums and service policyholders. Virtually all business has been written in Louisiana, where Security Plan is one of the leading writers of life insurance in the home service market. Security Plan s premium writings have been supplemented by the acquisition of life insurance policies from numerous companies in its history. Because of the type of business Security Plan writes, the average life insurance policy face amount in force is relatively small approximately $1,500 per policy in 2006 the underwriting performed on these applications is limited due to the small face amount.

Security Plan s book of premium income decreased each year from 2001 to 2005, until 2006 when this trend turned upward. Management replaced Security Plan s marketing leadership and believes that the new emphasis on sales has halted the shrinkage in the premium income and serves as a base from which to expand the home service business. This increase occurred despite the hurricanes that hit Louisiana in 2005, significantly disrupting Security Plan s customer base.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**

Security Plan owns a subsidiary, Security Plan Fire Insurance Company ( SPFIC ), which provides property and casualty coverage to lower income residents of Louisiana. SPFIC utilizes the same employees/agents as Security Plan. The maximum coverage on any one dwelling is $20,000 and content coverage is limited to $10,000. At December 31, 2006, SPFIC had total assets of approximately $5.7 million and annual revenues of $3.9 million. We utilize SPFIC to augment Security Plan s insurance sales. SPFIC was negatively impacted by the 2005 hurricanes in Louisiana. Through December 31, 2006, losses in excess of reinsurance amounted to more than $4.1 million, resulting in Security Plan infusing $4.0 million of additional capital into SPFIC.

## Our Products

*Life Insurance*

We offer several ordinary whole life insurance products designed to meet the needs of our non-U.S. policy owners through our product portfolio. These policies have been structured to provide:

- U.S. Dollar-denominated living cash values;
- rates that are competitive with or better than most foreign local companies;
- a hedge against local currency inflation;
- protection against devaluation of foreign currency;
- capital transference to a safe haven (U.S.);
- lifetime income;
- tax-free earnings on cash build-up; and
- cash values beginning in the first policy year.

Our products have living benefit features: every policy contains guaranteed cash values and is participating (i.e., receiving an annual cash dividend). The major portion of each premium payment goes toward building guaranteed cash values, while a lesser portion goes to dividends and direct retirement benefits. Once the policy owner pays the annual premium and the policy is issued, we immediately pay a cash dividend to the owner. The policy owner has several options with regard to the dividend, including the right to assign the dividends to a third-party trust account, along with an annual policy Retirement Fund Benefit.

Our domestic products in the Life Insurance segment focus primarily on living needs, and provide death benefits as a side effect of accumulating money for the insured. Our domestic life insurance policies are designed to provide for:

- cash accumulation/living benefits;
- tax-deferred interest earnings;

- guaranteed lifetime income at age 65;
- monthly income for surviving family members;
- significant accidental death benefits; and
- payment waiver in the event of disability.

Our life insurance products are designed to address the issue of outliving an insured s monthly income, and at the same time, provide death benefits in case of an early demise. The primary purpose of our Fortune Builder portfolio is to help the insured create capital for needs such as retirement income, children s higher educational funds, business opportunities, emergencies and healthcare needs.

*Home Service*

The products of Security Plan are small face amount ordinary whole life policies, which are designed to provide a means to taking care of final expenses for the insured, primarily consisting of funeral and burial costs. The products of SPFIC are small face amount property policies designed primarily to cover dwellings. The policies in effect are those of many small companies that Security Plan has acquired over many years. We intend to continue to market these types of small face amount policies.

**Operations and Technology**

Our administrative operations are conducted primarily at our executive offices in Austin, Texas through approximately 100 administrative, operating and underwriting personnel. Operations of Security Plan are conducted to a large degree from our support center in Donaldsonville, Louisiana through approximately 70 operations personnel. During 2007, continued consolidation of certain administrative functions is expected. At our offices, we perform policy design, marketing oversight, underwriting, accounting, customer service and investment.

Our senior management has a history in insurance company operating system design and implementation. Beginning in the mid-1960 s, we developed a new operating system that has evolved continually since that time. We have a single data processing administrative system for our entire Company, which is a sophisticated mainframe administrative system. Since early 2005, we have been converting Security Plan s administrative system to our processing system, a process expected to be completed in mid-2007. Functions of our administrative system include policy set up, several internal control functions, administration, billing and collections, valuation, storage backup and related tasks. Each company we acquire is converted onto our administrative system. This system has been in place for several years, and we believe it is a significant asset to us. We update our administrative system on an ongoing basis. This system is also capable of significant expansion without substantial capital outlay or increase in staff. Therefore, we believe we can achieve additional growth without operating system upgrades, delays or failures or the addition of substantial amounts of staff.

**Consolidated Information Regarding Our Insurance Businesses**

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**

The following tables set forth certain statistical information on the basis of accounting principles generally accepted in the U.S. concerning our operations for each of the five years ended December 31, 2006.

The following table sets forth certain information about our direct and assumed life insurance in force on a yearly comparative basis.

| | In Force, Beginning of Year | New Business Issued During Year | Claims, Lapses, Surrenders During Year | Acquisitions During Year | In Force, End of Year |
|---|---|---|---|---|---|
| | | | (In millions) | | |
| 2006 | $4,280 | 727 | (366) | | 4,641 |
| 2005 | 4,001 | 725 | (446) | | 4,280 |
| 2004 | 2,921 | 570 | (472) | 982 | 4,001 |
| 2003 | 2,408 | 434 | (193) | 272 | 2,921 |
| 2002 | 2,417 | 410 | (497) | 78 | 2,408 |

The following table sets forth consolidated (i) gross life insurance in force and (ii) mean life insurance in force.

| | In Force Beginning of Year (a) | In Force End of Year (a) | Mean Life Insurance In Force (a) |
|---|---|---|---|
| | | (In millions) | |
| 2006 | $4,280 | 4,641 | 4,461 |
| 2005 | 4,001 | 4,280 | 4,141 |
| 2004 | 2,921 | 4,001 | 3,461 |
| 2003 | 2,408 | 2,921 | 2,665 |
| 2002 | 2,417 | 2,408 | 2,413 |

(a) Before ceding amounts to reinsurers.

The 2006 and 2005 growth represented the increased volume of new international business written and improvements in persistency on policies issued to foreign nationals. The acquisition of Security Plan in October 2004 added approximately $982 million to the life insurance in force at year end, with the remainder of the increase in 2004 reflecting growth in our international life business. Increased issuance of new policies coupled with acquisitions contributed to the growth in insurance in force in 2003 compared to 2002.

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The following table sets forth life reinsurance ceded.

| | Reinsurance Ceded | |
|---|---|---|
| | Inforce | Premium |
| | (In thousands) | |
| 2006 | $258,756 | $1,844 |
| 2005 | 221,793 | 1,907 |
| 2004 | 265,001 | 1,001 |
| 2003 | 301,366 | 1,382 |
| 2002 | 152,103 | 1,321 |

Lapses and surrenders were flat during 2006 compared to 2005, due to improved persistency. Lapses and surrenders increased in 2005 compared to 2004 due to Security Plan s inclusion for the entire year. Reinsurance declined from 2005 compared to 2004 because of a decrease in the average face amount of international policies issued. Lapse and surrender activity attributed to policyholders of two companies we acquired in 2003 contributed approximately $39.6 million to the increase in 2003 lapses and surrenders.

The following table sets forth information with respect to our total insurance premiums.

| | Ordinary Life (a) | Casualty (a) | Group Life | Accident & Health (a) | Total |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| 2006 | $122,277 | 3,777 | 981 | 1,461 | 128,496 |
| 2005 | 110,519 | 3,627 | 568 | 1,560 | 116,274 |
| 2004 | 77,377 | 1,113 | 636 | 788 | 79,914 |
| 2003 | 60,395 | | 463 | 14,785 | 75,643 |
| 2002 | 54,033 | | 421 | 13,474 | 67,928 |

(a) After deduction for reinsurance ceded.

Premium grew in 2006 due to the continued emphasis on new business in the Life Insurance segment. The substantial growth in 2005 compared to 2004 was due to the inclusion of Security Plan for the entire year. In comparing 2004 to 2003, the decline in accident and health premium as a result of the cession of the business to another carrier was offset by increases in our international business and the acquisition of Security Plan. The casualty premiums in 2006, 2005 and 2004 resulted from the acquisition of Security Plan, which has a small casualty subsidiary, SPFIC. Casualty premium for 2004 reflected the quarter ended December 31, 2004 only. The 2003 premium increase over 2002 was related to increased new life revenues and the acquisitions of two domestic life insurance companies.

The following table sets forth information relating to the ratio of our underwriting and other expenses to insurance revenues.

**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**

| | Insurance Premiums (a) | Commissions, Underwriting and Operating Expenses Amount (a) | Commissions, Underwriting and Operating Expenses Ratio to Insurance Premiums | Commissions, Underwriting and Operating Expenses, Policy Reserve Increases, Policyholder Benefits and Dividends to Policyholders Amount (a) | Commissions, Underwriting and Operating Expenses, Policy Reserve Increases, Policyholder Benefits and Dividends to Policyholders Ratio to Insurance Premiums |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| 2006 | $128,496 | $63,298 | 49.3% | $155,662 | 121.1% |
| 2005 | 116,274 | 58,414 | 50.2 | 138,511 | 119.1 |
| 2004 | 79,914 | 38,665 | 48.4 | 95,874 | 120.0 |
| 2003 | 75,643 | 37,194 | 49.2 | 89,455 | 118.3 |
| 2002 | 67,928 | 31,411 | 46.2 | 79,320 | 116.8 |

(a) After premiums ceded to reinsurers.

In 2006, expenses as a ratio to insurance premiums increased from 2005 due to continued adverse loss development due mainly to Hurricane Katrina. During 2005, operating expenses increased compared to 2004 due to the inclusion of Security Plan for the entire year. In 2004, expense reductions resulted in improvement in the ratio of expenses to premiums compared to 2003; however, the claims incurred by Security Plan caused the overall expense and benefit ratio to increase slightly. Because of the nature of Security Plan s business, a high benefit ratio is not unusual. During 2003, increased new life revenues from new business and two domestic life insurance company acquisitions resulted in decreases in the ratio of benefits compared to 2002; however, the expenses of these two acquisitions resulted in increases in the ratios of expenses to premiums.

The following table sets forth the face amount of new life insurance business produced between participating and non-participating policies. Dividends paid on participating policies are at the discretion of the insurance company issuing the policy.

| | Total New Business | Participating Amount | Participating Percent | Non-participating Amount | Non-participating Percent |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| 2006 | $727,134 | $429,382 | 59.1% | $297,752 | 40.9% |
| 2005 | 725,199 | 399,008 | 55.0 | 326,191 | 45.0 |
| 2004 | 570,462 | 339,008 | 59.4 | 231,454 | 40.6 |
| 2003 | 433,697 | 266,303 | 61.4 | 167,394 | 38.6 |
| 2002 | 410,352 | 265,476 | 64.7 | 144,876 | 35.3 |

In 2006, the Company wrote approximately $30 million less credit insurance than in 2005, decreasing the amount of non-participating business. Also in 2006, the Company wrote approximately $30 million more whole life business, increasing the amount of participating business. The 2004 purchase of Security Plan increased the percentage of non-participating business. During 2003, two acquisitions of domestic life insurance companies contributed to the increase in non-participating new business compared to 2002.

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The following table sets forth the amount of new life insurance business issued according to policy types.

| | Total Face Amount New Business | Whole Life and Endowment | | Term | | Credit | |
|---|---|---|---|---|---|---|---|
| | | Amount | Percent | Amount | Percent | Amount | Percent |
| | (In thousands) | | | | | | |
| 2006 | $727,134 | $600,755 | 82.6% | $79,460 | 10.9% | $46,919 | 6.5% |
| 2005 | 725,199 | 569,933 | 78.6 | 79,025 | 10.9 | 76,241 | 10.5 |
| 2004 | 570,462 | 406,075 | 71.2 | 82,839 | 14.5 | 81,548 | 14.3 |
| 2003 | 433,697 | 297,280 | 68.5 | 76,637 | 17.7 | 59,780 | 13.8 |
| 2002 | 410,352 | 289,976 | 70.7 | 80,342 | 19.5 | 40,034 | 9.8 |

The Life Insurance segment continued to write increasing amounts of new business, primarily whole life policies, during 2006, particularly in the international market. In 2005, Security Plan, whose business is whole life, was included for the entire year, plus new international policies grew significantly. In 2004, new life business, measured in paid, annualized premiums, increased 145% compared to the prior year. The addition of Security Plan, which contributed three months results, coupled with growth in CICA s overseas business, increased the percentage of whole life insurance in force. The 2003 growth was slowed by the economic downturn in several Latin American countries.

The following table sets forth deferred policy acquisition costs capitalized and amortized.

| | Deferred Policy Acquisition Costs | |
|---|---|---|
| | Capitalized | Amortized |
| | (In thousands) | |
| 2006 | $26,986 | $11,391 |
| 2005 | 24,388 | 10,313 |
| 2004 | 17,241 | 8,439 |
| 2003 | 16,558 | 11,807 |
| 2002 | 14,423 | 10,039 |

The 2006 increase in capitalized costs and amortization compared to 2005 related to the continued new business written in the Life Insurance segment, as well as higher commissions on the Home Service segment. The 2005 growth in capitalized costs and amortization compared to 2004 resulted from the inclusion of Security Plan for the full year and the increase in new international business. In 2004, persistency on our international business improved, contributing to lower amortization, as well as no amortization for the accident and health business that was ceded in 2004. Amortization expense in 2003 increased over the prior year due to higher surrender activity.

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**Investments**

State insurance statutes prescribe the quality and percentage of the various types of investments that may be made by insurance companies and generally permit investment in qualified state, municipal, federal and foreign government obligations, high quality corporate bonds, preferred and common stock, real estate and mortgage loans within certain specified percentages.

The administration of our investment portfolios is handled by management, pursuant to board-approved investment guidelines, with all trading activity approved by a committee of the respective boards of directors of our insurance company subsidiaries. The guidelines used require that bonds, both government and corporate, are of high quality and comprise a majority of the investment portfolio. The assets selected are intended to mature in accordance with the average maturity of the insurance products and to provide the cash flow for our insurance company subsidiaries to meet their respective policyholder obligations.

*Valuation of Investments in Fixed Maturity and Equity Securities*

At December 31, 2006, investments in fixed maturity and equity securities were 94.9% of our total investments. All of our fixed maturities were classified as available-for-sale securities at December 31, 2006. We had no fixed maturity or equity securities that were classified as trading securities at December 31, 2006. During 2006, we sold one bond previously classified as held-to-maturity because of an unexpected market offer. Following the sale, only one bond with a carrying value of $5.5 million and a fair market value of $6.2 million remained classified as held-to-maturity. This bond was transferred to our available-for-sale portfolio at December 31, 2006, which resulted in an increase to equity of $484,000, net of tax.

At December 31, 2006, 67.2% of our fixed maturity securities were invested in securities backed by the full faith and credit of the U.S. Government or U.S. Government-sponsored enterprises.

We evaluate the carrying value of our fixed maturity and equity securities at least quarterly. A decline in the fair value of any fixed maturity or equity security below cost that is deemed other-than-temporary is charged to earnings resulting in the establishment of a new cost basis for the security. The new cost basis is not changed for subsequent recoveries in the fair value of the fixed maturity or equity security. With the exception of Security Plan, virtually all of our subsidiaries investments are in bonds that carry the full faith and credit of the U.S. Government or U.S. Government-sponsored enterprises. Security Plan has significant investments in corporate and municipal bonds. Based upon our emphasis on investing in fixed maturity securities primarily composed of obligations of U.S. Government-sponsored corporations, U.S. Treasury securities and obligations of the U.S. Government and agencies, our intent and ability to hold temporarily impaired fixed maturities until recovery, and our analysis of whether declines in fair value below cost are temporary or other-than-temporary, management believes that our investments in fixed maturity and equity securities at December 31, 2006 were not impaired, and no other-than-temporary losses needed to be recorded.

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Gross unrealized losses on fixed maturities available-for-sale amounted to $10.9 million as of December 31, 2006 and $10.5 million as of December 31, 2005, due primarily to increases in interest rates.

| | December 31, 2006 | |
|---|---|---|
| | Carrying Value | Percent of Total |
| | (In thousands) | |
| Fixed maturity securities: | | |
| U.S. Government and Government agencies (1) | $ 275,390 | 51.1% |
| Mortgage-backed (1) | 52,843 | 9.8 |
| Corporate | 98,353 | 18.2 |
| Municipal bonds | 61,732 | 11.4 |
| Total fixed maturity securities | 488,318 | 90.5 |
| Cash and cash equivalents | 24,521 | 4.5 |
| Other investments: | | |
| Policy loans | 23,542 | 4.4 |
| Equity securities | 312 | 0.1 |
| Mortgage Loans | 456 | 0.1 |
| Real estate and other invested assets | 2,427 | 0.4 |
| Total | $ 539,576 | 100.0% |

(1) U.S. Government and government agencies include U.S. Treasury securities ($14,637) and U.S. government-sponsored enterprises ($313,566).

The following table shows the distribution of the contractual maturities of our portfolio of fixed maturity securities by carrying value as of December 31, 2006. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties:

| | Fixed Maturities Available-For-Sale (In thousands) | |
|---|---|---|
| | Amortized cost | Fair value |
| Due in one year or less | $ 11,208 | 11,171 |
| Due after one year through five years | 41,774 | 40,615 |
| Due after five years through ten years | 21,937 | 21,437 |
| Due after ten years | 368,660 | 362,252 |
| | 443,579 | 435,475 |
| Securities not due at a single maturity date | 54,360 | 52,843 |

| | | | |
|---|---|---|---|
| Totals | $ | 497,939 | 488,318 |

The securities not due at a single maturity date are obligations of U.S. Government-sponsored enterprises.
At December 31, 2006, the average duration of our investment portfolio was 8.0 years.
The following table sets forth the mean amount of our invested assets and net investment income from our investment portfolio.

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| Year Ended December 31 | Mean Amount of Invested Assets | Net Investment Income (a) | Ratio of Net Investment Income to Mean Amount of Invested Assets (a) |
|---|---|---|---|
| | (In thousands) | | |
| 2006 | $ 499,933 | $ 26,975 | 5.4% |
| 2005 | 480,306 | 23,568 | 4.9 |
| 2004 | 375,495 | 17,005 | 4.5 |
| 2003 | 250,598 | 14,322 | 5.7 |
| 2002 | 216,352 | 14,252 | 6.6 |

(a) Does not include realized and unrealized gains and losses on investments.

During 2006, available bond yields were higher than in 2005, but fell during the fourth quarter. In 2005, Security Plan was included for the entire year; however, available returns in the bond market remained low. In 2004, Security Plan s investment income for the fourth quarter was included, leading to a further decline in percentage return. During 2003, the low interest rates available on newly invested money relative to prior years and the significant call activity on the bonds owned negatively impacted our net investment income percentage compared to 2002.

**Reserves**

Our insurance subsidiaries establish liabilities for policyholders account balances and future policy benefits to meet obligations on various policies and contracts. Reserves for policyholders account balances for investment-type policies are equal to cumulative account balances consisting of deposits plus credited interest, less expense and mortality charges and withdrawals. Future policy benefits for ordinary life products are computed on the net level premium method, which utilizes assumed investment yields, mortality, persistency, morbidity and expenses (including a margin for adverse deviation). These reserves are established at the time of issuance of a policy and generally vary by product, year of issue and policy duration. We periodically review both reserve assumptions and policyholder liabilities. In addition, we retain a consulting actuary to review our reserves on a quarterly basis and provide reports thereon.

**Reinsurance**

As is customary among insurance companies, our insurance company subsidiaries reinsure with other companies portions of the life insurance risks they underwrite. A primary purpose of reinsurance agreements is to enable an insurance company to reduce the amount of risk on any particular policy and, by reinsuring the amount exceeding the maximum amount the insurance company is willing to retain, to write policies in amounts larger than it could without such agreements. Even though a portion of the risk may be reinsured, our insurance company subsidiaries remain liable to perform all the obligations imposed by the policies issued by them and could be liable if their reinsurers were unable to meet their obligations under the reinsurance agreements.

We believe that we have established appropriate reinsurance coverage based upon our net retained insured liabilities compared to our surplus. Based on a review of our reinsurers

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financial positions and reputations in the reinsurance marketplace, we believe that our reinsurers are financially sound

*Insurance Ceded*

CICA retains up to $100,000 of risk on any one person. As of December 31, 2006, the aggregate amount of life insurance ceded by CICA was $248,944,000 or 7.0% of its total direct and assumed life insurance in force, and at December 31, 2005 was $209,441,000 or 6.5% of its direct insurance in force. CICA is contingently liable with respect to ceded insurance should any reinsurer be unable to meet the obligations reinsured.

CICA has in effect automatic reinsurance agreements with nonaffiliated reinsurers that provide for cessions of ordinary insurance from CICA. These treaties provide for both automatic and facultative reinsurance of standard and substandard risks for life, accident and health and supplemental benefits above CICA s retention limit on a yearly renewable term, or coinsurance basis. Automatic cession means that so long as the risk is within the limits of the reinsurance agreement, the reinsurer must assume the risk. Facultative cases are subject to specific underwriting approval of the reinsurer.

Since 2003, CICA has obtained reinsurance with Worldwide Reassurance of England (Worldwide) and Converium Ruckversicherung Deutschland Ag of Germany (Converium). At December 31, 2006, CICA had ceded $43,881,000 in face amount of insurance to Worldwide and $76,028,000 to Converium. Prior to 2005, CICA had outside reinsurance from Employers Reassurance (ERC), American United Life Insurance Company (AUL) and Businessmen s Assurance (BMA). The former reinsurers retain their risk on business previously ceded. At December 31, 2006, CICA had ceded $43,626,000 in face amount of insurance to ERC, $18,166,000 to Riunione Adriatica di Sicurta of Italy, a predecessor to AUL, $12,545,000 to BMA, $20,372,000 to AUL and $34,088,000 to Optimum Re Insurance Company.

Worldwide and Converium are unauthorized reinsurers in the state of Colorado. However, they each have agreed in writing to provide a letter of credit issued by a U.S. bank in the amount of any liabilities they may incur under the reinsurance agreements with CICA in the event that a reinsurance credit is significant. There were no such significant credits as of December 31, 2006, and no letter of credit was necessary or provided.

In addition, a reinsurance treaty with Swiss Re Life & Health America, Inc. (Swiss Re) covers all of CICA s accidental death insurance supplementing its life insurance policies. These cessions are on a yearly renewable term basis and occur automatically if total accidental death benefits known to CICA are less than $250,000 or otherwise on a facultative review basis. At December 31, 2006, CICA had ceded $1.5 billion of supplemental life insurance benefits to Swiss Re under this treaty.

CICA monitors the solvency of its reinsurers in seeking to minimize the risk of loss in the event of a failure by a reinsurer. The primary reinsurers of CICA are large, well capitalized entities.

Effective January 1, 2004, CICA entered into a coinsurance agreement with Texas International Life Insurance Company (TILIC), an unaffiliated party, whereby TILIC

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administers and reinsures all of CICA s non-credit accident and health business. During 2005, an agreement was reached to sell Citizens National Life Insurance (CNLIC), which represented approximately 66.0% of the ceded business to TILIC. In 2006, the Texas Department of Insurance recommended that the sale be deferred until 2007 to give TILIC time to improve its operating results and level of capital. The remaining 34% of business continues to cede under the same contract coinsurance agreement.

Consistent with the general practice in the life insurance industry, Security Plan has reinsured portions of the coverage provided by its insurance products with other non-affiliated insurance companies. Insurance is ceded principally to reduce net liability on individual risks, to provide protection against large losses and to obtain a greater diversification of risk. Although reinsurance does not legally discharge the ceding insurer from its primary liability for the full amount of policies reinsured, it does make the reinsurers liable to the insurer to the fullest extent of the reinsurance ceded.

Security Plan seeks to enter into reinsurance treaties with well capitalized insurers. Its policy is to use reinsurers who, in the opinion of management, have significant levels of capital and surplus. In addition, Security Plan maintains a coinsurance agreement with the former parent of Security Plan on a closed block of business and with other carriers as necessary that represents less than 1% of total business in force. The total face amount ceded at December 31, 2006 was $5.8 million or less than 1% of Security Plan s insurance in force. Security Plan also maintains agreements with unaffiliated reinsurers to provide catastrophe coverage in the event of a significant loss.

SPFIC had reinsurance agreements in place to protect it from catastrophic events such as Hurricanes Katrina and Rita that struck Louisiana in 2005. The agreements in place during 2005 provided that SPFIC bore responsibility for the first $250,000 of incurred claims. Reinsurers indemnified SPFIC for losses in excess of $250,000 up to $7.1 million per event. Any amount over that was SPFIC s responsibility. SPFIC incurred claims of approximately $750,000 in excess of $7.1 million on Hurricane Katrina in 2005. Additional claims of $2.9 million were incurred in 2006, including $430,000 of incurred but not reported (IBNR) losses that were considered necessary because the Louisiana legislature extended the prescriptive period an additional one year for filing claims and lawsuits related to Hurricanes Katrina and Rita. Once the $7.1 million limit was met, SPFIC had an opportunity to pay for 2nd event coverage, upon payment of approximately $400,000 in premium. SPFIC elected to do so and the claims for Hurricane Rita were covered under this second event reinsurance. Through December 31, 2006, SPFIC s claims related to Hurricane Rita were approximately $4.7 million and were 100% reinsured in excess of our $250,000 deductible. We do not expect the claims for Hurricane Rita to exceed our reinsurers limits. For calendar year 2006, SPFIC elected to increase the amount of 1st event catastrophe reinsurance to $10 million and raise the deductible to $500,000 by paying an annual premium of $799,000; thus, the first $500,000 of incurred claims and any claims in excess of $10 million would be SPFIC s responsibility. The reinsurance premium for first event catastrophe reinsurance will be $840,000 in 2007.

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*Insurance Assumed*

At December 31, 2006, CICA had in-force reinsurance assumed as follows:

| Name of Company | Type of Business Assumed | Amount in Force at End of Year (In thousands) |
|---|---|---|
| Prudential Insurance Company (Prudential) | Group Life | $ 659,066 |
| Landmark Life Insurance Company (Landmark) | Ordinary Life | $ 10,721 |

The reinsurance agreement with Prudential provides for CICA to assume a portion of the insurance under a group insurance policy issued by Prudential to the Administrator of Veterans Affairs. CICA s portion of the total insurance under the policy is allocated to CICA in accordance with the criteria established by the administrator.

The Landmark agreement was entered into in June of 2006. Landmark has a right to recapture the ceded business after 15 years. We received $2.7 million, representing the statutory reserve transfer. Of this, $1.8 million was recorded as future policy benefit reserves and $900,000 was recorded as a deferred gain on reinsurance, which will be recognized over the life of the business. We also paid a ceding commission of $970,000, which was recorded to deferred acquisition costs and is being amortized over 15 years.

**Competition**

The life insurance business is highly competitive, and we compete with a large number of stock and mutual life companies both internationally and domestically as well as from financial institutions that offer insurance products. There are more than 1,000 other life insurance companies in the U.S., some of which also provide insurance to foreign nationals.

International Market A large percentage of our first year and renewal life insurance premium income comes from the international market. Given the significance of our international business, the variety of markets in which we make ordinary whole-life insurance available and the impact that economic changes have on these foreign markets, it is not possible to ascertain our competitive position. Our international marketing plan stresses making available U.S. Dollar-denominated life insurance products to significant net worth individuals residing around the world. We experience competition primarily from the following sources:

*Locally Operated Companies with Local Currency Policies.* We compete with companies formed and operated in the country in which the insureds reside.

However, because our premiums must be paid in U.S. Dollars drawn on U.S. banks, and we pay claims in U.S. Dollars, we have a different clientele and product than foreign-domiciled companies. Our products are usually acquired by persons in the top income bracket of their respective countries. The policies sold by foreign companies are offered

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broadly and are priced based on the mortality of the entire populace of the respective geographic region. Because of the predominance of lower incomes in most of these countries, the mortality experience tends to be very high on the average compared to the U.S., causing mortality charges that are considered unreasonable based on the life mortality experience of the upper income of the local population.

Additionally, the assets that back up the policies issued by foreign companies are substantially invested in the respective countries and, therefore, are exposed to the inflationary risks and economic crises that historically have impacted many foreign countries. Another reason that we experience an advantage is that many of our policyholders desire to transfer capital out of their countries due to the perceived financial strength and security of the U.S.

*U.S. Companies Issuing U.S. Dollar Policies.* We also face direct competition from companies that operate in the same manner as we do. We compete using our history of performance and our products.

Competitors in our international markets include National Western Life Insurance Company, Best Meridian Insurance Company and to a lesser extent, Pan American Life Insurance Company and American International Group, although these companies tend to focus on non-traditional life insurance and annuities.

*Foreign Operated Companies with Local Currency Policies.* Another group of competitors consists of companies that are foreign to the countries in which the policies are sold, but use the local currencies of those countries. These competitors include a number of large U.S. issuers who maintain foreign operations. Local currency policies entail a risk of uncertainty due to local currency fluctuations as well as the perceived instability and weakness of local currencies. We have observed that local currency policies, whether issued by foreign or locally operated companies, tend to focus on universal life insurance and annuities instead of whole life insurance as we do.

Some companies may be deemed to have a competitive advantage over us due to histories of successful operations and large agency forces. Management believes that our experience, combined with the special features of CICA s unique policies, allows CICA to compete effectively in pursuing new business.

Domestic Market The life insurance industry in the U.S. is a mature industry that, in recent years, has experienced little to no growth in life insurance sales. Competition has also increased because the life insurance industry is consolidating, with larger, more effective organizations emerging from consolidation. Furthermore, mutual insurance companies are converting to stock ownership, which should give them greater access to capital markets, resulting in greater competition with respect to corporate finance as well. Additionally, legislation became effective in 2000 permitting commercial banks, insurance companies and investment banks to combine. This law permits, for instance, a commercial bank to acquire or form an insurance company. These factors increased competitive pressures in general. Because of our limited nature of domestic marketing activities, we have no readily identifiable domestic competitors.

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Many life insurance companies have greater financial resources, longer business histories, and more diversified lines of insurance coverage than we do. These companies also generally have larger sales forces. We also face competition from companies marketing in person as well as with direct mail sales campaigns. Although we may be at a competitive disadvantage to these entities, we believe that our products are competitive in the marketplace. We believe that our premium rates and policies are generally competitive with those of other life insurance companies selling similar types of ordinary life insurance, many of which are larger than we are.

Home Service Security Plan faces competition in Louisiana with a handful of other companies who specialize in home service distribution of insurance. Competitors include Presidential Life Insurance Company, Monumental Life Insurance Company and Union National Life Insurance Company. Security Plan also competes indirectly with other domestic life insurance companies operating in Louisiana.

### Employees

We have 170 administrative, underwriting and operations employees, including our management, and we have approximately 320 employee/agents who work exclusively for Security Plan. We consider our employee relationships to be good.

### Other Operations

We have several small operations conducted through subsidiaries that are not material to our business, including a funeral home in Baker, Louisiana, an aircraft and a data processing operation.

## REGULATION

### General

Our U.S. insurance operations are subject to a wide variety of laws and regulations. State insurance laws regulate most aspects of our U.S. insurance businesses, and our insurance subsidiaries are regulated by the insurance departments of each the states in which they are licensed. Our insurance products and thus our businesses also are affected by U.S. federal, state and local tax laws.

The purpose of the laws and regulations that affect our insurance business is primarily to protect our insureds and not our stockholders. Many of the laws and regulations to which we are subject are regularly re-examined, and existing or future laws and regulations may become more restrictive or otherwise adversely affect our operations.

In addition, insurance regulatory authorities (including state law enforcement agencies and attorneys general) periodically make inquiries and regularly conduct examinations regarding compliance by us and our subsidiaries with insurance, and other laws and regulations regarding the conduct of our insurance businesses. We cooperate with such inquiries and examinations and take corrective action when warranted.

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Many of our independent agents also operate in regulated environments. Changes in the regulations that affect their operations also may affect our business relationships with them and their ability to purchase or to distribute our products.

At the present time, our insurance subsidiaries are collectively licensed to transact business in 28 states. We have insurance subsidiaries domiciled in the states of Colorado, Louisiana and Texas.

**U.S. Insurance Regulation**

Our U.S. insurance subsidiaries are licensed and regulated in all jurisdictions in which they conduct insurance business. The extent of this regulation varies, but most jurisdictions have laws and regulations governing the financial condition of insurers, including standards of solvency, types and concentration of investments, establishment and maintenance of reserves, credit for reinsurance and requirements of capital adequacy, and the business conduct of insurers, including marketing and sales practices and claims handling. In addition, statutes and regulations usually require the licensing of insurers and their agents, the approval of policy forms and related materials and the approval of rates for certain types of insurance products.

The types of U.S. insurance laws and regulations applicable to us or our U.S. insurance subsidiaries are described in more detail below.

*Insurance holding company regulation*

All U.S. jurisdictions in which our U.S. insurance subsidiaries conduct insurance business have enacted legislation that requires each U.S. insurance company in a holding company system, except captive insurance companies, to register with the insurance regulatory authority of its jurisdiction of domicile and to furnish that regulatory authority financial and other information concerning the operations of, and the interrelationships and transactions among, companies within its holding company system that may materially affect the operations, management or financial condition of the insurers within the system. These laws and regulations also regulate transactions between insurance companies and their parents and affiliates. Generally, these laws and regulations require that all transactions within a holding company system between an insurer and its affiliates be fair and reasonable and that the insurer s statutory surplus following any transaction with an affiliate be both reasonable in relation to its outstanding liabilities and adequate to its financial needs. Statutory surplus is the excess of admitted assets over the sum of statutory liabilities and capital. For certain types of agreements and transactions between an insurer and its affiliates, these laws and regulations require prior notification to, and non-disapproval or approval by, the insurance regulatory authority of the insurer s jurisdiction of domicile.

*Policy forms*

Our U.S. insurance subsidiaries policy forms are subject to regulation in every U.S. jurisdiction in which such subsidiaries are licensed to transact insurance business. In most U.S. jurisdictions, policy forms must be filed prior to their use. In some U.S. jurisdictions, forms must also be approved prior to use.

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*Dividend limitations*

The payment of dividends or other distributions to us by our U.S. insurance subsidiaries is regulated by the insurance laws and regulations of their respective states of domicile. In general, an insurance company subsidiary may not pay an extraordinary dividend or distribution until 30 days after the applicable insurance regulator has received notice of the intended payment and has not objected in such period or has approved the payment within the 30-day period. In general, an extraordinary dividend or distribution is defined by these laws and regulations as a dividend or distribution that, together with other dividends and distributions made within the preceding 12 months exceeds the greater (or, in some jurisdictions, the lesser) of:

- 10% of the insurer s statutory surplus as of the immediately prior year end; or

- the statutory net gain from the insurer s operations (if a life insurer) or the statutory net income (if not a life insurer) during the prior calendar year.

The laws and regulations of some of these jurisdictions also prohibit an insurer from declaring or paying a dividend except out of its earned surplus or require the insurer to obtain regulatory approval before it may do so. In addition, insurance regulators may prohibit the payment of ordinary dividends or other payments by our insurance subsidiaries to us (such as a payment under a tax sharing agreement or for employee or other services) if they determine that such payment could be adverse to our policyholders or contract holders.

*Market conduct regulation*

The laws and regulations of U.S. jurisdictions include numerous provisions governing the marketplace activities of insurers, including provisions governing the form and content of disclosure to consumers, product illustrations, advertising, product replacement, sales and underwriting practices, complaint handling and claims handling. The regulatory authorities in U.S. jurisdictions generally enforce these provisions through periodic market conduct examinations. These examinations may be conducted by a single state or by multiple states ( association exams).

*Financial examinations*

As part of their regulatory oversight process, insurance departments in U.S. jurisdictions also conduct periodic detailed examinations of the books, records, accounts and financial practices of insurers domiciled in their jurisdictions. These examinations generally are conducted in cooperation with the insurance departments of two or three other states or jurisdictions, representing each of the NAIC zones, under guidelines promulgated by the National Association of Insurance Commissioners ( NAIC ). In the three-year period ended December 31, 2006, we have not received any material adverse findings resulting from any insurance department examinations of our U.S. insurance subsidiaries. CICA, Security Plan and SPFIC are scheduled to be examined in early 2007. CNLIC was examined during 2006.

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*Guaranty funds or associations*

Most of the jurisdictions in which our U.S. insurance subsidiaries are licensed to transact business require life insurers doing business within the jurisdiction to participate in guaranty funds or associations, which are established by state law, subject to regulation by the state insurance department and are organized to pay, subject to statutory limits, conditions, and priorities, contractual benefits owed pursuant to insurance policies of insurers who become impaired or insolvent. These funds or associations levy assessments, up to prescribed limits, on all member insurers in a particular jurisdiction on the basis of the proportionate share of the premiums written by member insurers in the lines of business in which the impaired, insolvent or failed insurer is engaged. Some jurisdictions permit member insurers to recover assessments paid through full or partial premium tax offsets.

Aggregate assessments levied against our U.S. insurance subsidiaries were immaterial for the years ended December 31, 2006, 2005 and 2004. Although the amount and timing of future assessments are not predictable, we have established liabilities for guaranty fund assessments that we consider adequate for assessments with respect to insurers that currently are subject to insolvency proceedings.

*Change of control*

The laws and regulations of the jurisdictions in which our U.S. insurance subsidiaries are domiciled require that a person obtain the approval of the insurance commissioner of the insurance company s jurisdiction of domicile prior to acquiring control of the insurer. Generally, such laws provide that control over an insurer is presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, 10% or more of the voting securities of the insurer. In considering an application to acquire control of an insurer, the insurance commissioner generally will consider such factors as the experience, competence and financial strength of the applicant, the integrity of the applicant s board of directors and executive officers, the acquirer s plans for the management and operation of the insurer, and any anti-competitive results that may arise from the acquisition. In addition, a person seeking to acquire control of an insurance company is required in some states to make filings prior to completing an acquisition if the acquirer and the target insurance company and their affiliates have sufficiently large market shares in particular lines of insurance in those states. Approval of an acquisition is not required in these states, but the state insurance departments could take action to impose conditions on an acquisition that could delay or prevent its consummation. These laws may discourage potential acquisition proposals and may delay, deter or prevent a change of control involving us, including through transactions, and in particular unsolicited transactions, that some or all of our stockholders might consider to be desirable.

*Policy and contract reserve sufficiency analysis*

Under the laws and regulations of their jurisdictions of domicile, our U.S. life insurance subsidiaries are required to conduct annual analyses of the sufficiency of their life insurance and annuity statutory reserves. In addition, other jurisdictions in which these subsidiaries are licensed may have certain reserve requirements that differ from those of their domiciliary jurisdictions. In each case, a qualified actuary must submit an opinion that states that the aggregate statutory reserves, when considered in light of the assets held

with respect to such reserves, make good and sufficient provision for the associated contractual obligations and related expenses of the insurer. If such an opinion cannot be provided, the affected insurer must set up additional reserves by moving funds from surplus. Our U.S. life insurance subsidiaries submit these opinions annually to applicable insurance regulatory authorities in support of and as part of their required annual statements.

*Surplus and capital requirements*

Insurers must satisfy capital and surplus requirements to be licensed. Insurance regulators have the discretionary authority, in connection with the regulation of our U.S. insurance subsidiaries, to limit or prohibit the ability of an insurer to issue new policies if, in the regulators judgment, the insurer is not maintaining a minimum amount of surplus or is in hazardous financial condition as defined in the insurance laws. Insurance regulators may also limit the ability of an insurer to issue new life insurance policies and annuity contracts above an amount based upon the face amount and premiums of policies of a similar type issued in the prior year. We do not believe that the current or anticipated levels of statutory surplus of our U.S. insurance subsidiaries present a material risk such that any such regulator would limit the amount of new policies that our U.S. insurance subsidiaries may issue.

*Statutory accounting principles*

Statutory accounting principles, or SAP, is a basis of accounting developed by U.S. insurance regulators to monitor and regulate the solvency of insurance companies. In developing SAP, insurance regulators were primarily concerned with assuring an insurer s ability to pay all its current and future obligations to policyholders. As a result, statutory accounting focuses on conservatively valuing the assets and liabilities of insurers, generally in accordance with standards specified by the insurer s domiciliary jurisdiction. Uniform statutory accounting practices are established by the NAIC and adopted by regulators in the various U.S. jurisdictions. These accounting principles and related regulations determine, among other things, the amounts our insurance subsidiaries may pay to us as dividends.

U.S. GAAP is designed to measure a business on a going-concern basis. It gives consideration to matching of revenue and expenses and, as a result, certain expenses are capitalized when incurred and then amortized over the life of the associated policies. The valuation of assets and liabilities under U.S. GAAP is based in part upon best estimate assumptions made by the insurer. As a result, the values for assets, liabilities and equity reflected in financial statements prepared in accordance with U.S. GAAP may be, and in fact usually are, different from those reflected in financial statements prepared under SAP.

*Insurance Regulatory Information System*

The NAIC Insurance Regulatory Information System (IRIS) was developed to help state regulators identify companies that may require special attention. The IRIS system consists of a statistical phase and an analytical phase whereby financial examiners review annual statements and financial ratios. The statistical phase consists of 12 key financial ratios based on year-end data that are generated from the NAIC database annually; each ratio has

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an established usual range of results. These ratios assist state insurance departments in executing their statutory mandate to oversee the financial condition of insurance companies.

A ratio result falling outside the usual range of IRIS ratios is not considered a failing result; rather, unusual values are viewed as part of the regulatory early monitoring system. Furthermore, in some years, it may not be unusual for financially sound companies to have several ratios with results outside the usual ranges. Generally, an insurance company will become subject to regulatory scrutiny if it falls outside the usual ranges of four or more of the ratios. In the past, variances in certain ratios of our insurance subsidiaries have resulted in inquiries from insurance departments, to which we have responded. These inquiries have not led to any restrictions affecting our operations.

*Risk-Based Capital (RBC) Requirements*

In order to enhance the regulation of insurer solvency, the NAIC has adopted formulas and model laws to implement RBC requirements for life and health insurers, for property and casualty insurers, and, most recently, for health organizations. These formulas and model laws are designed to determine minimum capital requirements and to raise the level of protection that statutory surplus provides for policyholder obligations.

Under laws adopted by individual states, insurers having less total adjusted capital (generally, as defined by the NAIC) than that required by the relevant RBC formula will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. The RBC laws provide for four levels of regulatory action. The extent of regulatory intervention and action increases as the ratio of total adjusted capital to RBC falls. The first level, the Company Action Level, requires an insurer to submit a plan of corrective actions to the regulator if total adjusted capital falls below 200% of the RBC amount (or below 250%, when the insurer has a negative trend as defined under the RBC laws). The second level, the Regulatory Action Level, requires an insurer to submit a plan containing corrective actions and requires the relevant insurance commissioner to perform an examination or other analysis and issue a corrective order if total adjusted capital falls below 150% of the RBC amount. The third level, the Authorized Control Level, authorizes the relevant insurance commissioner to take whatever regulatory actions considered necessary to protect the best interests of the policyholders and creditors of the insurer, which may include the actions necessary to cause the insurer to be placed under regulatory control, i.e., rehabilitation or liquidation, if total adjusted capital falls below 100% of the RBC amount. The fourth action level is the Mandatory Control Level, which requires the relevant insurance commissioner to place the insurer under regulatory control if total adjusted capital falls below 70% of the RBC amount. The formulas have not been designed to differentiate among adequately capitalized companies that operate with higher levels of capital. At December 31, 2006, all of our insurance subsidiaries had total adjusted capital in excess of amounts requiring company or regulatory action at any prescribed RBC action level.

*Regulation of investments*

Each of our U.S. insurance subsidiaries is subject to laws and regulations that require diversification of its investment portfolio and limit the amount of investments in certain

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asset categories, such as below investment grade fixed maturities, equity real estate, other equity investments and derivatives. Failure to comply with these laws and regulations would cause investments exceeding regulatory limitations to be treated as non-admitted assets for purposes of measuring surplus, and, in some instances, would require divestiture of such non-complying investments. We believe the investments made by our U.S. insurance subsidiaries comply with these laws and regulations.

*Federal initiatives*

Although the federal government generally does not directly regulate the insurance business, federal initiatives often and increasingly have an impact on the business in a variety of ways. There have been recent calls by insurer and broker trade associations for optional federal chartering of insurance companies, similar to the federal chartering of banks in the United States, which would include various forms of direct federal regulation of insurance. From time to time, federal measures are proposed which may significantly affect the insurance business, including limitations on antitrust immunity, tax incentives for lifetime annuity payouts, simplification bills affecting tax-advantaged or tax-exempt savings and retirement vehicles, and proposals to modify or make permanent the estate tax repeal enacted in 2001. These proposals have included The Federal Insurance Consumer Protection Act of 2003 and The State Modernization and Regulatory Transparency Act or SMART Act. The Federal Insurance Consumer Protection Act of 2003 would have established comprehensive and exclusive federal regulation over all interstate insurers, including all life insurers selling in more than one state. This proposed legislation was not enacted. The SMART Act would maintain state-based regulation of insurance but would change the way that states regulate certain aspects of the business of insurance including rates, agent and company licensing, and market conduct examinations. The U.S. House of Representatives Financial Services Committee recently held hearings on the draft of the SMART Act that has been proposed for discussion; however, the proposed legislation remains pending. Rather than providing for the option of federal chartering, the SMART Act would establish minimum requirements for certain specified areas of state regulation of insurance, including surplus lines laws. These minimum requirements are largely, but not completely, based on NAIC model laws and regulations. We cannot predict whether this or other proposals will be adopted, or what impact, if any, such proposals or, if adopted, such laws may have on our business, financial condition or results of operation.

*Changes in tax laws*

Changes in tax laws could make some of our products less attractive to consumers. For example, the gradual repeal of the federal estate tax, begun in 2001, is continuing to be phased in through 2010. The repeal and continuing uncertainty created by the repeal of the federal estate tax has resulted in reduced sales, and could continue to adversely affect sales and surrenders, of some of our insurance policies. In May 2003, President Bush signed into law the Jobs and Growth Tax Relief Reconciliation Act of 2003, which lowered the federal income tax rate on capital gains and certain ordinary dividends. These and other possible reductions in the federal income tax that investors are required to pay on long-term capital gains and dividends paid on stock may provide an incentive for some of our customers and potential customers to shift assets away from some insurance company products, including life insurance and annuities, designed to defer taxes payable on investment returns. A shift away from life insurance and annuity contracts and other tax-

deferred products could reduce our revenue from sales of these products, as well as the assets upon which we earn investment income. On the other hand, individual income tax rates are scheduled to revert to previous levels in 2010, and that could have a positive influence on the interest of investors in our products. Similarly, the 2008 expiration of favorable income tax rates for dividend income could increase interest in our products. We cannot predict whether any tax legislation impacting insurance products will be enacted, what the specific terms of any such legislation will be or whether, if at all, any legislation would have a material adverse effect on our financial condition and results of operations.

**Other Laws and Regulations**

*USA Patriot Act*

The USA Patriot Act of 2001, or the Patriot Act, enacted in response to the terrorist attacks on September 11, 2001, contains anti-money laundering and financial transparency laws and mandates the implementation of various new regulations applicable to broker / dealers and other financial services companies including insurance companies. The Patriot Act seeks to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. Anti-money laundering laws outside of the U.S. contain similar provisions. The increased obligations of financial institutions to identify their customers, watch for and report suspicious transactions, respond to requests for information by regulatory authorities and law enforcement agencies, and share information with other financial institutions, require the implementation and maintenance of internal practices, procedures and controls. On March 9, 2006, the President signed the USA Patriot Improvement and Reauthorization Act, which extended and modified the original act. We believe that we have implemented, and that we maintain, appropriate internal practices, procedures and controls to enable us to comply with the provisions of the Patriot Act.

*The International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001*

The International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 ( IMLAFATA ), a part of the Patriot Act, authorizes the U.S. Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to banks and other financial institutions to enhance record keeping and reporting requirements for certain financial transactions that are of primary money laundering concern. Among its other provisions, IMLAFATA requires each financial institution to: (a) establish an anti-money laundering program; (b) establish due diligence policies, procedures and controls with respect to its private banking accounts and correspondent banking accounts involving individuals and certain foreign banks; and (c) avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign bank that does not have a physical presence in any country. In addition, IMLAFATA contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities.

The Treasury Department s regulations implementing IMLAFATA mandate that federally-insured banks and other financial institutions establish customer identification programs

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designed to verify the identity of persons opening new accounts, maintain the records used for verification, and determine whether the person appears on any list of known or suspected terrorists or terrorist organizations.

*The Bank Secrecy Act of 1970*

In 1970, Congress passed the Currency and Foreign Transactions Reporting Act, otherwise known as the Bank Secrecy Act (the BSA ), to require financial institutions to maintain certain records and to report certain transactions to prevent such institutions from being used to hide money derived from criminal activity and tax evasion. The BSA was designed to help identify the source, volume and movement of currency and other monetary instruments into and out of the United States in order to help detect and prevent money laundering connected with drug trafficking, terrorism and other criminal activities. The primary tool used to implement BSA requirements is the filing of Suspicious Activity Reports. Although the federal regulations for the BSA do not specifically refer to insurance companies, the definition of financial institution is broad enough to include insurance companies. The BSA establishes, among other things, (a) record keeping requirements to assist government enforcement agencies in tracing financial transactions and flow of funds; (b) reporting requirements for Suspicious Activity Reports and Currency Transaction Reports to assist government enforcement agencies in detecting patterns of criminal activity; (c) enforcement provisions authorizing criminal and civil penalties for illegal activities and violations of the BSA and its implementing regulations; and (d) safe harbor provisions that protect financial institutions from civil liability for their cooperative efforts. The BSA requires that all covered financial institutions develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with certain recordkeeping and reporting requirements regarding both domestic and international currency transactions. These programs must, at a minimum, provide for a system of internal controls to assure ongoing compliance, provide for independent testing of such systems and compliance, designate individuals responsible for such compliance and provide appropriate personnel training.

*The Money Laundering Control Act of 1986*

The Money Laundering Control Act imposes sanctions, including revocation of federal deposit insurance, for institutions convicted of money laundering. Specifically, the Money Laundering Control Act of 1986 criminalized the act of laundering money, prohibited structuring transactions to avoid Currency Transaction Report filings, and introduced criminal and civil forfeiture for BSA violations.

*Privacy of consumer information*

U.S. federal and state laws and regulations require financial institutions, including insurance companies, to protect the security and confidentiality of consumer financial information and to notify consumers about their policies and practices relating to their collection and disclosure of consumer information and their policies relating to protecting the security and confidentiality of that information. Similarly, federal and state laws and regulations also govern the disclosure and security of consumer health information. In particular, regulations promulgated by the U.S. Department of Health and Human Services regulate the disclosure and use of protected health information by health insurers and others, the physical and procedural safeguards employed to protect the security of that

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information and the electronic transmission of such information. Congress and state legislatures are expected to consider additional legislation relating to privacy and other aspects of consumer information.

*The Terrorism Risk Insurance Act*

On November 26, 2002, the Terrorism Risk Insurance Act of 2002 was enacted to ensure the availability of insurance coverage for terrorist acts in the U.S. This law requires insurers writing certain lines of property and casualty insurance to offer coverage against certain acts of terrorism causing damage within the U.S. or to U.S. flagged vessels or aircraft. In return, the law requires the federal government to indemnify such insurers for 90% of insured losses resulting from covered acts of terrorism, subject to a premium-based deductible. Any existing policy exclusions for such coverage were immediately nullified by the law, although such exclusions may be reinstated if either the insured consents to reinstatement or fails to pay any applicable increase in premium resulting from the additional coverage within 30 days of being notified of such an increase. It should be noted that an act of terrorism as defined by the law excludes purely domestic terrorism. For an act of terrorism to have occurred, the U.S. Secretary of the Treasury must make several findings, including that the act was committed on behalf of a foreign person or foreign interest.

The Terrorism Risk Insurance Act of 2002, as extended and amended by the Terrorism Risk Insurance Extension Act of 2005, or TRIA, provides insurers with federally funded reinsurance for acts of terrorism. TRIA also requires insurers to make coverage for acts of terrorism available in certain commercial property / casualty insurance policies and to comply with various other provisions of TRIA. For applicable policies in force on or after November 26, 2002, we are required to provide coverage for losses arising from acts of terrorism as defined by TRIA on terms and in amounts that may not differ materially from other policy coverages. To be covered under TRIA, aggregate industry losses from a terrorist act must exceed $50 million in 2006 and $100 million in 2007, the act must be perpetrated within the U.S. or in certain instances outside of the U.S. on behalf of a foreign person or interest and the U.S. Secretary of the Treasury must certify that the act is covered under the program.

The federal reinsurance assistance under TRIA is scheduled to expire on December 31, 2007 unless Congress decides to further extend it. We cannot predict whether or when another extension may be enacted or what the final terms of such legislation would be. While the provisions of TRIA and the purchase of terrorism coverage described above mitigate our exposure in the event of a large scale terrorist attack, our effective deductible is significant. Regardless of TRIA, some state insurance regulators do not permit terrorism exclusions for various coverages or causes of loss.

The Terrorism Risk Insurance Act of 2002 required the U.S. Secretary of the Treasury to conduct an expedited study as to whether or not group life insurance should be covered under the law. Based on the study, the Secretary concluded that inclusion of group life insurance was not appropriate. Given that our property and casualty insurance products primarily cover personal residences and personal property, we do not believe our property and casualty exposure to terrorist acts to be significant.

*OFAC*

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The Treasury Department s Office of Foreign Asset Control, or OFAC, maintains various economic sanctions regulations against certain foreign countries and groups and prohibits U.S. Persons from engaging in certain transactions with certain persons or entities in or associated with those countries or groups. One key element of these sanctions regulations is a list maintained by the OFAC of Specifically Designated Nationals and Blocked Persons, or the SDN List. The SDN List identifies persons and entities that the government believes are associated with terrorists, rogue nations and / or drug traffickers.

OFAC s regulations, among other things, prohibit insurers and others from doing business with persons or entities on the SDN List. If the insurer finds and confirms a match, the insurer must take steps to block or reject the transaction, notify the affected person and file a report with OFAC. The focus on insurers responsibilities with respect to the sanctions regulations compliance has increased significantly since the terrorist attacks of September 11, 2001.

*Gramm-Leach-Bliley Act*

On November 12, 1999, the Gramm-Leach-Bliley Act of 1999 became law, implementing fundamental changes in the regulation of the financial services industry in the U.S. The Act permits the transformation of the already converging banking, insurance and securities industries by permitting mergers that combine commercial banks, insurers and securities firms under one holding company. Under the Act, national banks retain their existing ability to sell insurance products in some circumstances. In addition, bank holding companies that qualify and elect to be treated as financial holding companies may engage in activities, and acquire companies engaged in activities, that are financial in nature or incidental or complementary to such financial activities, including acting as principal, agent or broker in selling life, property and casualty and other forms of insurance, including annuities. A financial holding company can own any kind of insurance company or insurance broker or agent, but its bank subsidiary cannot own the insurance company. Under state law, the financial holding company would need to apply to the insurance commissioner in the insurer s state of domicile for prior approval of the acquisition of the insurer, and the Act provides that the commissioner, in considering the application, may not discriminate against the financial holding company because it is affiliated with a bank. Under the Act, no state may prevent or interfere with affiliations between banks and insurers, insurance agents or brokers, or the licensing of a bank or affiliate as an insurer or agent or broker. Privacy provisions of the Act became fully effective in 2001. These provisions established consumer protections regarding the security and confidentiality of nonpublic personal information and require us to make full disclosure of our privacy policies to our customers. In 2002, to further facilitate the implementation of the Gramm- Leach-Bliley Act, the NAIC adopted the Standards for Safeguarding Customer Information Model Regulation. A majority of states have adopted similar provisions regarding the safeguarding of nonpublic personal information. We have adopted a privacy policy for safeguarding nonpublic personal information, and follow procedures pertaining to applicable customers to comply with the Gramm-Leach-Bliley Act s related privacy requirements. We may also be subject to future privacy laws and regulations, which could impose additional costs and impact our results of operations or financial condition.

*Environmental considerations*

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As an owner and operator of real property, we are subject to extensive U.S. federal and state and environmental laws and regulations. Potential environmental liabilities and costs in connection with any required remediation of such properties also is an inherent risk in property ownership and operation. We cannot provide assurance that unexpected environmental liabilities will not arise. However, based upon information currently available to us, we believe that any costs associated with compliance with environmental laws and regulations or any remediation of such properties will not have a material adverse effect on our business, financial condition or results of operations.

**Legislative Developments**

There is legislation pending in the U.S. Congress and in various states designed to provide additional privacy protections to consumer customers of financial institutions. These statutes, as well as the Fair Credit Reporting Act, and similar legislation and regulations in the U.S. or other jurisdictions could affect our ability to market our products or otherwise limit the nature or scope of our insurance operations.

The NAIC and several states have been reviewing statutes and regulations dealing with small face amount life insurance policies. Some initiatives that have been raised at the NAIC include further disclosure for small face amount policies and restrictions on premium to benefit ratios. The NAIC is also studying other issues such as suitability of insurance products for certain customers. This may have an effect on our home service pre-funded funeral insurance business. Suitability requirements such as a customer assets and needs worksheet could extend and complicate the sale of pre-funded funeral insurance products.

We are unable to evaluate new legislation that may be proposed and when or whether any such legislation will be enacted and implemented. However, many of the proposals, if adopted, could have a material adverse effect on our financial condition, cash flows or results of operations, while others, if adopted, could potentially benefit our business.

## Item 1A. Risk Factors

Set forth below are risks with respect to our Company. Readers should review these risks, together with the other information contained in this report. The risks and uncertainties we have described in this report are not the only ones we face. Additional risks and uncertainties not presently known to us, or that we currently deem not material, may also adversely affect our business. Any of the risks discussed in this report or that are presently unknown or not material, if they were to actually occur, could result in a significant adverse impact on our business, operating results, prospects or financial condition.

**A substantial amount of our revenue comes from foreign nationals. This involves risks associated with business in other countries, such as might result from political or economic instability or the application of laws or regulations to our business.**

A substantial part of our insurance policy sales are from foreign countries, primarily in Latin America. There is a risk of losing a significant portion of these sales should adverse events occur in the countries from which we receive insurance policy applications.

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Approximately 67% of our consolidated revenues in 2006 were from our Life Insurance segment, which is predominantly international business. If economic or political crises were to occur in any of the countries where our foreign policyowners reside, our revenues would likely decline. For example, Argentina underwent a severe financial economic recession in the early 2000 s. As a result, our lapse rates relating to insureds residing there increased significantly and our new insurance business generated there declined dramatically. Also, foreign expropriation laws could adversely affect our revenues by imposing restrictions on fund transfers outside of a country where our insureds reside. In addition, a country could decide that we are subject to their insurance, securities and other regulation, or that we are required to maintain assets in that country as a part of our operations. Such actions would require us to reevaluate our existing products, including the cessation of accepting new applications from residents of that country. Our revenues from nationals of that country would likely be reduced significantly. While our management has over 30 years of experience in writing life insurance policies for residents of foreign countries without any significant regulatory action or any significant adverse expropriation controls relating to our insureds, there can be no assurance that such situations will not occur and that our revenues will not be affected adversely. We have not obtained any opinion of counsel addressing whether we may be required to qualify to do business or become licensed as an insurance company in, or the applicability of any securities laws of, any foreign country to our operations or to that of foreign trusts who hold our Class A common stock for our policyholders, nor have we sought or obtained any order of any foreign regulatory body relating to these issues.

**We may not be able to continue our past strategy of acquiring other U.S. life insurance companies, and we may not realize improvements to our financial results due to past and future acquisitions.**

Over the past years, we have acquired several U.S. life insurance companies. Our objective in this strategy has been to increase our assets, revenues and capital, improve our competitive position and increase our earnings, in part by allowing us to realize certain operating efficiencies associated with economies of scale. Prior to 2004, increases in earnings were not significant from the completed acquisitions compared to increases in existing business.

On an ongoing basis we evaluate possible acquisition transactions and, at any given time, we may be engaged in discussions with respect to possible acquisitions. While our business model is not dependent primarily upon acquisitions, the time frame for achieving or further improving our market positions can be significantly shortened through acquisitions. There can be no assurance that suitable acquisitions presenting opportunities for continued growth and operating efficiencies will continue to be available to us, or that we will realize the anticipated financial results from acquisitions. Our failure to address adequately these acquisition risks may materially adversely affect our results of operations and financial condition.

We may be unable to integrate our acquisitions on an economic basis, and the process of integrating companies we acquire could have a material adverse effect on our results of operations and financial condition. Implementation of an acquisition strategy could entail a number of risks, including among other things:

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- inaccurate assessment of undisclosed liabilities and policyholder reserves;
- difficulties in realizing projected efficiencies, synergies and cost savings;
- failure to achieve anticipated revenues, earnings or cash flow;
- an increase in indebtedness and a limitation in our ability to access additional capital when needed; and
- adverse changes in the economies of geographic regions in which the businesses of our acquisitions are concentrated, due to natural disasters, changing population demographics, governmental actions and other causes.

For example, virtually all of the premium income of Security Plan, from which we obtained premium revenues of approximately $38 million in 2006, is generated in Louisiana. Premium income for Security Plan for the fourth quarter of 2005, following the two hurricanes that hit Louisiana in 2005, totaled $9.2 million compared to $9.6 million in the fourth quarter of 2004. As with other geographic areas in the United States in which the business operations of our acquisitions are located, Louisiana could again experience natural disasters, such as hurricanes and flooding. A large-scale natural disaster such as this would be expected to have an adverse effect on the economy of that area, which in turn could result in a material adverse effect on our premium income from Security Plan.

**Sales of our products may be reduced if we are unable to attract and retain marketing representatives or develop and maintain distribution sources.**

We distribute our insurance products through a variety of distribution channels, including independent marketing consultants, employee agents and third-party marketing organizations.

Our relationships with these persons are significant both for our revenues and profits. In our Life Insurance segment, we depend in large part on the services of independent marketers and marketing consultants. In our Home Service segment, we depend on employee agents whose role in our distribution process is critical, in particular to develop and maintain client relationships. Strong competition exists among insurers to form relationships with marketers of demonstrated ability. We compete with other insurers for representatives and consultants primarily on the basis of our compensation and support services. Any diminishment in our inability to attract and retain effective sales representatives could materially adversely affect our results of operations and financial condition.

**Policy lapses in excess of those actuarially anticipated would have a negative impact on our financial performance.**

If our insurance policy lapse and surrender rates were to exceed the assumptions upon which we priced our insurance policies, our business could be adversely affected. The prices and expected future profitability of our insurance products are based in part upon expected patterns of premiums, expenses and benefits, using a number of assumptions, including those related to persistency, which is the probability that a policy or contract will

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remain in-force from one period to the next. Lapses occur when premium payments are not made. Surrender of a policy occurs by an affirmative act of the policyholder and is usually accompanied by an economic benefit for the policyholder because the policy has accumulated value. Policy acquisition costs are deferred and recognized over the life of a policy. Actual persistency that is lower than our persistency assumptions could have an adverse impact on profitability, especially in the early years of a policy or contract, primarily because we would be required to accelerate the amortization of expenses we deferred in connection with the acquisition of the policy or contract.

**Our actual claims losses may exceed our reserves for claims that may require us to establish additional reserves, which in turn may materially reduce our earnings, profitability and capital.**

We maintain reserves to cover our estimated exposure for claims relating to our issued insurance policies. Reserves, whether calculated under accounting principles generally accepted in the United States ( U.S. GAAP ) or statutory accounting principles ( SAP ), do not represent an exact calculation of exposure, but instead represent our best estimates, generally involving actuarial projections, of what we expect claims will be based on mortality assumptions that are determined by various regulatory entities. Many reserve assumptions are not directly quantifiable, particularly on a prospective basis. In addition, when we acquire other domestic life insurance companies, our assessment of the adequacy of acquired policy liabilities is subject to our estimates and assumptions. Reserve estimates are refined as experience develops. Adjustments to reserves, both positive and negative, are reflected in our statements of operations of the period in which such estimates are updated. Because establishment of reserves is an inherently uncertain process involving estimates of future losses, there can be no certainty that ultimate losses will not exceed existing claims reserves and have a material adverse effect on our results of operations and financial condition. Future loss development could require reserves to be increased, which could have a material adverse effect on our earnings in the periods in which such increases are made. For example, SPFIC was negatively impacted by the 2005 hurricanes in Louisiana. Through December 31, 2006, losses in excess of reinsurance amounted to more than $4.1 million, resulting in Security Plan infusing $4.0 million of additional capital into SPFIC.

**Our investment portfolio is subject to several risks that may diminish the value of our invested assets and negatively affect profitability.**

*Our investment portfolio may suffer reduced returns or losses that could reduce our profitability.*

Investment returns are an important part of our overall profitability and significant fluctuations in the fixed income market could impair our profitability, financial condition and cash flows. Our investments are subject to market-wide risks and fluctuations, as well as to risks inherent in particular securities. If we do not structure our investment portfolio so that it is appropriately matched with our insurance liabilities, we may be forced to liquidate investments prior to maturity at a significant loss to cover such liabilities. For the year ended December 31, 2006, our net investment income was $27.0 million and our net

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realized gains on investments were $1.3 million, which collectively accounted for 17.9% of our total revenues during the year. For the year ended December 31, 2005, our net investment income was $23.6 million and our net realized gains on investments were $419,000, which collectively accounted for 16.9% of our total revenues during such period. For the year ended December 31, 2004, our net investment income was $17.0 million and our net realized gains on investments were $389,000, which collectively accounted for 17.4% of our total revenues during such period.

*The performance of our investment portfolio is subject to fluctuations due to changes in interest rates and market conditions.*

Changes in interest rates can negatively affect the performance of most of our investments. Interest rate volatility can reduce unrealized gains or create unrealized losses in our portfolios. Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. Fluctuations in interest rates affect our returns on, and the fair value of, fixed maturity investments, which comprised $488.3 million, or 94.8%, of the carrying value of our total investments as of December 31, 2006.

The fair value of the fixed maturity securities in our portfolio and the investment income from these securities fluctuate depending on general economic and market conditions. Fair value generally increases or decreases in an inverse relationship with fluctuations in interest rates, while net investment income realized by us from future investments in fixed maturity securities will generally increase or decrease with interest rates.

In addition, actual net investment income and/or cash flows from investments that carry prepayment risk, such as mortgage-backed and other asset-backed securities, may differ from those anticipated at the time of investment as a result of interest rate fluctuations. A significant portion of our investment portfolio is subject to prepayment risks. These investments were 9.8% and 10.6% of our investment portfolio assets at December 31, 2006 and 2005, respectively.

Because all of our fixed maturity securities are classified as available for sale, changes in the fair value of these securities are reflected in our assets and in stockholders equity. Similar treatment is not available for liabilities. Therefore, interest rate fluctuations affect the carrying value of our investments and could materially adversely affect our financial condition.

We do not employ specific asset/liability matching strategies to reduce the adverse effects of interest rate volatility and to ensure that cash flows are available to pay claims as they become due. We are subject to adverse effects of interest rate volatility, and no assurances can be given that significant fluctuations in the level of interest rates will not have a material adverse effect on our results of operations and financial condition.

*Our investment portfolio is subject to credit risk.*

We are subject to credit risk in our investment portfolio, primarily from our investments in corporate bonds, including bonds of U.S. Government-sponsored entities. If third parties that owe amounts to us for bonds or other obligations were to default in the payment or

performance of their obligations, this could reduce our investment income and realized investment gains or result in investment losses. Further, the value of any particular fixed maturity security is subject to impairment based on the creditworthiness of a given issuer. As of December 31, 2006, we held $328.2 million in bonds of U.S. Government-sponsored enterprises. A significant increase in defaults and impairments on our fixed maturity securities portfolio could materially adversely affect our results of operations and financial condition.

**We may be required to accelerate the amortization of deferred acquisition costs and the cost of customer relationships acquired, which would increase our expenses and reduce profitability.**

Deferred acquisition costs, or DAC, represent costs that vary with and are primarily related to the sale and issuance of our insurance policies that are deferred and amortized over the estimated life of the related insurance policies. These costs include commissions in excess of ultimate renewal commissions, solicitation and printing costs, sales material and some support costs, such as underwriting and contract and policy issuance expenses. Under U.S. GAAP, DAC is amortized to income over the lives of the underlying policies, in relation to the anticipated recognition of premiums.

In addition, when we acquire a block of insurance policies, we assign a portion of the purchase price to the right to receive future net cash flows from existing insurance and investment contracts and policies. This intangible asset, called the cost of customer relationships acquired, or CCR, represents the actuarially estimated present value of future cash flows from the acquired policies. We amortize the value of this intangible asset in a manner similar to the amortization of DAC. Our amortization of DAC and CCR generally depends upon anticipated profits from investments, surrender and other policy charges, mortality, morbidity and maintenance expense margins. Unfavorable experience with regard to expected expenses, investment returns, mortality, morbidity, withdrawals or lapses may cause us to increase the amortization of DAC or CCR, or both, or to record a charge to increase benefit reserves.

We regularly review DAC and CCR quality to determine if they are recoverable from future income. If these costs are not recoverable, they are charged to expenses in the financial period in which we make this determination. For example, if we determine that we are unable to recover DAC from profits, or if withdrawals or surrender charges associated with early withdrawals do not fully offset the unamortized acquisition costs related to that line of business, we would be required to recognize the additional DAC amortization as a current-period expense.

At December 31, 2006, we had $87.0 million of such deferred policy acquisition costs. These costs are amortized primarily over the estimated premium paying period of the related policies in proportion to the ratio of the annual premium recognized to the total premium revenue anticipated, using the same assumptions as were used in computing liabilities for future policy benefits. Excess policy lapses, however, would cause the immediate expensing or amortizing of deferred policy acquisition costs, which would adversely affect our profitability.

At December 31, 2006, we had $34.8 million of cost of customer relationships acquired. We amortized $3.6 million of cost of customer relationships acquired in 2006. These

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amounts are amortized over the estimated premium paying period or based on in force amounts for paid-up policies.

**We may be required to recognize impairment in the value of our excess of cost over net assets acquired that would increase our expenses and reduce our profitability.**

Excess of cost over net assets acquired, or goodwill , represents the excess of the amount paid to acquire various life insurance companies over the fair value of their net assets at the date of the acquisition. Under U.S. GAAP, we test the carrying value of goodwill for impairment at least annually at the reporting unit level, which is either an operating segment or a business one level below the operating segment. Goodwill is impaired if its carrying value exceeds its implied fair value. This may occur for various reasons, including changes in actual or expected earnings or cash flows of a reporting unit, generation of earnings by a reporting unit at a lower rate of return than similar businesses or declines in market prices for publicly traded businesses similar to our reporting units. If any portion of our goodwill becomes impaired, we would be required to recognize the amount of the impairment as a current-period expense. The Company performed assessments of whether there was an indication that goodwill was impaired on December 31, 2006 and wrote off $1.0 million of goodwill in 2006.

**Loss of the services of our senior management team would likely hinder development of our operating and marketing programs and our strategy for expanding our business.**

We rely on the active participation of our Chairman of the Board and Chief Executive Officer, Harold E. Riley (age 78), our Vice Chairman of the Board, Rick D. Riley (age 53), and our President, Mark A. Oliver (age 48), in connection with the development and execution of operating and marketing plans and strategy for expanding our business. We anticipate that their expertise will continue to be of substantial value in connection with our operations. The loss of the services of one of these individuals would likely have a significant adverse effect on us in these respects. We do not have an employment agreement with any of these persons nor do we carry a key-man insurance policy on any of their lives. In addition, our only credit agreement with a bank for up to $75 million in borrowing capacity provides that an event of default will occur in the event any of Messrs. Harold E. Riley, Rick D. Riley or Mark A. Oliver is not employed by us.

**We are a defendant in lawsuits, which may adversely affect our financial condition and detract from our management s time.**

We are a defendant in a lawsuit originally filed on August 6, 1999 in the Texas District Court, Austin, Texas, now styled *Citizens Insurance Company of America, Citizens, Inc., Harold E. Riley and Mark A. Oliver, Petitioners v. Fernando Hakim Daccach*, Respondent, in which a class was originally certified by the trial court, and affirmed by the Court of Appeals for the Third District of Texas. We appealed the grant of class status to the Texas Supreme Court, and oral arguments occurred on October 21, 2004. On March 2, 2007, the Texas Supreme Court reversed the Court of Appeal s affirmation of the trial court s class certification order, decertified the class and remanded the case to the trial court for further proceedings consistent with the Texas Supreme Court s opinion. The suit alleges that certain life insurance policies that we made available by our primary life insurance

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subsidiary to non-U.S. residents, when combined with a policy feature that allows policy dividends to be assigned to two non-U.S. trusts for the purpose of accumulating ownership of our Class A common stock, along with allowing the policyholders to make additional contributions to the trusts, were actually offers and sales of securities that occurred in Texas by unregistered dealers in violation of the registration provisions of the Texas securities laws. The remedy sought was rescission and return of the insurance premium payments. We intend to continue to pursue a vigorous defense in any remaining proceeding. However, we expect financial exposure to us, if any, would be significantly less than had the purported class not been decertified.

We are also a party to various legal proceedings incidental to our business. We have been named as a defendant in various legal actions, including one lawsuit pursuing class certification filed in the United States District Court, Eastern District of Louisiana, on August 28, 2006, styled *Abadie, et al v. Aegis Security Insurance Co., et al*, seeking payments for claims denied by Security Plan Fire Insurance Company ( SPFIC ) and other declaratory relief relevant to Hurricane Katrina. All property and casualty insurers in Louisiana were named in this lawsuit. On November 27, 2006, the trial court judge concluded that the flood exclusions contained in most, if not all, of the property and casualty insurance policies were ambiguous whether the exclusions pertained to flooding resulting from the negligence of third parties. As a result, the trial court judge concluded that the policies will provide coverage for all flooding resulting from the negligence of third parties. The trial court judge immediately certified his opinion for appeal. It is presently unknown whether the U.S. Court of Appeals for the Fifth Circuit will accept the appeal and, if so, what the briefing schedule will be for a resolution of this appeal. However, we assert, among other things, that the SPFIC policies flood exclusion language should apply. We intend to vigorously defend the applicable flood exclusion language and defend against the proposed class certification. In the event of an adverse outcome, especially with regard to (a) whether the flooding is covered by the SPFIC policies and (b) whether this litigation is appropriate for class certification, the potential exposure to SPFIC, while not at this time quantifiable, could be substantial. Reserves for claims payable are based on the expected claim amount to be paid after a case-by-case review of the facts and circumstances relating to each claim. A contingency exists with regard to these reserves until the claims are adjudicated and paid.

Litigation, such as the matters described above, also can require significant amounts of time of our management that would otherwise be devoted to our business.

**Our business is subject to risks related to litigation and regulatory actions**.

In addition to the other legal proceedings as described above, we may from time to time be subject to a variety of legal and regulatory actions relating to our current and past business operations, including, but not limited to:

- other possible disputes relating to the overseas trusts that hold our Class A common stock on behalf of CICA policyholders. We also could face claims in foreign countries relating to noncompliance with their securities laws in connection with policyholders who participate in a non-U.S. trust and who beneficially own our Class A common stock. We cannot, for example, ensure that our foreign sales associates are in compliance with foreign securities and

insurance laws, as we do not have oversight over such persons. The estimation of any liabilities from any possible claims would be difficult to determine;

disputes over insurance coverage or claims adjudication;

disputes regarding sales practices, disclosures or absence of disclosures in connection with the offer and sale of our insurance policies and the option available to policyholders to assign dividends to a non-U.S. trust for the purpose of accumulating our Class A common stock;

regulatory compliance with insurance and securities laws in the United States and in foreign countries;

disputes with our consultants or employee agents over compensation and termination of contracts and related claims;

disputes regarding our tax liabilities; and

disputes relating to businesses acquired by us.

In the absence of countervailing considerations, we would expect to defend any such claims, and we could incur significant defense costs, including not only attorneys fees and other direct litigation costs, but also the expenditure of substantial amounts of management time that otherwise would be devoted to our business. We could be faced with contingent liabilities with respect to possible claims for violations of foreign and domestic securities and insurance laws, the extent of which would be difficult to determine.

In addition, plaintiffs continue to bring new types of legal claims against insurance and related companies. Current and future court decisions and legislative activity may increase our exposure to these types of claims. Multiparty or class action claims may result in additional exposure to substantial economic, non-economic or punitive damage awards, including the litigation to which we are currently a party. The loss of even one of these actions, if it resulted in a significant damage award or a judicial ruling that was otherwise substantially detrimental, could have a material adverse effect on our results of operations and financial condition. The risk of incurring a large liability in the event of an unsuccessful defense may make it more difficult to settle claims on reasonable terms. We cannot determine with any certainty what theories of recovery may evolve or what the impact of litigation or regulatory changes may be on our businesses.

**We operate in a highly competitive, mature industry within the U.S., which could limit our ability to increase our domestic insurance operations.**

We compete with more than 1,000 other life insurance companies of various sizes in the U.S. The life insurance business is highly competitive, in part because it is a mature industry in the U.S. that, in recent years, has experienced little to no growth in life insurance sales. Competition has also increased because the life insurance industry is consolidating, with larger, more efficient organizations emerging from consolidation. Furthermore, mutual insurance companies are converting to stock ownership, which should give them greater access to capital markets, resulting in greater competition with respect to

corporate finance as well. Additionally, legislation became effective in 2000 permitting commercial banks, insurance companies and investment banks to combine. This law permits, for instance, a commercial bank to acquire or form an insurance company. We believe these factors have increased competitive pressures in general.

Many domestic life insurance companies have greater financial resources, longer business histories, and more diversified lines of insurance coverage than we do. These companies also generally have larger sales forces. Although we may be at a competitive disadvantage to these entities, we seek to provide products that are competitive in the marketplace.

Competition in our insurance businesses is based on many factors, including quality of service, product features, price, scope of distribution, scale, financial strength ratings and name recognition. We also compete for marketing consultants and agents to sell our insurance products. Some of our competitors may offer a broader array of products than we do with which they compete in particular markets, may have a greater diversity of distribution resources, may have better brand recognition, may from time to time have more competitive pricing, may have lower cost structures or may have higher financial strength or claims paying ratings. Moreover, some of our competitors may have a lower target for returns on capital allocated to their business than we do, which may lead them to price their products lower than we do. In addition, from time to time, companies enter and exit the markets in which we operate, thereby increasing competition at times when there are new entrants. We may lose business to competitors offering competitive products at lower prices, or for other reasons, which could materially adversely affect our results of operations and financial condition.

**Our international operations face competition from several sources.**

Our international marketing plan stresses making available U.S. Dollar-denominated life insurance products to significant net worth individuals residing around the world. New competition could also cause the supply of insurance to change, which could affect our ability to price our products at attractive rates and thereby adversely affect our underwriting results. Although there are some impediments facing potential competitors who wish to enter the markets we serve, the entry of new competitors into our markets can occur, affording our customers significant flexibility in moving to other insurance providers. We experience competition primarily from the following sources around the world:

*Locally operated companies with local currency policies.* We compete with companies formed and operated in the country in which our foreign insureds reside. Generally, these companies are subject to risks of currency fluctuations, and use mortality tables based on experience of the local population as a whole. These mortality tables are typically based on significantly shorter life spans than those we use. Also, as a result of the foregoing factors, the statistical cost of insurance for these companies tends to be higher than ours. However, they hold their assets in local currencies, which may be preferable to some potential customers.

C*ompanies foreign to the countries in which policies are sold but that issue local currency policies.* Another group of our competitors consists of

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companies that are foreign to the countries in which the policies are sold but use the local currencies of those countries. Local currency policies provide the benefit of assets located in the country of foreign residents but entail risks of uncertainty due to local currency fluctuations as well as the perceived instability and weakness of local currencies. We have observed that local currency policies, whether issued by foreign or locally operated companies, tend to focus on universal life insurance and annuities instead of whole life insurance as we do.

*Foreign operated companies with U.S. Dollar policies.* We also face direct competition from companies that operate in the same manner as we do. We compete using our history of performance and our products.

Competitors in our international markets include National Western Life Insurance Company, Best Meridian Insurance Company and to a lesser extent, Pan American Life Insurance Company and American International Group. There can be no assurances that competition from the above companies will not adversely affect our business.

Our ability to compete is dependent upon, among other things, our ability:

- to attract marketing organizations and individuals who will market our products;
- to market our insurance products;
- to develop competitive and profitable products; and
- to maintain our underwriting and claims handling criteria.

**We are subject to extensive governmental regulation in the U.S., which increases our costs and could restrict the conduct of our business.**

We and our U.S. life insurance subsidiaries are subject to extensive regulation and supervision in the U.S. jurisdictions in which we and they do business. This regulation is generally designed to protect the interests of policyholders, as opposed to stockholders and other investors. To that end, the laws of the various states establish insurance departments with broad powers with respect to such things as:

- licensing companies to transact business;
- authorizing lines of business;
- mandating capital and surplus requirements;
- imposing dividend limitations;

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- regulating changes in control;
- licensing agents and distributors of insurance products;
- placing limitations on the minimum size of life insurance contracts;
- restricting companies ability to enter and exit markets;
- admitting statutory assets;
- mandating certain insurance benefits;
- restricting companies ability to terminate or cancel coverage;
- requiring companies to provide certain types of coverage;
- regulating premium rates, including the ability to increase premium rates;
- approving policy forms;
- regulating trade and claims practices;
- imposing privacy requirements;
- establishing reserve requirements and solvency standards;
- restricting certain transactions between affiliates;
- regulating the content of disclosures to debtors in the credit insurance area;
- mandating assessments or other surcharges for guaranty funds;
- regulating market conduct and sales practices of insurers and their marketers; and
- restricting contact with consumers, such as the recently created national do not call list, and imposing consumer protection measures.

The capacity for an insurance company s growth in premiums is partially a function of its statutory regulatory surplus. Maintaining appropriate levels of statutory surplus, as measured by statutory accounting practices and procedures, is considered important by insurance regulatory authorities. Failure to maintain required levels of statutory surplus could result in increased regulatory scrutiny and enforcement action by regulatory authorities.

If we are unable to maintain all required licenses and approvals, or if our U.S. domestic insurance business is determined not to fully comply with the wide variety of applicable

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laws and regulations or the relevant authority s interpretation of the laws and regulations, our business could be harmed. Also, some regulatory authorities have relatively broad discretion to grant, renew or revoke licenses and approvals, and could preclude or temporarily suspend us from carrying on some or all of our activities or monetarily penalize us. Any of these actions could materially adversely affect our results of operations and financial condition.

**We are unable to quantify the effect of foreign regulation of our insurance business if regulation were to be imposed on us, but we believe we could expend substantial amounts of time and incur substantial expense in complying with any foreign regulation, and we may decide to withdraw from the particular market where the regulation was imposed.**

We do not have any assets or employees in foreign countries. In connection with business from foreign countries, we only accept applications at our executive office in Austin, Texas. In addition, we require premium payments to be in U.S. Dollars, which may include checks drawn on U.S. banks. As a result, we have not been subject to regulation in the foreign countries from which we receive applications for insurance. Although we provide insurance to foreign nationals, independent associates and marketing consulting firms, rather than our employees, submit the applications. In addition, we do not at present ensure that our independent sales associates certify as to compliance with foreign securities laws in connection with the ability of foreign nationals to assign policy dividends to a U.S. stock investment plan for the purpose of accumulating our Class A common stock. We are unable to predict whether foreign regulation will be asserted or implemented in the future. If this were to happen, and we were to agree to submit to such regulation, we would expect to devote significant amounts of time and incur substantial ongoing expenses in complying with any foreign regulation imposed on us. We have not sought or obtained any opinion of counsel addressing whether we may be required to qualify to do business or become licensed as an insurer in any foreign country, or whether the above trust arrangements are subject to foreign securities laws, nor have we sought or obtained any order or declaration of any foreign regulatory authority or court relating to these issues.

**Changes in U.S. regulation may reduce our profitability and limit our prospective growth.**

State insurance regulators and the National Association of Insurance Commissioners (NAIC), regularly re-examine existing laws and regulations applicable to insurance companies and their products. Changes in these laws and regulations, or in interpretations thereof, are often made for the benefit of the consumer at the expense of the insurer and, thus, could adversely affect our financial condition and results of operations.

In December 2004, the NAIC approved amendments to its model Producer Licensing Act. The amendments contain new disclosure requirements for producers regarding compensation arrangements. If adopted, the NAIC amendments would require producers to disclose to customers, in certain circumstances, information concerning compensation arrangements with producers. The NAIC also directed its Executive Task Force on Broker Activities to further consider the development of additional requirements for recognition of a fiduciary responsibility on the part of producers, disclosure of all quotes received by a broker and disclosures relating to reinsurance arrangements between insurers and

reinsurance companies affiliated with a producer. We cannot predict the effect the NAIC s recent compensation disclosure amendments or anticipated future activities in this area, at the NAIC or state level, will have on influencing future legal actions, changes to business practices or regulatory requirements applicable to us.

Currently, the U.S. Government does not regulate directly the insurance business. However, federal legislation and administrative policies in several areas can significantly and adversely affect insurance companies. These areas include financial services regulation, securities regulation, including the Sarbanes-Oxley Act of 2002, pension regulation, privacy, tort reform legislation and taxation. In addition, various forms of direct federal regulation of insurance have been proposed. These proposals include The State Modernization and Regulatory Transparency Act, which would maintain state-based regulation of insurance but would affect state regulation of certain aspects of the insurance business, including rates, agent and company licensing and market conduct examinations. We cannot predict whether this or other proposals will be adopted, or what impact, if enacted, such laws may have on our business, financial condition or results of operations.

Many of our independent marketers also operate in regulated environments. Changes in regulations that affect their operations also may affect our business relationships with them and their ability to purchase or to distribute our products. Accordingly, these changes could have an adverse effect on our financial condition and results of operation. Changes in laws and regulations that apply to us and our marketing representatives may materially increase our expense of doing business, thus having an adverse effect on our financial condition and results of operations.

**Reinsurers with which we do business with may not honor their obligations, leaving us liable for the reinsured coverage, and our reinsurers could increase their premium rates.**

We reinsure certain risks underwritten by our various operating segments, including life and casualty. Market conditions beyond our control determine the availability and cost of the reinsurance protection we purchase. The high cost of reinsurance or lack of affordable coverage could adversely affect our operating results.

Although our reinsurers are liable to us to the extent of the ceded reinsurance, we remain liable as the direct insurer on all risks reinsured. As a result, ceded reinsurance arrangements do not eliminate our obligation to pay claims. We are subject to credit risk with respect to our ability to recover amounts due from reinsurers. Our reinsurers may not pay the reinsurance recoverables that they owe to us or they may not pay such recoverables on a timely basis. A reinsurer s insolvency, underwriting results or investment returns may affect its ability to fulfill reinsurance obligations.

Our reinsurance facilities are generally subject to annual renewal. We may not be able to maintain our current reinsurance facilities and, even where highly desirable or necessary,

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we may not be able to obtain other reinsurance facilities in adequate amounts and at favorable rates. If we are unable to renew our expiring facilities or to obtain new reinsurance facilities, either our net exposures would increase or, if we are unwilling or unable to bear an increase in net exposures, we may have to reduce the level of our underwriting commitments. Either of these potential developments could materially adversely affect our results of operations and financial condition.

For the majority of our business, we retain only the first $100,000 of risk on any one life and cede the remaining risk to our reinsurers, with the remainder of our policies having lower levels of retained risk. In 2006, we reinsured $259 million of face amount of our life insurance policies, and in 2005 we reinsured $222 million of face amount of our life insurance policies. Amounts reinsured in 2006 and 2005 represented 5.6% and 5.2%, respectively, of the face amount of life insurance in effect in those years. Although the cost of reinsurance is, in some cases, reflected in premium rates, under certain reinsurance agreements, the reinsurer may increase the rate it charges us for reinsurance. If the cost of reinsurance were to increase with respect to policies for which we have guaranteed the rates to our insureds, we could be adversely affected.

**The failure to effectively maintain and modernize our information systems could adversely affect our business.**

Our business is dependent upon our ability to keep up to date with technological advances. This is particularly important in our life insurance operations, where our information systems are critical to the operation of our business. Our failure to update these systems to reflect technological advancements or to protect our systems may adversely affect our ability to do business.

We must maintain and enhance our existing information systems and develop new information systems in order to keep pace with continuing changes in information processing technology, evolving industry and regulatory standards and changing customer preferences. Our failure to maintain effective and efficient information systems, or our failure to efficiently and effectively consolidate our information systems to eliminate redundant or obsolete applications, could have a material adverse effect on our results of operations and financial condition. If we do not maintain adequate systems we could experience adverse consequences, including:

- inadequate information on which to base pricing, underwriting and reserve decisions;
- the loss of existing customers;
- difficulty in attracting new customers;
- customer and marketer disputes;
- regulatory problems, such as failure to meet prompt payment obligations;
- litigation exposure; or

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increases in administrative expenses.

In addition, our management information, internal control and financial reporting systems may need further enhancements and development to satisfy the financial and other reporting requirements of being a public company. There is a risk that we may not be able to adequately upgrade and improve our information systems on an ongoing basis, which could have an adverse effect on our business.

**To the extent that we fail to maintain our current system of internal controls to an effective level with regard to material weaknesses we may identify, there is a risk that we may not be able to report our financial results accurately. As a result, our business could be harmed, and current and potential investors could lose confidence in our financial reporting, which could have a negative effect on the trading price of our securities.**

Effective internal controls are necessary for us to provide reliable financial reports and to effectively prevent fraud. If we are unable to provide reliable financial reports or prevent fraud, our operating results and the market value of our securities could be harmed. We have in the past discovered, and may in the future discover, areas of our internal controls that need improvement.

As discussed in our 2005 Annual Report on Form 10-K, we concluded that we had remediated all previously identified material weaknesses in our disclosure and financial reporting controls. However, as discussed in Item 4 of our September 30, 2006 Quarterly Report on Form 10-Q, during the course of preparing the financial statements for that report, we discovered cumulative misstatements of $3.1 million that were attributed to periods prior to December 31, 2004. As we discussed, we have made adjustments to our accounts as of December 31, 2006, in accordance with recent guidance from the SEC as set forth in Staff Accounting Bulletins 99 and 108, concerning the process of quantifying and reporting financial statement misstatements. Based on the accounting treatment allowed under Staff Accounting Bulletin 108 after applying a dual method to evaluate the materiality of misstatements, the net adjustment was recorded by increasing our retained deficit as of January 1, 2006 and making corresponding adjustments to multiple balance sheet accounts.

We have determined that not identifying and quantifying these misstatements on a timely basis was indicative of a material weakness in our disclosure controls and controls over financial reporting. Although, as discussed in our 2005 Form 10-K, we made substantial improvements to previously identified weaknesses, we did not implement sufficient procedures for the timely review of supporting work papers and documentation for prior accounting periods, where the effects of prior misstatements could materially affect the financial statements for subsequent reporting periods. These processes should have included not only a review of these materials, but also adequate analyses to assure that the accounting treatment conformed with U.S. GAAP.

Although numerous actions were taken during the fourth quarter of 2006 to strengthen existing controls and implement additional controls with respect to the above material weakness, the material weakness still existed at December 31, 2006 relating to the financial statement close process. This resulted from inadequate support and resources at

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appropriate levels within the finance and accounting organization to enable the timely review of supporting workpapers for the prior and current accounting periods and to prevent and detect misapplications of U.S. GAAP.

We have devoted significant resources to remediate and improve our internal controls, and we have been monitoring the effectiveness of our improved procedures. We also intend to continue reviewing our procedures and implementing further improvements or changes to our internal control procedures as necessary or warranted. However, we cannot be certain that these measures will ensure the continued adequacy of our controls over our financial processes and reporting in the future, or that there are no additional, existing, but as yet undiscovered, weaknesses that we need to address.

**Failure to protect confidential information and privacy could result in the loss of customers, reduction to our profitability and subject us to fines and penalties.**

Our insurance subsidiaries are subject to privacy regulations and to confidentiality obligations. We also have legal obligations to protect certain confidential information we obtain from our existing vendors. These obligations generally include protecting confidential information in the same manner and to the same extent as we protect our own confidential information. The actions we take to protect confidential information include among other things:

- monitoring our record retention plans and any changes in state or federal privacy and compliance requirements;
- drafting appropriate contractual provisions into any contract that raises proprietary and confidentiality issues;
- maintaining secure storage facilities for tangible records; and
- limiting access to electronic information in order to safeguard certain current information.

In addition, the Gramm-Leach-Bliley Act requires that we deliver a notice regarding our privacy policy both at the delivery of the insurance policy and annually thereafter. Certain exceptions are allowed for sharing of information under joint marketing agreements. However, certain state laws may require individuals to opt in to information sharing instead of being immediately included. Additionally, when final U.S. Treasury Department regulations are promulgated in connection with the USA Patriot Act, we will likely have to expend additional resources to tailor our existing efforts to the new rules.

We have, and maintain, a written information security program with appropriate administrative, technical and physical safeguards to protect such confidential information. If we do not comply with privacy regulations and protect confidential information, we could experience adverse consequences, including regulatory problems, loss of reputation and litigation.

**The insurance business in which we operate may be subject to periodic negative publicity, which may negatively impact our financial results**.

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The nature of the markets for the insurance products we provide, including international life and home service, is that we interface with and distribute our products to individual consumers. There may be a perception that these purchasers may be unsophisticated and in need of consumer protection. Accordingly, from time to time, consumer advocate groups or the media may focus attention on our products, thereby subjecting us to periodic negative publicity. We may also be negatively impacted if another insurance company engages in practices resulting in increased public attention to our businesses. Negative publicity may result in lower sales of insurance, increased regulation and legislative scrutiny of industry practices as well as increased litigation, which may further increase our costs of doing business and adversely affect our profitability by impeding our ability to market our products, requiring us to change our products or increasing the regulatory burdens under which we operate.

**General economic, financial market and political conditions may adversely affect our results of operations and financial condition.**

Our results of operations and financial condition may be materially adversely affected from time to time by general economic, financial market and political conditions, both in the U.S. and in the foreign countries where our non-U.S. policy owners reside. These conditions include economic cycles such as:

- insurance industry cycles;
- levels of employment;
- levels of consumer spending;
- levels of inflation; and
- movements of the financial markets.

Fluctuations in interest rates, monetary policy, demographics, and legislative and competitive factors also influence our performance. During periods of economic downturn, individuals and businesses may choose not to purchase our insurance products and other related products and services, may terminate existing policies or contracts, permit them to lapse or may choose to reduce the amount of coverage purchased.

**The inability of our subsidiaries to make payments to us in sufficient amounts for us to conduct operations could harm our ability to meet our obligations.**

As a holding company whose principal assets are the capital stock of our subsidiaries, we will rely primarily on statutorily permissible payments from our subsidiaries to meet our obligations for payment of corporate expenses. The ability of our subsidiaries to make payments to us and to make other payments in the future will depend on their statutory surplus (which is the excess of assets over liabilities as determined in accordance with statutory accounting principles set by state insurance regulatory authorities), future statutory earnings (which are earnings as determined in accordance with statutory accounting principles) and regulatory restrictions. Except to the extent that we are a

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creditor with recognized claims against our subsidiaries, claims of our subsidiaries creditors, including policyholders, have priority with respect to the assets and earnings of the subsidiaries over the claims of our creditors. If any of our subsidiaries becomes insolvent, liquidates or otherwise reorganizes, our creditors and shareholders will have no right to proceed against the assets of that subsidiary or to cause the liquidation, bankruptcy or winding-up of the subsidiary under applicable liquidation, bankruptcy or winding-up laws.

**The price of our Class A common stock may be volatile and may be affected by market conditions beyond our control.**

Our Class A share price is likely to fluctuate in the future because of the volatility of the stock market in general and as a result of a variety of other factors, many of which are beyond our control, including:

- quarterly variations in actual or anticipated results of our operations including for individual products;
- interest rate fluctuations;
- changes in financial estimates by securities analysts;
- our failure to meet the expectations of securities analysts and investors; and
- actions or announcements by our competitors.

**Class A common stockholders will always be minority holders who will not control us, will have a limited ability to influence our business policies and corporate actions, and will not by themselves be able to elect any directors.**

It is difficult for our minority shareholders to elect any of our directors or otherwise exert influence over our business. Our outstanding Class B common stock elects a simple majority of our board of directors. All of the Class B common stock is owned indirectly by Harold E. Riley, Chairman of the Board and Chief Executive Officer, through the Harold E. Riley Trust. Additionally, Mr. Riley is the largest Class A shareholder. Therefore, Mr. Riley has virtually complete control over significant corporate transactions. These factors would also make it more difficult and time consuming for a third party to acquire control of, or to change, our board of directors.

**Our articles of incorporation, bylaws and insurance laws may discourage takeovers and business combinations that our stockholders might consider in their best interests.**

Our articles of incorporation and bylaws, as well as various state insurance laws, may delay, defer, prevent or render more difficult a takeover attempt that our stockholders might consider in their best interests. For instance, they may prevent our stockholders from receiving the benefit from any premium to the market price of our common stock offered by a bidder in a takeover context. Even in the absence of a takeover attempt, the

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existence of these provisions may adversely affect the prevailing market price of our common stock if they are viewed as discouraging takeover attempts in the future.

Our articles of incorporation and bylaws may also make it difficult for stockholders to replace or remove our directors. These provisions may facilitate entrenchment of our directors, which may delay, defer or prevent a change in our control, which may not be in the best interests of our stockholders.

The following provisions in our articles of incorporation and bylaws have anti-takeover effects that may delay, defer or prevent a takeover attempt. In particular, our articles of incorporation and bylaws:

- provide that our Class B common stock elects a simple majority of our board of directors; all of such stock is beneficially owned by Harold E. Riley; and

- permit our board of directors to issue one or more series of preferred stock.

State insurance laws generally require prior approval of a change in control of an insurance company. Generally, such laws provide that control over an insurer is presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing 10% or more of the voting securities of the insurer. In considering an application to acquire control of an insurer, an insurance commissioner generally will consider such factors as the experience, competence and financial strength of the applicant, the integrity of the applicant s board of directors and executive officers, the acquirer s plans for the management and operation of the insurer, and any anti-competitive results that may arise from the acquisition. In addition, a person seeking to acquire control of an insurance company is required in some states to make filings prior to completing an acquisition if the acquirer and the target insurance company and their affiliates have sufficiently large market shares in particular lines of insurance in those states. These laws may discourage potential acquisition proposals and may delay, deter or prevent a change of control involving us, including through transactions, and in particular unsolicited transactions, that some or all of our stockholders might consider to be desirable.

**You should not anticipate receiving cash dividends on your Citizens Class A common stock, because we have not paid any cash dividends and do not anticipate doing so in the foreseeable future.**

To date we have not paid cash dividends on our Class A common stock or Class B common stock, because it is our policy to retain earnings for use in the operation and expansion of our business. Thus, you should not rely on your investment in us for periodic dividend income. The only return on your investment in our Class A common stock will be the appreciation in its market value, if any.

**There are a substantial number of shares of our Class A common stock eligible for future sale in the public market. The sale of a large number of these shares could cause the market price of our Class A common stock to fall.**

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There were 43,425,524 shares of our Class A common stock outstanding as of December 31, 2006.

The outstanding shares of our Series A-1 Convertible Preferred Stock were convertible, at December 31, 2006, into 1,974,724 shares of Class A common stock at a conversion price of $6.33 per share. Although we have no present plans to do so, if we were to increase the Series A-1 Preferred Stock issue size from its existing $12.5 million up to a maximum of $25 million, then an additional 1,974,724 shares of our Class A common stock may be issuable upon conversion of those preferred shares. The Series A-2 Preferred can be converted into an aggregate number of shares based on a variable defined price.

The Series A-1 and A-2 Preferred Stock is mandatorily redeemable in 2009. Both may also become redeemable at the option of the holder if certain conditions exist, as described below. Under either scenario, the shares may be redeemed in cash or shares of Class A common stock depending on the circumstances. If redeemable in stock, the redemption price is based on a defined formula.

The unit warrants, which were also issued on July 12, 2004, entitled the investors to purchase from the Company up to $5 million of Series A-2 Convertible Preferred Stock. Three of the four investors exercised their unit warrants, for an exercise price of $3.75 million, before the unit warrants expired in October 2005. The three issuances of Series A-2 Preferred Stock are convertible into Class A common stock at conversion prices equal to 110% of the average market closing prices of the Class A common stock for the 30 trading days before the respective dates of issuance of the Series A-2 Preferred Stock to the three investors.

The conversion, exercise and redemption prices set forth in this and the two following risk factors, along with the numbers of shares and warrants, except as otherwise provided in the amendment to our articles of incorporation establishing the Series A Preferred Stock, have been adjusted for the respective stock dividends paid December 31, 2004 and December 30, 2005. For further discussion concerning the Series A Preferred Stock, see Notes 1(i) and 8 of the Notes to Consolidated Financial Statements.

The three investors exercised their unit warrants in July, September and October 2005. Upon exercise, these three investors each acquired 1,338 shares of Series A-2 Preferred Stock, together totaling 4,014 shares. In addition, in connection with their unit warrant exercises, the three investors received additional warrants to purchase a total of 151,351 shares of Class A common stock at exercise prices ranging from $6.72 to $7.99 per share. The Series A-2 Preferred Stock is convertible into Class A common stock at prices ranging from $6.11 to $7.26 per common share. The conversion prices per common share could be reduced below these amounts if our Class A common stock trading price declines, therefore, increasing the number of Class A common stock shares we would be required to issue.

In connection with the issuance of Series A-1 Preferred Stock and associated warrants in July 2004, the finders with respect to these transactions received, as part of the finders compensation, warrants to purchase 98,835 shares of Series A common stock at an exercise price of $6.95 per share. In connection with the issuances of Series A-2 Preferred Stock and associated warrants in 2005, the finders received, as part of the finders

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compensation, warrants to purchase 27,525 shares of Class A common stock at exercise prices ranging from $6.72 to $7.99.

Holders of the Series A Preferred Stock receive a 4% annual dividend that is payable by issuing Class A common stock. To date, we have paid all of these dividends by issuing our Class A common stock, and we intend to do so assuming we meet the conditions for issuance. Furthermore, we could be obligated to issue a significant number of shares of Class A common stock if the Series A Preferred Stock and warrants noted above are exercised and converted.

In addition, members of our management and other affiliates owned approximately 5,793,000 shares of our Class A common stock, representing 13.3% of our outstanding Class A common stock as of December 31, 2006. Sale of a substantial number of the shares described above would likely have a significant negative affect on the market price of our Class A common stock.

If our stockholders sell a large number of shares of our Class A common stock, or if we issue a large number of shares of our Class A common stock in connection with future acquisitions, financings, or other circumstances, the market price of shares of our Class A common stock could decline significantly. Moreover, the perception in the public market that our stockholders might sell shares of our Class A common stock could depress the market price of those shares.

**Provisions of our Series A Preferred Stock may prevent or make it more difficult for us to raise funds or take certain other actions.**

In July 2004, we completed the private placement to four institutional investors of (a) an aggregate of 25,000 shares of our Series A-1 Senior Convertible Preferred Stock, and (b) seven-year warrants to purchase up to an aggregate of 543,790 shares of our Class A common stock at an exercise price of $6.95 per share. In addition, Series A-2 Preferred stock and additional warrants were issued upon the exercise, by three of the four institutional investors, of their unit warrants as discussed in the immediately foregoing risk factor. Provisions of the currently outstanding Series A Preferred Stock may require us to obtain the approval of the holders of such shares, or otherwise trigger rights of first refusal or payment provisions, to (a) incur debt or allow liens on our property, other than certain permitted debt and liens, (b) issue or sell additional shares of our Class A common stock, (c) amend our articles of incorporation so as to affect adversely any rights of the preferred shareholders, (d) authorize or create a new class of stock that will be senior or equal to the Series A Preferred Stock in terms of dividends, redemption or distribution of assets, or (e) take certain other actions. For example, we cannot incur debts of greater than $30 million without approval of the holders of the Series A Preferred Stock. These provisions may make it more difficult for us to take certain corporate actions and could delay, discourage or prevent future financings.

**Holders of our Series A Preferred Stock may obtain the right to require us to redeem their Series A Preferred Stock and we will be required to redeem any shares of**

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**Series A Preferred Stock that remain outstanding on the fifth anniversary of their issuance**.

The provisions of the Series A Preferred Stock require that if (i) at any time after the original issue date of the stock, the closing price of our Class A common stock for any 42 trading days, including a period not less than five consecutive trading days, is less than $4.80, or (ii) we issue Class A common stock or common stock equivalents for less than $6.11 per share, then the holders of the Series A Preferred Stock may require us to redeem their shares of Series A Preferred Stock at a price equal to the amount of the original holder s original investment, plus all accrued but unpaid dividends thereon to the date of payment and any applicable penalties. The preferred holders right to require a redemption has not been triggered under clause (i) or clause (ii) above.

We will be required to redeem any shares of the Series A Preferred Stock that remain outstanding on the fifth anniversary after their issuance at a price equal to the amount of the original holder s original investment, plus all accrued but unpaid dividends thereon to the date of such payment.

We can elect to pay the redemption price in shares of our Class A common stock if:

- the average closing price of our Class A common stock is $3.50 per share or above;
- we have sufficient number of shares of Class A common stock available for issuance;
- our Class A common stock is listed on NYSE or other eligible market;
- the shares of Class A common stock to be issued are registered under an effective registration statement;
- the shares to be issued can be issued without violating the rules of the NYSE or any applicable trading market or a provision of our agreement with the holders;
- we have not filed for protection under applicable bankruptcy laws; and
- certain other enumerated conditions.

We would likely pay the redemption price of any Series A Preferred Stock in shares of our Class A common stock, assuming we met the foregoing criteria. The number of shares of Class A common stock that we would be required to issue to redeem the preferred stock would be determined by dividing the sum of the stated value of $500 per preferred share, plus accrued dividends at 4% per annum (paid quarterly), by the lesser of $6.11 or 95% of the volume weighted average price per share of the common stock for 15 days before the redemption date. The number of additional shares of common stock that we may be required to issue to redeem these shares of Series A Preferred Stock could have a significant dilutive effect on the book value of the shares of Class A common stock held by existing stockholders. However, there are provisions of the Series A Preferred Stock, that could, under certain circumstances, including failure to meet the requirements

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enumerated above, require us to pay part or all of the redemption price in cash rather than common stock.

Another provision of the Series A Preferred Stock allows the preferred holders to require the Company to repurchase in cash (i) any shares of Series A Preferred Stock still held by the preferred shareholders and (ii) any shares of Class A common stock still held by the preferred shareholders pursuant to the provisions of the Preferred Stock if certain defined Events or other conditions occur and are not cured within specified time periods. The Events or other conditions generally consist of the failure to meet requirements such as or similar to those enumerated above during the period that ends on the earlier of (i) the fifth anniversary of the initial registration statement filed to cover the resale of the preferred shareholders shares of Class A common stock or (ii) the date when all preferred shareholders shares of Class A common stock covered by that registration statement have been sold.

If the preferred shareholders obtain the right to require redemption or repurchase of their shares of stock there can be no assurance that they will not elect to exercise that right. If we are required or elect to redeem shares of the Series A Preferred Stock using cash, we may have to curtail our expansion and acquisition plans. In that event, we would likely try to raise additional capital by issuing new stock, but there can be no assurance that capital will be available on acceptable terms or at all.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

We own our principal office in Austin, Texas, consisting of an 80,000 square foot office building and approximately one acre of land nearby that contains housing storage facilities. Approximately 50,000 square feet is occupied or reserved for our operations, with the remainder of the building leased to a single tenant under a lease that expired in late 2006. Management has not made a final decision on future plans for the formerly leased space.

We also own a 6,324 square foot funeral home in Baker, Louisiana acquired at a total cost of $527,000. This facility, acquired in a 1995 acquisition, is owned and operated by FHA. In addition, we own other properties in Texas and Louisiana that are incidental to our operations.

**Item 3. Legal Proceedings**

We are a defendant in a lawsuit originally filed on August 6, 1999 in the Texas District Court, Austin, Texas, now styled *Citizens Insurance Company of America, Citizens, Inc., Harold E. Riley and Mark A. Oliver, Petitioners v. Fernando Hakim Daccach*, Respondent, in which a class was originally certified by the trial court, and affirmed by the Court of Appeals for the Third District of Texas. We appealed the grant of class status

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to the Texas Supreme Court, and oral arguments occurred on October 21, 2004. On March 2, 2007, the Texas Supreme Court reversed the Court of Appeal s affirmation of the trial court s class certification order, decertified the class and remanded the case to the trial court for further proceedings consistent with the Texas Supreme Court s opinion. The suit alleges that certain life insurance policies that we made available by our primary life insurance subsidiary to non-U.S. residents, when combined with a policy feature that allows policy dividends to be assigned to two non-U.S. trusts for the purpose of accumulating ownership of our Class A common stock, along with allowing the policyholders to make additional contributions to the trusts, were actually offers and sales of securities that occurred in Texas by unregistered dealers in violation of the registration provisions of the Texas securities laws. The remedy sought was rescission and return of the insurance premium payments. We intend to continue to pursue a vigorous defense in any remaining proceeding. However, we expect financial exposure to us, if any, would be significantly less than had the purported class not been decertified.

We are also a party to various legal proceedings incidental to our business. We have been named as a defendant in various legal actions, including one lawsuit pursuing class certification filed in the United States District Court, Eastern District of Louisiana, on August 28, 2006, styled *Abadie, et al v. Aegis Security Insurance Co., et al*, seeking payments for claims denied by Security Plan Fire Insurance Company ( SPFIC ) and other declaratory relief relevant to Hurricane Katrina. All property and casualty insurers in Louisiana were named in this lawsuit. On November 27, 2006, the trial court judge concluded that the flood exclusions contained in most, if not all, of the property and casualty insurance policies were ambiguous whether the exclusions pertained to flooding resulting from the negligence of third parties. As a result, the trial court judge concluded that the policies will provide coverage for all flooding resulting from the negligence of third parties. The trial court judge immediately certified his opinion for appeal. It is presently unknown whether the U.S. Court of Appeals for the Fifth Circuit will accept the appeal and, if so, what the briefing schedule will be for a resolution of this appeal. However, we assert, among other things, that the SPFIC policies flood exclusion language should apply. We intend to vigorously defend the applicable flood exclusion language and defend against the proposed class certification. In the event of an adverse outcome, especially with regard to (a) whether the flooding is covered by the SPFIC policies and (b) whether this litigation is appropriate for class certification, the potential exposure to SPFIC, while not at this time quantifiable, could be substantial. Reserves for claims payable are based on the expected claim amount to be paid after a case-by-case review of the facts and circumstances relating to each claim. A contingency exists with regard to these reserves until the claims are adjudicated and paid.

Litigation, such as the matters described above, also can require significant amounts of time of our management that would otherwise be devoted to our business.

## Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of the security holders during the fourth quarter of the fiscal year covered by this report.

**PART II**

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**Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities**

Our Class A common stock is traded on the New York Stock Exchange (NYSE) under the symbol CIA. The quarterly high and low prices per share as reported by the NYSE are shown below. These prices have been adjusted to reflect 7% stock dividends paid in 2004 and 2005.

| | 2006 | | 2005 | |
|---|---|---|---|---|
| **Quarter Ended** | **High** | **Low** | **High** | **Low** |
| **March 31** | $5.60 | 4.78 | 5.80 | 5.01 |
| **June 30** | 5.54 | 4.57 | 5.79 | 4.79 |
| **September 30** | 6.04 | 4.88 | 6.93 | 5.70 |
| **December 31** | 6.97 | 5.60 | 6.05 | 4.92 |

As of December 31, 2006, the approximate number of record owners of our Class A common stock was 50,000. Management estimates the number of beneficial owners to be approximately 125,000.

On December 31, 2004, we paid a 7% common stock dividend to holders of record as of December 1, 2004. The dividend resulted in the issuance of 2,649,695 Class A shares (including 191,722 shares in treasury) and 61,246 Class B shares.

On December 31, 2005, we paid a 7% common stock dividend to holders of record as of December 15, 2005. The dividend resulted in the issuance of 2,840,821 Class A shares (including 205,142 shares in treasury) and 65,533 Class B shares.

We have not paid cash dividends in any of the past five years and do not expect to pay such in the foreseeable future. For restrictions on the present and future ability to pay dividends, see Note 6 of the Notes to Consolidated Financial Statements.

We did not purchase any of our equity securities during any quarter in 2004, 2005 and 2006.

**Securities Authorized for Issuance Under Equity Compensation Plans**

We do not maintain any equity compensation plans or arrangements. Thus, we do not have any securities authorized for issuance under these types of plans, nor have we issued any options, warrants or similar instruments to purchase any of our equity securities, except for warrants issued in conjunction with the convertible preferred stock issued in 2005. (See Note 8 of the Notes to Consolidated Financial Statements. )

**Item 6. Selected Financial Data**

The table below sets forth, in summary form, selected data of the Company. This data, which is not covered in the report of our independent registered public accounting firm, should be read in conjunction with the consolidated financial statements and notes, which are included elsewhere herein. The net income per share amounts have been adjusted

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retroactively for all periods presented to reflect the 7% common stock dividends paid on December 31, 2005 and December 31, 2004.

| | Year Ended December 31, (In thousands except per share data) | | | | |
|---|---|---|---|---|---|
| | **2006** | **2005** | **2004** | **2003** | **2002** |
| **Total Revenues** | $158,059 | 142,113 | 99,859 | 92,060 | 82,901 |
| **Net Income** | 8,677 | 7,302 | 7,732 | 3,126 | 4,254 |
| **Basic Earnings Per Share** | 0.16 | 0.13 | 0.17 | 0.08 | 0.12 |
| **Total Assets at December 31** | 711,184 | 661,889 | 661,212 | 390,093 | 326,291 |
| **Long-term Debt** | | | 30,000 | | |
| **Total Liabilities** | 558,690 | 513,380 | 520,179 | 263,066 | 224,499 |
| **Total Stockholders Equity** | 139,611 | 136,963 | 135,131 | 127,027 | 101,792 |
| **Book Value Per Share** | 3.38 | 3.33 | 3.29 | 3.10 | 2.76 |

See Item 1 Business (a) and (b), and Item 7 Management s Discussion and Analysis, for information that may affect the comparability of the financial data contained in the above table.

**Item 7. Management s Discussio**