

GOLDMAN SACHS GROUP INC

Form 424B2

March 28, 2019

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Filed Pursuant to Rule 424(b)(2)

Registration Statement No. 333-219206

GS Finance Corp.

\$752,000

Autocallable Motif Capital Aging of America 7 ER Index-Linked Notes due 2026

guaranteed by

The Goldman Sachs Group, Inc.

The notes do not bear interest. Unless your notes are automatically called on any annual call observation date, the amount that you will be paid on your notes on the stated maturity date (April 9, 2026) will be based on the performance of the Motif Capital Aging of America 7 ER Index as measured from the trade date (March 26, 2019) to and including the determination date (March 26, 2026). If the final level on the determination date is greater than the initial level of 118.38, the return on your notes will be the index return (the percentage increase or decrease in the final level from the initial level) times 2. If the final level is equal to or less than the initial level, you will receive the face amount of your notes at maturity.

Your notes will be automatically called if the closing level of the index on any call observation date (specified on page S-3) is greater than or equal to the applicable call level (specified on page S-3), resulting in a payment on the corresponding call payment date (the tenth business day after the call observation date) equal to the face amount of your notes plus the product of \$1,000 times the applicable call return (specified on page S-3).

The index tracks the U.S. exchange-listed common equity securities of companies that may benefit from the long-term demographic shift towards an older population in the U.S. because they have revenues from developing therapies for medical conditions that disproportionately affect senior citizens (i.e., cancer, heart disease, diabetes, arthritis, kidney disease, chronic obstructive pulmonary disease and hearing loss) or providing senior housing facilities or Medicare insurance. To be included in the index, a company must have a specific sector classification and must meet certain minimum market capitalization, revenue, price, average daily trading volume and historical information thresholds. The index measures the extent to which (a) the stocks and any money market position outperform (b) 3-month USD LIBOR plus 0.75% per annum (accruing daily). If the index fails to outperform 3-month USD LIBOR plus 0.75% per annum (accruing daily) you will receive no return on your investment. LIBOR is being modified, see page S-18. The index rebalances annually and the weights of the stocks are based on the percentage of each stock's revenue derived from the above-referenced therapies and services, subject to a minimum weight constraint (0.1% of the index) and a maximum weight constraint (10% or less of the index).

However, with respect to each index business day the realized volatility of the stocks for a 20 index business day look-back period is calculated and, if it exceeds 7%, the index will be rebalanced for that day by ratably reallocating all or a portion of the exposure to the stocks in the index to the money market position sufficient to reduce the realized volatility for such period to 7%. Realized volatility is the degree of variation in the daily closing prices of the aggregate of the stocks included in the index during the applicable 20 index business day look-back period.

The money market position reflects the returns accruing on a hypothetical cash investment in a notional money market account denominated in U.S. dollars that accrues interest at the notional interest rate, which is equal to 3-month USD LIBOR. The index may allocate its entire exposure to the money market position, the return on which will always be less than the sum of the return on 3-month USD LIBOR plus 0.75% per annum (accruing daily).

The greater the percentage of the index allocated to the money market position, the higher the return that will be required on the stocks in order to have a return on your investment. Historically, a very significant portion (up to approximately 90%) of the index consistently has been allocated to the money market position.

If your notes are not automatically called, at maturity, for each \$1,000 face amount of your notes you will receive an amount in cash equal to:

if the index return is positive (the final level is greater than the initial level), the sum of (i) \$1,000 plus (ii) the product of (a) \$1,000 times (b) 2 times (c) the index return; or

·if the index return is zero or negative (the final level is equal to or less than the initial level), \$1,000.

You should read the disclosure herein to better understand the terms and risks of your investment, including the credit risk of GS Finance Corp. and The Goldman Sachs Group, Inc. See page S-10.

The estimated value of your notes at the time the terms of your notes are set on the trade date is equal to approximately \$924 per \$1,000 face amount. For a discussion of the estimated value and the price at which Goldman Sachs & Co. LLC would initially buy or sell your notes, if it makes a market in the notes, see the following page.

Original issue date: March 29, 2019 Original issue price: 100% of the face amount

Underwriting discount: 4.15% of the face amount Net proceeds to the issuer: 95.85% of the face amount

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense. The notes are not bank deposits and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency, nor are they obligations of, or guaranteed by, a bank.

Goldman Sachs & Co. LLC

Prospectus Supplement No. 5,280 dated March 26, 2019.

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## Table of Contents

The issue price, underwriting discount and net proceeds listed above relate to the notes we sell initially. We may decide to sell additional notes after the date of this prospectus supplement, at issue prices and with underwriting discounts and net proceeds that differ from the amounts set forth above. The return (whether positive or negative) on your investment in notes will depend in part on the issue price you pay for such notes.

GS Finance Corp. may use this prospectus in the initial sale of the notes. In addition, Goldman Sachs & Co. LLC or any other affiliate of GS Finance Corp. may use this prospectus in a market-making transaction in a note after its initial sale. Unless GS Finance Corp. or its agent informs the purchaser otherwise in the confirmation of sale, this prospectus is being used in a market-making transaction.

### Estimated Value of Your Notes

The estimated value of your notes at the time the terms of your notes are set on the trade date (as determined by reference to pricing models used by Goldman Sachs & Co. LLC (GS&Co.) and taking into account our credit spreads) is equal to approximately \$924 per \$1,000 face amount, which is less than the original issue price. The value of your notes at any time will reflect many factors and cannot be predicted; however, the price (not including GS&Co.'s customary bid and ask spreads) at which GS&Co. would initially buy or sell notes (if it makes a market, which it is not obligated to do) and the value that GS&Co. will initially use for account statements and otherwise is equal to approximately the estimated value of your notes at the time of pricing, plus an additional amount (initially equal to \$38.5 per \$1,000 face amount).

Prior to April 9, 2020, the price (not including GS&Co.'s customary bid and ask spreads) at which GS&Co. would buy or sell your notes (if it makes a market, which it is not obligated to do) will equal approximately the sum of (a) the then-current estimated value of your notes (as determined by reference to GS&Co.'s pricing models) plus (b) any remaining additional amount (the additional amount will decline to zero on a straight-line basis from the time of pricing through April 8, 2020). On and after April 9, 2020, the price (not including GS&Co.'s customary bid and ask spreads) at which GS&Co. would buy or sell your notes (if it makes a market) will equal approximately the then-current estimated value of your notes determined by reference to such pricing models.

### About Your Prospectus

The notes are part of the Medium-Term Notes, Series E program of GS Finance Corp. and are fully and unconditionally guaranteed by The Goldman Sachs Group, Inc. This prospectus includes this prospectus supplement and the accompanying documents listed below. This prospectus supplement constitutes a supplement to the documents listed below, does not set forth all the terms of your notes and therefore should be read in conjunction with such documents:

- [Prospectus supplement dated July 10, 2017](#)
- [Prospectus dated July 10, 2017](#)

The information in this prospectus supplement supersedes any conflicting information in the documents listed above. In addition, some of the terms or features described in the listed documents may not apply to your notes.

We refer to the notes we are offering by this prospectus supplement as the "offered notes" or the "notes". Each of the offered notes has the terms described below. Please note that in this prospectus supplement, references to "GS Finance Corp.", "we", "our" and "us" mean only GS Finance Corp. and do not include its subsidiaries or affiliates, references to "The Goldman Sachs Group, Inc.", our parent company, mean only The Goldman Sachs Group, Inc. and do not include its subsidiaries or affiliates and references to "Goldman Sachs" mean The Goldman Sachs Group, Inc. together with its consolidated subsidiaries and affiliates, including us. The notes will be issued under the senior debt indenture, dated as of October 10, 2008, as supplemented by the First Supplemental Indenture, dated as of February 20, 2015, each among us, as issuer, The Goldman Sachs Group, Inc., as guarantor, and The Bank of New York Mellon, as trustee. This indenture, as so supplemented and as further supplemented thereafter, is referred to as the "GSFC 2008 indenture" in the accompanying prospectus supplement. The notes will be issued in book-entry form and represented by a master global note.

Table of Contents

TERMS AND CONDITIONS

(Terms From Prospectus Supplement No. 5,280 Incorporated Into Master Note No. 2)

These terms and conditions relate to prospectus supplement no. 5,280 dated March 26, 2019 of GS Finance Corp. and The Goldman Sachs Group, Inc. with respect to the issuance by GS Finance Corp. of its Autocallable Motif Capital Aging of America 7 ER Index-Linked Notes due 2026 and the guarantee thereof by The Goldman Sachs Group, Inc.

The provisions below are hereby incorporated into master note no. 2, dated August 22, 2018. References herein to “this note” shall be deemed to refer to “this security” in such master note no. 2, dated August 22, 2018. Certain defined terms may not be capitalized in these terms and conditions even if they are capitalized in master note no. 2, dated August 22, 2018. Defined terms that are not defined in these terms and conditions shall have the meanings indicated in such master note no. 2, dated August 22, 2018, unless the context otherwise requires.

CUSIP / ISIN: 40056EZX7 / US40056EZX71

Company (Issuer): GS Finance Corp.

Guarantor: The Goldman Sachs Group, Inc.

Index: Motif Capital Aging of America 7 ER Index (current Bloomberg symbol: “MCAER Index”), or any successor index, as it may be modified, replaced or adjusted from time to time as provided herein

Face amount: \$752,000 in the aggregate on the original issue date; the aggregate face amount may be increased if the company, at its sole option, decides to sell an additional amount on a date subsequent to the trade date.

Authorized denominations: \$1,000 or any integral multiple of \$1,000 in excess thereof

Principal amount: Subject to redemption by the company as provided under “— Company’s redemption right (automatic call feature)” below, on the stated maturity date, the company will pay, for each \$1,000 of the outstanding face amount, an amount in cash equal to the cash settlement amount

Cash settlement amount:

- if the index return is positive, the sum of (i) \$1,000 plus (ii) the product of (a) \$1,000 times (b) the upside participation rate times (c) the index return; or
- if the index return is zero or negative, \$1,000.

Initial index level: 118.38

Final index level: the closing level of the index on the determination date, subject to adjustment as provided in “— Consequences of a non-trading day” and “— Discontinuance or modification of the index” below

Index return: the quotient of (i) the final index level minus the initial index level divided by (ii) the initial index level, expressed as a positive or negative percentage

Upside participation rate: 200%

Company’s redemption right (automatic call feature): If a redemption event occurs, then the outstanding face amount will be automatically redeemed in whole and the company will pay an amount in cash on the following call payment date for each \$1,000 of the outstanding face amount equal to the sum of (i) \$1,000 plus (ii) the product of \$1,000 times the applicable call return specified under “Call observation dates” below.

Redemption event: a redemption event will occur if, as measured on any call observation date, the closing level of the index is greater than or equal to the applicable call level set forth below under “— Call observation dates”

Call level: with respect to any call observation date, the applicable call level specified in the table set forth under “Call observation dates” below; as shown in such table, the call level increases the longer the notes are outstanding

Call return: with respect to any call payment date, the applicable call return specified in the table set forth under “Call observation dates” below; as shown in such table, the call return increases the longer the notes are outstanding

Call payment dates: the call payment dates are the tenth business day after each call observation date. If a call observation date is postponed as described under “— Call observation dates” below, such postponement of the call observation date will not postpone the related call payment date.

Call observation dates: the dates specified as such in the table below, commencing March 2020 and ending March 2025, unless the note calculation agent determines that such day is not a trading day. In that event, the applicable call observation date will be the first following trading day. In no event, however, will the applicable call observation date

be postponed more than five scheduled trading days. If a call observation date is postponed to the last possible day for that period, but that day is not a trading day, that day will nevertheless be the applicable call observation date.

S-3

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Table of Contents

Call Observation Date	Call Level (Expressed as a Percentage of the Initial Index Level)	Call Return
March 26, 2020	102.4%	7%
March 26, 2021	104.8%	14%
March 28, 2022	107.2%	21%
March 27, 2023	109.6%	28%
March 26, 2024	112%	35%
March 26, 2025	114.4%	42%

Trade date: March 26, 2019

Original issue date: March 29, 2019

Determination date: March 26, 2026, unless the note calculation agent determines that such day is not a trading day. In that event, the determination date will be the first following trading day. In no event, however, will the determination date be postponed by more than five scheduled trading days. If the determination date is postponed to the last possible day, but such day is not a trading day, that day will nevertheless be the determination date.

Stated maturity date: April 9, 2026, unless that day is not a business day, in which case the stated maturity date will be the next following business day. If the determination date is postponed as described under “— Determination date” above, such postponement of the determination date will not postpone the stated maturity date.

Closing level of the index: the official closing level of the index or any successor index published by the index sponsor (including any index calculation agent acting on the index sponsor’s behalf) on any trading day for the index

Level of the index: at any time on any trading day, the official level of the index or any successor index published by the index sponsor (including any index calculation agent acting on the index sponsor’s behalf) at such time on such trading day

Business day: each Monday, Tuesday, Wednesday, Thursday and Friday that is not a day on which banking institutions in New York City generally are authorized or obligated by law, regulation or executive order to close

Trading day: a day on which the index is calculated and published by the index sponsor (including any index calculation agent acting on the index sponsor’s behalf). For the avoidance of doubt, if the index calculation agent determines that an index market disruption event occurs or is continuing on any day, such day will not be a trading day. A day is a scheduled trading day with respect to the index if, as of the trade date, the index is expected to be calculated and published by the index sponsor (including any index calculation agent acting on the index sponsor’s behalf) on such day.

Index calculation agent: Solactive AG or any replacement index calculation agent

Index sponsor: at any time, the person or entity, including any successor sponsor, that determines and publishes the underlier as then in effect (current index sponsor: Motif Capital Management, Inc.). The notes are not sponsored, endorsed, sold or promoted by the index sponsor or any of its affiliates and the index sponsor and its affiliates make no representation regarding the advisability of investing in the notes.

Successor index: any substitute index approved by the note calculation agent as a successor index as provided under “— Discontinuance or modification of the index” below

Underlying stocks: with respect to the index, at any time, the stocks (and, if applicable, the exchange-traded fund) that comprise the index as then in effect, after giving effect to any additions, deletions or substitutions.

Consequences of a non-trading day: If a day that would otherwise be the applicable originally scheduled call observation date or the originally scheduled determination date, as applicable, is not a trading day, then such call observation date or the determination date, as applicable, will be postponed as described under “— Call observation dates” or “— Determination date” above.

If the note calculation agent determines that the closing level of the index is not available on the last possible applicable call observation date or the final index level is not available on the last possible determination date because of a non-trading day or for any other reason (other than as described under “— Discontinuance or modification of the index” below), then the note calculation agent will nevertheless determine the level of the index based on its assessment, made in its sole discretion, of the level of the index on that day.

Discontinuance or modification of the index: If the index sponsor discontinues publication of the index and the index sponsor or anyone else publishes a substitute index that the note calculation agent determines is comparable to the

index, or if the note calculation agent designates a substitute index, then the note calculation agent will determine the cash settlement amount payable on the stated maturity date or the amount payable on a call payment date, as applicable, by reference to the substitute index. We refer to any substitute index approved by the note calculation agent as a successor index.

If the note calculation agent determines that the publication of the index is discontinued and there is no successor index, the note calculation agent will determine the amount payable on the applicable call payment date or on the stated maturity

S-4

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Table of Contents

date, as applicable, by a computation methodology that the note calculation agent determines will as closely as reasonably possible replicate the index.

If the note calculation agent determines that the index, the underlying stocks or the method of calculating the index is changed at any time in any respect — including any split or reverse split and any addition, deletion or substitution and any reweighting or rebalancing of the index or of the underlying stocks and whether the change is made by the index sponsor under its existing policies or following a modification of those policies, is due to the publication of a successor index, is due to events affecting one or more of the underlying stocks or their issuers, or is due to any other reason — and is not otherwise reflected in the level of the index by the index sponsor pursuant to the then-current index methodology of the index, then the note calculation agent will be permitted (but not required) to make such adjustments in the index or the method of its calculation as it believes are appropriate to ensure that the level of the index used to determine the amount payable on a call payment date or the stated maturity date, as applicable, is equitable.

All determinations and adjustments to be made by the note calculation agent with respect to the index may be made by the note calculation agent in its sole discretion. The note calculation agent is not obligated to make any such adjustments.

Note calculation agent (calculation agent): Goldman Sachs & Co. LLC (“GS&Co.”)

Default amount: If an event of default occurs and the maturity of your notes is accelerated, the company will pay the default amount in respect of the principal of your notes at the maturity, instead of the amount payable on the stated maturity date as described earlier. The default amount for your notes on any day (except as provided in the last sentence under “— Default quotation period” below) will be an amount, in the specified currency for the face amount of your notes, equal to the cost of having a qualified financial institution, of the kind and selected as described below, expressly assume all of our payment and other obligations with respect to your notes as of that day and as if no default or acceleration had occurred, or to undertake other obligations providing substantially equivalent economic value to you with respect to your notes. That cost will equal:

- the lowest amount that a qualified financial institution would charge to effect this assumption or undertaking, plus the reasonable expenses, including reasonable attorneys’ fees, incurred by the holder of your notes in preparing any documentation necessary for this assumption or undertaking.

During the default quotation period for your notes, which is described below, the holder of the notes and/or the company may request a qualified financial institution to provide a quotation of the amount it would charge to effect this assumption or undertaking. If either party obtains a quotation, it must notify the other party in writing of the quotation. The amount referred to in the first bullet point above will equal the lowest — or, if there is only one, the only — quotation obtained, and as to which notice is so given, during the default quotation period. With respect to any quotation, however, the party not obtaining the quotation may object, on reasonable and significant grounds, to the assumption or undertaking by the qualified financial institution providing the quotation and notify the other party in writing of those grounds within two business days after the last day of the default quotation period, in which case that quotation will be disregarded in determining the default amount.

Default quotation period: The default quotation period is the period beginning on the day the default amount first becomes due and ending on the third business day after that day, unless:

- no quotation of the kind referred to above is obtained, or
- every quotation of that kind obtained is objected to within five business days after the day the default amount first becomes due.

If either of these two events occurs, the default quotation period will continue until the third business day after the first business day on which prompt notice of a quotation is given as described above. If that quotation is objected to as described above within five business days after that first business day, however, the default quotation period will continue as described in the prior sentence and this sentence.

In any event, if the default quotation period and the subsequent two business day objection period have not ended before the determination date, then the default amount will equal the principal amount of your notes.

Qualified financial institutions: For the purpose of determining the default amount at any time, a qualified financial institution must be a financial institution organized under the laws of any jurisdiction in the United States of America, Europe or Japan, which at that time has outstanding debt obligations with a stated maturity of one year or less from



the date of issue and that is, or whose securities are, rated either:

A-1 or higher by Standard & Poor's Ratings Services or any successor, or any other comparable rating then used by that rating agency, or

P-1 or higher by Moody's Investors Service, Inc. or any successor, or any other comparable rating then used by that rating agency.

Overdue principal rate: the effective Federal Funds rate

Defeasance: not applicable

S-5

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Table of Contents

HYPOTHETICAL EXAMPLES

The following examples are provided for purposes of illustration only. They should not be taken as an indication or prediction of future investment results and are intended merely to illustrate the impact that the various hypothetical closing levels of the index on a call observation date and on the determination date could have on the amount of cash payable on a call payment date or on the stated maturity date, as the case may be, assuming all other variables remain constant.

The examples below are based on a range of index levels that are entirely hypothetical; no one can predict what the index level will be on any day throughout the life of your notes, and no one can predict what the closing level of the index will be on any call observation date or what the final index level will be on the determination date. The index has been highly volatile in the past — meaning that the index level has changed considerably in relatively short periods — and its performance cannot be predicted for any future period.

The information in the following examples assumes that the offered notes are purchased on the original issue date at the face amount and held to a call payment date or the stated maturity date, as the case may be. If you sell your notes in a secondary market prior to the stated maturity date, your return will depend upon the market value of your notes at the time of sale, which may be affected by a number of factors that are not reflected in the examples below such as the volatility of the index, the creditworthiness of GS Finance Corp., as issuer, and the creditworthiness of The Goldman Sachs Group, Inc., as guarantor. In addition, the estimated value of your notes at the time the terms of your notes are set on the trade date (as determined by reference to pricing models used by GS&Co.) is less than the original issue price of your notes. For more information on the estimated value of your notes, see “Additional Risk Factors Specific to Your Notes — The Estimated Value of Your Notes At the Time the Terms of Your Notes Are Set On the Trade Date (as Determined By Reference to Pricing Models Used By GS&Co.) Is Less Than the Original Issue Price Of Your Notes” on page S-10 of this prospectus supplement. The information in the examples also reflects the key terms and assumptions in the box below.

Key Terms and Assumptions

Face amount \$1,000

Upside participation rate 200%

No non-trading day occurs on any originally scheduled call observation date or the originally scheduled determination date

No change in or affecting any of the underlying stocks or the method by which the index sponsor calculates the index

Notes purchased on original issue date and held to a call payment date or the stated maturity date

For these reasons, the actual performance of the index over the life of your notes, particularly on each call observation date and the determination date, as well as the amount payable on a call payment date or at maturity, may bear little relation to the hypothetical examples shown below or to the historical index performance information or hypothetical performance data shown elsewhere in this prospectus supplement. For historical index performance information and hypothetical performance data of the index during recent periods, see “The Index —Closing Levels of the Index” on page S-45. Before investing in the offered notes, you should consult publicly available information to determine the level of the index between the date of this prospectus supplement and the date of your purchase of the offered notes.

Any rate of return you may earn on an investment in the notes may be lower than that which you could earn on a comparable investment in the underlying stocks.

Also, the hypothetical examples shown below do not take into account the effects of applicable taxes. Because of the U.S. tax treatment applicable to your notes, tax liabilities could affect the after-tax rate of return on your notes to a

comparatively greater extent than the after-tax return on the underlying stocks.

S-6

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Table of Contents

Hypothetical Amount In Cash Payable on a Call Payment Date

The following examples reflect hypothetical amounts that you could receive on the applicable call payment dates. While there are six potential call payment dates with respect to your notes, the examples below only illustrate the amount you will receive, if any, on the first and second call payment date.

If, for example, your notes are automatically called on the first call observation date (i.e., on the first call observation date the closing level of the index is greater than or equal to 102.4% of the initial index level), the amount in cash that we would deliver for each \$1,000 face amount of your notes on the applicable call payment date would be the sum of \$1,000 plus the product of the applicable call return times \$1,000. Therefore, for example, if the closing level of the index on the first call observation date were determined to be 120% of the initial index level, your notes would be automatically called and the amount in cash that we would deliver on your notes on the corresponding call payment date would be 107% of the face amount of your notes or \$1,070 for each \$1,000 face amount of your notes. Even if the closing level of the index on a call observation date exceeds the applicable call level, causing the notes to be automatically called, the amount in cash payable on the call payment date will be limited due to the applicable call return.

If, for example, the notes are not automatically called on the first call observation date and are automatically called on the second call observation date (i.e., on the first call observation date the closing level of the index is less than 102.4% of the initial index level and on the second call observation date the closing level of the index is greater than or equal to 104.8% of the initial index level), the amount in cash that we would deliver for each \$1,000 face amount of your notes on the applicable call payment date would be the sum of \$1,000 plus the product of the applicable call return times \$1,000. Therefore, for example, if the closing level of the index on the second call observation date were determined to be 140% of the initial index level, your notes would be automatically called and the amount in cash that we would deliver on your notes on the corresponding call payment date would be 114% of the face amount of your notes or \$1,140 for each \$1,000 face amount of your notes. Even if the closing level of the index on a call observation date exceeds the applicable call level, causing the notes to be automatically called, the amount in cash payable on the call payment date will be limited due to the applicable call return.

Table of ContentsHypothetical Cash Settlement Amount at Maturity

If the notes are not automatically called on any call observation date (i.e., on each call observation date the closing level of the index is less than the applicable call level), the cash settlement amount we would deliver for each \$1,000 face amount of your notes on the stated maturity date will depend on the performance of the index on the determination date, as shown in the table below. The table below shows the hypothetical cash settlement amounts that we would deliver on the stated maturity date in exchange for each \$1,000 face amount of the notes if the final index level (expressed as a percentage of the initial index level) were any of the hypothetical levels shown in the left column.

The levels in the left column of the table below represent hypothetical final index levels and are expressed as percentages of the initial index level. The amounts in the right column represent the hypothetical cash settlement amounts, based on the corresponding hypothetical final index level (expressed as a percentage of the initial index level), and are expressed as percentages of the face amount of a note (rounded to the nearest one-hundredth of a percent). Thus, a hypothetical cash settlement amount of 100.00% means that the value of the cash payment that we would deliver for each \$1,000 of the outstanding face amount of the offered notes on the stated maturity date would equal 100.00% of the face amount of a note, based on the corresponding hypothetical final index level (expressed as a percentage of the initial index level) and the assumptions noted above.

The Notes Have Not Been Automatically Called

<u>Hypothetical Final Index Level</u> <u>(as Percentage of Initial Index Level)</u>	<u>Hypothetical Cash Settlement Amount</u> <u>(as Percentage of Face Amount)</u>
175.00%	250.00%
150.00%	200.00%
140.00%	180.00%
130.00%	160.00%
120.00%	140.00%
110.00%	120.00%
100.00%	100.00%
90.00%	100.00%
75.00%	100.00%
50.00%	100.00%
25.00%	100.00%
0.00%	100.00%

If, for example, the notes have not been automatically called on a call observation date and the final index level were determined to be 25.00% of the initial index level, the cash settlement amount that we would deliver on your notes at maturity would be 100.00% of the face amount of your notes, as shown in the table above. As a result, if you purchased your notes on the original issue date and held them to the stated maturity date, you would receive no return on your investment.

The following chart also shows a graphical illustration of the hypothetical cash settlement amounts (expressed as a percentage of the face amount of your notes) that we would pay on your notes on the stated maturity date, if the final index level (expressed as a percentage of the initial index level) were any of the hypothetical levels shown on the horizontal axis. The chart shows that any hypothetical final index level (expressed as a percentage of the initial index level) of less than 100.00% (the section left of the 100.00% marker on the horizontal axis) would result in a hypothetical cash settlement amount of 100.00% of the face amount of your notes.

Table of Contents

The amounts shown above are entirely hypothetical; they are based on closing levels of the index that may not be achieved on a call observation date or the determination date, as the case may be, and on assumptions that may prove to be erroneous. The actual market value of your notes on a call payment date, the stated maturity date or at any other time, including any time you may wish to sell your notes, may bear little relation to the hypothetical amounts shown above, and these amounts should not be viewed as an indication of the financial return on an investment in the offered notes. The hypothetical amounts on notes held to a call payment date or the stated maturity date, as the case may be, in the examples above assume you purchased your notes at their face amount and have not been adjusted to reflect the actual issue price you pay for your notes. The return on your investment (whether positive or negative) in your notes will be affected by the amount you pay for your notes. If you purchase your notes for a price other than the face amount, the return on your investment will differ from, and may be significantly lower than, the hypothetical returns suggested by the above examples. Please read “Additional Risk Factors Specific to Your Notes — The Market Value of Your Notes May Be Influenced by Many Unpredictable Factors” on page S-19.

Payments on the notes are economically equivalent to the amounts that would be paid on a combination of other instruments. For example, payments on the notes are economically equivalent to a combination of a zero coupon bond bought by the holder and one or more options entered into between the holder and us (with one or more implicit option premiums paid over time). The discussion in this paragraph does not modify or affect the terms of the notes or the U.S. federal income tax treatment of the notes, as described elsewhere in this prospectus supplement.

We cannot predict the actual closing levels of the index on each of the call observation dates or final index level on the determination date or what the market value of your notes will be on any particular trading day, nor can we predict the relationship between the index level and the market value of your notes at any time prior to the stated maturity date. The actual amount in cash that you will receive and the rate of return on the offered notes will depend on whether or not the notes are automatically called, the actual closing level of the index on each call observation date and the actual final index level on the determination date, each as determined by the note calculation agent as described above. Moreover, the assumptions on which the hypothetical examples are based may turn out to be inaccurate. Consequently, the amount in cash to be paid in respect of your notes on a call payment date or the stated maturity date, as the case may be, may be very different from the information reflected in the examples above.

Table of Contents

**ADDITIONAL RISK FACTORS SPECIFIC TO YOUR NOTES**

An investment in your notes is subject to the risks described below, as well as the risks and considerations described in the accompanying prospectus and in the accompanying prospectus supplement. You should carefully review these risks and considerations as well as the terms of the notes described herein and in the accompanying prospectus and the accompanying prospectus supplement. Your notes are a riskier investment than ordinary debt securities. Also, your notes are not equivalent to investing directly in any underlying stocks, i.e., the stocks comprising the index to which your notes are linked. You should carefully consider whether the offered notes are suited to your particular circumstances.

**The Estimated Value of Your Notes At the Time the Terms of Your Notes Are Set On the Trade Date (as Determined By Reference to Pricing Models Used By GS&Co.) Is Less Than the Original Issue Price Of Your Notes**

The original issue price for your notes exceeds the estimated value of your notes as of the time the terms of your notes are set on the trade date, as determined by reference to GS&Co.'s pricing models and taking into account our credit spreads. Such estimated value on the trade date is set forth above under "Estimated Value of Your Notes"; after the trade date, the estimated value as determined by reference to these models will be affected by changes in market conditions, the creditworthiness of GS Finance Corp., as issuer, the creditworthiness of The Goldman Sachs Group, Inc., as guarantor, and other relevant factors. The price at which GS&Co. would initially buy or sell your notes (if GS&Co. makes a market, which it is not obligated to do), and the value that GS&Co. will initially use for account statements and otherwise, also exceeds the estimated value of your notes as determined by reference to these models. As agreed by GS&Co. and the distribution participants, this excess (i.e., the additional amount described under "Estimated Value of Your Notes") will decline to zero on a straight line basis over the period from the date hereof through the applicable date set forth above under "Estimated Value of Your Notes". Thereafter, if GS&Co. buys or sells your notes it will do so at prices that reflect the estimated value determined by reference to such pricing models at that time. The price at which GS&Co. will buy or sell your notes at any time also will reflect its then current bid and ask spread for similar sized trades of structured notes.

In estimating the value of your notes as of the time the terms of your notes are set on the trade date, as disclosed above under "Estimated Value of Your Notes", GS&Co.'s pricing models consider certain variables, including principally our credit spreads, interest rates (forecasted, current and historical rates), volatility, price-sensitivity analysis and the time to maturity of the notes. These pricing models are proprietary and rely in part on certain assumptions about future events, which may prove to be incorrect. As a result, the actual value you would receive if you sold your notes in the secondary market, if any, to others may differ, perhaps materially, from the estimated value of your notes determined by reference to our models due to, among other things, any differences in pricing models or assumptions used by others. See "— The Market Value of Your Notes May Be Influenced by Many Unpredictable Factors" below.

The difference between the estimated value of your notes as of the time the terms of your notes are set on the trade date and the original issue price is a result of certain factors, including principally the underwriting discount and commissions, the expenses incurred in creating, documenting and marketing the notes, and an estimate of the difference between the amounts we pay to GS&Co. and the amounts GS&Co. pays to us in connection with your notes. We pay to GS&Co. amounts based on what we would pay to holders of a non-structured note with a similar maturity. In return for such payment, GS&Co. pays to us the amounts we owe under your notes.

In addition to the factors discussed above, the value and quoted price of your notes at any time will reflect many factors and cannot be predicted. If GS&Co. makes a market in the notes, the price quoted by GS&Co. would reflect any changes in market conditions and other relevant factors, including any deterioration in our creditworthiness or perceived creditworthiness or the creditworthiness or perceived creditworthiness of The Goldman Sachs Group, Inc. These changes may adversely affect the value of your notes, including the price you may receive for your notes in any market making transaction. To the extent that GS&Co. makes a market in the notes, the quoted price will reflect the estimated value determined by reference to GS&Co.'s pricing models at that time, plus or minus its then current bid and ask spread for similar sized trades of structured notes (and subject to the declining excess amount described above).

Furthermore, if you sell your notes, you will likely be charged a commission for secondary market transactions, or the price will likely reflect a dealer discount. This commission or discount will further reduce the proceeds you would receive for your notes in a secondary market sale.

There is no assurance that GS&Co. or any other party will be willing to purchase your notes at any price and, in this regard, GS&Co. is not obligated to make a market in the notes. See “— Your Notes May Not Have an Active Trading Market” below.

S-10

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## Table of Contents

### The Notes Are Subject to the Credit Risk of the Issuer and the Guarantor

Although the return on the notes will be based on the performance of the index, the payment of any amount due on the notes is subject to the credit risk of GS Finance Corp., as issuer of the notes, and the credit risk of The Goldman Sachs Group, Inc., as guarantor of the notes. The notes are our unsecured obligations. Investors are dependent on our ability to pay all amounts due on the notes, and therefore investors are subject to our credit risk and to changes in the market's view of our creditworthiness. Similarly, investors are dependent on the ability of The Goldman Sachs Group, Inc., as guarantor of the notes, to pay all amounts due on the notes, and therefore are also subject to its credit risk and to changes in the market's view of its creditworthiness. See "Description of the Notes We May Offer — Information About Our Medium-Term Notes, Series E Program — How the Notes Rank Against Other Debt" on page S-4 of the accompanying prospectus supplement and "Description of Debt Securities We May Offer — Guarantee by The Goldman Sachs Group, Inc." on page 42 of the accompanying prospectus.

### You May Receive Only the Face Amount of Your Notes at Maturity

If the index return is zero or negative on the determination date, the return on your notes will be limited to the face amount.

Even if the amount paid on your notes at maturity exceeds the face amount of your notes, the overall return you earn on your notes may be less than you would have earned by investing in a note with the same stated maturity that bears interest at the prevailing market rate.

### Your Notes Do Not Bear Interest

You will not receive any interest payments on your notes. As a result, even if the cash settlement amount payable for your notes on the stated maturity date exceeds the face amount of your notes, the overall return you earn on your notes may be less than you would have earned by investing in a non-indexed debt security of comparable maturity that bears interest at a prevailing market rate.

### The Amount In Cash That You Will Receive on a Call Payment Date or on the Stated Maturity Date is Not Linked to the Closing Level of the Index at Any Time Other Than on the Applicable Call Observation Date or the Determination Date, as the Case May Be

The amount in cash that you will receive on a call payment date, if any, will be paid only if the closing level of the index on the applicable call observation date is greater than or equal to the applicable call level. Therefore, the closing level of the index on dates other than the call observation dates will have no effect on any amount paid in respect of your notes on the call payment date. In addition, the cash settlement amount you will receive on the stated maturity date (if the notes were not previously automatically called) will be based on the closing level of the index on the determination date and, therefore, the closing level of the index on dates other than the determination date will have no effect on any cash settlement amount paid in respect of your notes on the stated maturity date. Therefore, for example, if the closing level of the index dropped precipitously on the determination date, the cash settlement amount for the notes may be significantly less than it otherwise would have been had the cash settlement amount been linked to the closing level of the index prior to such drop. Although the actual closing level of the index on the applicable call payment dates, the stated maturity date or at other times during the life of the notes may be higher than the closing level of the index on the call observation dates or the final index level on the determination date, you will not benefit from the closing level of the index at any time other than on the call observation dates or on the determination date.

### The Amount You Will Receive on a Call Payment Date Will Be Limited

Regardless of the closing level of the index on each of the call observation dates, the amount in cash that you may receive on a call payment date is limited. Even if the closing level of the index on a call observation date exceeds the applicable call level, causing the notes to be automatically called, the amount in cash payable on the call payment date will be limited due to the applicable call return. If your notes are automatically called on a call observation date, the maximum payment you will receive for each \$1,000 face amount of your notes will depend on the applicable call return.

### Your Notes Are Subject to Automatic Redemption

We will automatically call and redeem all, but not part, of your notes on a call payment date, if, as measured on any call observation date, the closing level of the index is greater than or equal to the applicable call level. Therefore, the term for your notes may be reduced and you will not receive any further payments on the notes since your notes will no longer be outstanding. You may not be able to reinvest the proceeds from an investment in the notes at a

comparable return for a similar level of risk in the event the notes are called prior to maturity.

S-11

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## Table of Contents

The Index Measures the Performance of the Total Return Index Less the Sum of the Return on the Notional Interest Rate Plus 0.75% Per Annum (Accruing Daily)

Your notes are linked to the index. The index measures the performance of the total return index, which includes the underlying stocks and, in certain circumstances, the money market position, less the sum of the return on the notional interest rate plus 0.75% per annum (accruing daily). Increases in the level of the notional interest rate may offset in whole or in part increases in the levels of the underlying stocks. As a result, any return on the index — and thus on your notes — may be reduced or eliminated, which will have the effect of reducing the amount payable in respect of your notes. The total return index must produce positive returns at least as great as the sum of the return on the notional interest rate plus 0.75% per annum (accruing daily) before the index will have a positive return. If the index fails to outperform 3-month USD LIBOR plus 0.75% per annum (accruing daily) you will receive no return on your investment.

The index, through the total return index, may allocate its entire exposure to the money market position, the return on which will always be less than the sum of the return on 3-month USD LIBOR plus 0.75% per annum (accruing daily). The greater the percentage of the index allocated to the money market position, the higher the return that will be required on the underlying stocks in order to have a return on your investment. Historically, a very significant portion (up to approximately 90%) of the index exposure consistently has been to the money market position.

The Underlying Stocks are Concentrated in the Health Care and Real Estate Sectors, With Exposure to Products and Services Used by Senior Citizens

The index is comprised of U.S. exchange-listed stocks of companies in the health care and real estate sectors that derive at least 10% of their revenue (and in some cases up to 100% of their revenue) from products and services that may benefit from the long-term demographic shift towards an older population in the United States. Because these companies are concentrated in the health care and real estate sectors, the index is more likely to be adversely affected by the negative performance of either of these sectors (particularly the health care sector) than an index that has more diversified holdings across a larger number of sectors. Beyond that, the exposure of the index at any time could be limited to the money market position.

Although your investment in the notes will not result in the ownership or other direct interest in the underlying stocks that comprise the index, the return on your investment in the notes will be subject to certain risks and other factors similar to those associated with direct investments in the sectors represented by the underlying stocks and also will be subject to reduction by the sum of the return on the notional interest rate plus 0.75% per annum (accruing daily). For example, factors affecting companies in the health care sector include government regulation, restrictions on government reimbursement for medical expenses, rising costs of medical products and services, pricing pressure (including price discounting), limited product lines, the ability to obtain and defend patents, litigation based on product liability and similar claims, industry innovation and changes in technologies or other market developments. Factors affecting companies in the real estate sector include general economic and political conditions, the availability of financing for real estate, governmental actions that affect real estate, liquidity in the real estate market and interest rates.

The Index May Not Successfully Capture Exposure to Products and Services Used by Senior Citizens or Benefit From the Long-Term Demographic Shift Towards an Older Population in the United States

The index attempts to track U.S. exchange-listed stocks of companies in the health care and real estate sectors that derive revenue from products and services that may benefit from the long-term demographic shift towards an older population in the United States, subject to a limitation on volatility. As such, each year the index is rebalanced by calculating a company's exposure to such products and services. However, there is no guarantee that the methodology the index sponsor has implemented in order to determine a company's exposure will accurately capture (i) all such companies that provide such products and services or (ii) the percentage of revenue derived from such products and services, which in turn determines a company's initial weight in the base index.

Also, the volatility control may limit the index's ability to track the performance of such companies. The index may fail to realize gains that could occur as a result of reducing the exposure of the total return index to stocks that have experienced price volatility. As a result, if market conditions do not represent a continuation of prior observed trends, the level of the index, which is rebalanced into the money market position based on prior volatility trends, may decline. No assurance can be given that the investment methodology used to construct the index will outperform any

alternative index that might be constructed from the underlying stocks. The index is different from an investment that seeks long-term exposure to a constant set of underlying stocks.

In addition, pursuant to its methodology and among other rules, the index excludes companies that derive less than 10% of their revenue from products or services that may benefit from the demographic shift towards an older population in the United States. Thus, large companies that derive significant revenue from such sources will be excluded from the

S-12

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Table of Contents

index if such revenue does not satisfy the 10% test, even if the products or services provided are critical to an older population and even if the revenue, on a dollar basis, is equal to or greater than revenue from such products or services provided by smaller companies.

Further, index market disruption events, particularly during the implementation of annual base index rebalancing, may cause the underlying stocks to be overweighted or underweighted relative to what their weight otherwise would have been and this overweighting or underweighting of underlying stocks will inform an underlying stock's weight in the index until the next annual base index rebalancing. This may further prevent the index from successfully capturing exposure to products and services used by senior citizens and also may have an adverse impact on the level of the index. See “ Index Market Disruption Events Could Affect the Level of the Index on Any Date” and “The Index Index Market Disruptions” below.

In addition, while the index attempts to track U.S. exchange-listed stocks of companies that derive revenue from products and services that may benefit from the long-term demographic shift towards an older population in the United States, any such effect may not occur during the term of the notes. Therefore, even if the products and services provided by such companies do ultimately benefit from

(11,011

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Total stockholders' equity

266,772

245,809

Total liabilities and stockholders' equity

\$

1,318,499

1,216,280

See accompanying notes to consolidated financial statements.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Comprehensive Income

Three Months Ended September 30,

(In thousands, except per share amounts)

(Unaudited)

	2014		2013	
Revenues:				
Premiums:				
Life insurance	\$45,234		42,091	
Accident and health insurance	394		380	
Property insurance	1,295		1,276	
Net investment income	10,384		9,570	
Realized investment gains (losses), net	(222	)	30	
Other income	145		269	
Total revenues	57,230		53,616	
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	17,326		16,763	
Increase in future policy benefit reserves	19,307		17,398	
Policyholders' dividends	2,573		2,362	
Total insurance benefits paid or provided	39,206		36,523	
Commissions	11,116		9,940	
Other general expenses	6,029		6,163	
Capitalization of deferred policy acquisition costs	(8,126	)	(7,067	)
Amortization of deferred policy acquisition costs	5,276		4,758	
Amortization of cost of customer relationships acquired	453		681	
Total benefits and expenses	53,954		50,998	
Income before federal income tax	3,276		2,618	
Federal income tax expense	952		794	
Net income	2,324		1,824	
Per Share Amounts:				
Basic earnings per share of Class A common stock	\$0.04		\$0.03	
Basic earnings per share of Class B common stock	0.03		0.02	
Diluted earnings per share of Class A common stock	0.04		0.03	
Diluted earnings per share of Class B common stock	0.03		0.02	
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities:				
Unrealized holding losses arising during period	(1,628	)	(4,128	)
Reclassification adjustment for (gains) losses included in net income	227		(84	)
Unrealized gains (losses) on available-for-sale securities, net	(1,401	)	(4,212	)
Income tax benefit on unrealized losses on available-for-sale securities	(490	)	(1,474	)
Other comprehensive loss	(911	)	(2,738	)
Comprehensive income (loss)	\$1,413		(914	)
See accompanying notes to consolidated financial statements.				



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Comprehensive Income

Nine Months Ended September 30,

(In thousands, except per share amounts)

(Unaudited)

	2014		2013
Revenues:			
Premiums:			
Life insurance	\$131,298		123,728
Accident and health insurance	1,135		1,135
Property insurance	3,832		3,658
Net investment income	30,373		27,224
Realized investment gains (losses), net	(351	)	143
Other income	477		882
Total revenues	166,764		156,770
Benefits and expenses:			
Insurance benefits paid or provided:			
Claims and surrenders	50,451		48,229
Increase in future policy benefit reserves	56,984		52,253
Policyholders' dividends	7,087		6,671
Total insurance benefits paid or provided	114,522		107,153
Commissions	31,429		29,427
Other general expenses	19,979		20,204
Capitalization of deferred policy acquisition costs	(22,617	)	(21,101
Amortization of deferred policy acquisition costs	15,378		13,747
Amortization of cost of customer relationships acquired	1,598		1,819
Total benefits and expenses	160,289		151,249
Income before federal income tax	6,475		5,521
Federal income tax expense	1,804		1,534
Net income	4,671		3,987
Per Share Amounts:			
Basic earnings per share of Class A common stock	\$0.09		\$0.08
Basic earnings per share of Class B common stock	0.05		0.04
Diluted earnings per share of Class A common stock	0.09		0.08
Diluted earnings per share of Class B common stock	0.05		0.04
Other comprehensive income (loss):			
Unrealized gains (losses) on available-for-sale securities:			
Unrealized holding gains (losses) arising during period	24,764		(29,576
Reclassification adjustment for (gains) losses included in net income	332		(188
Unrealized gains (losses) on available-for-sale securities, net	25,096		(29,764
Income tax expense (benefit) on unrealized gains (losses) on available-for-sale securities	8,804		(10,400
Other comprehensive income (loss)	16,292		(19,364
Comprehensive income (loss)	\$20,963		(15,377
See accompanying notes to consolidated financial statements.			





Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Cash Flows

Nine Months Ended September 30,

(In thousands)

(Unaudited)

	2014	2013	
Cash flows from operating activities:			
Net income	\$4,671	3,987	
Adjustments to reconcile net income to net cash provided by operating activities:			
Realized (gains) losses on sale of investments and other assets	351	(143	)
Net deferred policy acquisition costs	(7,239	)	(7,354
Amortization of cost of customer relationships acquired	1,598	1,819	)
Depreciation	964	955	
Amortization of premiums and discounts on investments	7,014	6,228	
Deferred federal income tax benefit	(1,140	)	(2,384
Change in:			
Accrued investment income	(915	)	(1,436
Reinsurance recoverable	64	5,161	)
Due premiums	1,182	533	
Future policy benefit reserves	56,932	47,989	
Other policyholders' liabilities	4,282	(84	)
Federal income tax receivable	201	685	
Commissions payable and other liabilities	264	(1,045	)
Other, net	(1,373	)	(581
Net cash provided by operating activities	66,856	54,330	)
Cash flows from investing activities:			
Sale of fixed maturities, available-for-sale	680	317	
Maturities and calls of fixed maturities, available-for-sale	38,658	41,054	
Maturities and calls of fixed maturities, held-to-maturity	10,523	37,213	
Purchase of fixed maturities, available-for-sale	(88,860	)	(71,818
Purchase of fixed maturities, held-to-maturity	(12,158	)	(75,386
Sale of equity securities, available-for-sale	15,029	—	)
Calls of equity securities, available-for-sale	200	400	
Purchase of equity securities, available-for-sale	(21,285	)	—
Principal payments on mortgage loans	30	829	
Increase in policy loans, net	(3,707	)	(4,366
Sale of other long-term investments	1	1	)
Purchase of other long-term investments	(4	)	(86
Sale of property and equipment	5	—	)
Purchase of property and equipment	(388	)	(386
Maturity of short-term investments	531	2,841	
Purchase of short-term investments	(531	)	(531
Net cash used in acquisition	(4,810	)	—
Net cash provided by (used in) investing activities	(66,086	)	(69,918

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Cash Flows, Continued

Nine Months Ended September 30,

(In thousands)

(Unaudited)

	2014	2013	
Cash flows from financing activities:			
Annuity deposits	\$5,479	4,293	
Annuity withdrawals	(3,856	) (3,317	)
Net cash provided by financing activities	1,623	976	
Net increase (decrease) in cash and cash equivalents	2,393	(14,612	)
Cash and cash equivalents at beginning of year	54,593	56,299	
Cash and cash equivalents at end of period	\$56,986	41,687	
Supplemental disclosures of operating activities:			
Cash paid during the period for income taxes, net	\$2,721	3,232	

## Supplemental Disclosures of Non-Cash Investing Activities:

None.

See accompanying notes to consolidated financial statements.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014

(Unaudited)

(1) Financial Statements

Basis of Presentation and Consolidation

The accompanying consolidated financial statements of Citizens, Inc. and its wholly-owned subsidiaries have been prepared in conformity with U.S. generally accepted accounting principles ("U.S. GAAP").

The consolidated financial statements include the accounts and operations of Citizens, Inc. ("Citizens"), a Colorado corporation, and its wholly-owned subsidiaries, CICA Life Insurance Company of America ("CICA"), Security Plan Life Insurance Company ("SPLIC"), Security Plan Fire Insurance Company ("SPFIC"), Citizens National Life Insurance Company ("CNLIC"), Magnolia Guaranty Life Insurance Company ("MGLIC"), Computing Technology, Inc. ("CTI") and Insurance Investors, Inc. ("III"). Citizens and its wholly-owned subsidiaries are collectively referred to as "the Company," "we," "us" or "our."

The consolidated statements of financial position for September 30, 2014, and the consolidated statements of comprehensive income for the three and nine months ended September 30, 2014 and 2013 and cash flows for the nine-month periods ended September 30, 2014 and 2013, have been prepared by the Company without audit. In the opinion of management, all adjustments to present fairly the financial position, results of operations, and changes in cash flows at September 30, 2014 and for comparative periods have been made. The consolidated financial statements have been prepared in accordance with U.S. GAAP accounting principles for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission ("SEC"). Accordingly, the financial statements do not include all of the information and footnotes required for complete financial statements and should be read in conjunction with the Company's consolidated financial statements, and notes thereto, for the year ended December 31, 2013. Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

We provide primarily life insurance and a small amount of health insurance policies through our insurance subsidiaries: CICA, SPLIC, MGLIC and CNLIC. CICA and CNLIC issue ordinary whole-life policies, credit life and disability, burial insurance, pre-need policies, and accident and health related policies, throughout the Midwest and southern United States. CICA also issues ordinary whole-life and endowment policies to non-U.S. residents. SPLIC offers final expense and home service life insurance in Louisiana, Arkansas and Mississippi and SPFIC, a wholly-owned subsidiary of SPLIC, writes a limited amount of property insurance in Louisiana. MGLIC provides industrial life policies through independent funeral homes in Mississippi.

CTI provides data processing systems and services, as well as furniture and equipment, to the Company. III provides aviation transportation to the Company.

In accordance with our purchase agreement dated October 7, 2013, we finalized the MGLIC stock acquisition on March 7, 2014 for approximately \$5.2 million in cash consideration. The assets recorded as of acquisition were \$12.0 million, liabilities of \$6.8 million and stockholders equity of \$5.2 million. We recorded goodwill of \$0.1 million related to this purchase. This entity is reported as part of our home service segment business with total revenues of \$1.7 million and net income of \$0.2 million as of September 30, 2014, and is a wholly owned subsidiary of SPLIC. We have converted the policy inforce data to our policy administration system and we are continuing the process of data validation and therefore our initial accounting is provisional. We anticipate the completion of our conversion

efforts and final accounting will be reflected in our year end reporting.

#### Use of Estimates

The preparation of financial statements, in conformity with U.S. GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

The most significant estimates include those used in the evaluation of other-than-temporary impairments on debt and equity securities and valuation allowances on investments, actuarially determined assets and liabilities and assumptions, goodwill impairment, valuation allowance on deferred tax assets, and contingencies relating to litigation and regulatory matters. Certain of these estimates are particularly sensitive to market conditions, and deterioration and/or volatility in the worldwide debt or equity markets could have a material impact on the Consolidated Financial Statements.

Reclassification

Reclassifications have been made in the current year related to certain prior year reported amounts to provide consistent presentation. No individual amounts were material.

Significant Accounting Policies

For a description of significant accounting policies, see Note 1 of the Notes to Consolidated Financial Statements included in our 2013 Form 10-K Annual Report, which should be read in conjunction with these accompanying Consolidated Financial Statements.

(2) Accounting Pronouncements

Accounting Standards Recently Adopted

On January 1, 2014, we adopted Accounting Standards Update (ASU) ASU 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" to eliminate diversity in practice. This ASU requires that companies net their unrecognized tax benefits against all same-jurisdiction net operating losses or tax credit carryforwards that would be used to settle the position with a tax authority. The adoption of this ASU did not have an effect on our consolidated financial statements.

Accounting Standards Not Yet Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process to achieve that core principle. ASU 2014-09 requires disclosures enabling users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, using one of two retrospective application methods. Early application is not permitted. The Company is currently evaluating the effect that the adoption of this ASU will have on its financial statements.



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

## (3) Segment Information

The Company has three reportable segments: Life Insurance, Home Service Insurance, and Other Non-Insurance Enterprises. The accounting policies of the segments are in accordance with U.S. GAAP and are the same as those used in the preparation of the consolidated financial statements. The Company evaluates profit and loss performance based on U.S. GAAP income before federal income taxes for its three reportable segments.

The Company has no reportable differences between segments and consolidated operations.

	Three Months Ended September 30, 2014			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	\$35,359	11,564	—	46,923
Net investment income	6,660	3,389	335	10,384
Realized investment losses, net	(159	) (63	) —	(222
Other income	130	3	12	145
Total revenue	41,990	14,893	347	57,230
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	12,205	5,121	—	17,326
Increase in future policy benefit reserves	18,314	993	—	19,307
Policyholders' dividends	2,560	13	—	2,573
Total insurance benefits paid or provided	33,079	6,127	—	39,206
Commissions	7,351	3,765	—	11,116
Other general expenses	2,464	3,227	338	6,029
Capitalization of deferred policy acquisition costs	(6,708	) (1,418	) —	(8,126
Amortization of deferred policy acquisition costs	4,449	827	—	5,276
Amortization of cost of customer relationships acquired	163	290	—	453
Total benefits and expenses	40,798	12,818	338	53,954
Income before income tax expense	\$1,192	2,075	9	3,276



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

	Nine Months Ended September 30, 2014			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	\$ 101,739	34,526	—	136,265
Net investment income	19,409	9,958	1,006	30,373
Realized investment gains (losses), net	(271	) (81	) 1	(351
Other income	406	7	64	477
Total revenue	121,283	44,410	1,071	166,764
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	34,183	16,268	—	50,451
Increase in future policy benefit reserves	54,139	2,845	—	56,984
Policyholders' dividends	7,043	44	—	7,087
Total insurance benefits paid or provided	95,365	19,157	—	114,522
Commissions	20,073	11,356	—	31,429
Other general expenses	8,269	9,895	1,815	19,979
Capitalization of deferred policy acquisition costs	(18,215	) (4,402	) —	(22,617
Amortization of deferred policy acquisition costs	13,061	2,317	—	15,378
Amortization of cost of customer relationships acquired	454	1,144	—	1,598
Total benefits and expenses	119,007	39,467	1,815	160,289
Income (loss) before income tax expense	\$ 2,276	4,943	(744	) 6,475

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

	Three Months Ended September 30, 2013			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	\$32,800	10,947	—	43,747
Net investment income	5,924	3,309	337	9,570
Realized investment gains, net	23	2	5	30
Other income	261	(7	) 15	269
Total revenue	39,008	14,251	357	53,616
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	11,249	5,514	—	16,763
Increase in future policy benefit reserves	16,756	642	—	17,398
Policyholders' dividends	2,343	19	—	2,362
Total insurance benefits paid or provided	30,348	6,175	—	36,523
Commissions	6,282	3,658	—	9,940
Other general expenses	2,780	3,205	178	6,163
Capitalization of deferred policy acquisition costs	(5,685	) (1,382	) —	(7,067
Amortization of deferred policy acquisition costs	3,947	811	—	4,758
Amortization of cost of customer relationships acquired	171	510	—	681
Total benefits and expenses	37,843	12,977	178	50,998
Income before income tax expense	\$1,165	1,274	179	2,618

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

	Nine Months Ended September 30, 2013			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	\$95,767	32,754	—	128,521
Net investment income	16,412	9,830	982	27,224
Realized investment gains, net	104	33	6	143
Other income	675	129	78	882
Total revenue	112,958	42,746	1,066	156,770
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	32,016	16,213	—	48,229
Increase in future policy benefit reserves	49,845	2,408	—	52,253
Policyholders' dividends	6,618	53	—	6,671
Total insurance benefits paid or provided	88,479	18,674	—	107,153
Commissions	18,558	10,869	—	29,427
Other general expenses	8,560	9,696	1,948	20,204
Capitalization of deferred policy acquisition costs	(16,941)	(4,160)	—	(21,101)
Amortization of deferred policy acquisition costs	11,802	1,945	—	13,747
Amortization of cost of customer relationships acquired	492	1,327	—	1,819
Total benefits and expenses	110,950	38,351	1,948	151,249
Income (loss) before income tax expense	\$2,008	4,395	(882)	5,521

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

## (4) Earnings Per Share

The following tables set forth the computation of basic and diluted earnings per share.

	Three Months Ended	
	September 30, 2014	September 30, 2013
	(In thousands, except per share amounts)	
Basic and diluted earnings per share:		
Numerator:		
Net income	\$2,324	1,824
Net income allocated to Class A common stock	\$2,301	1,806
Net income allocated to Class B common stock	23	18
Net income	\$2,324	1,824
Denominator:		
Weighted average shares of Class A outstanding - basic	49,080	49,080
Weighted average shares of Class A outstanding - diluted	49,080	49,080
Weighted average shares of Class B outstanding - basic and diluted	1,002	1,002
Basic earnings per share of Class A common stock	\$0.04	0.03
Basic earnings per share of Class B common stock	0.03	0.02
Diluted earnings per share of Class A common stock	0.04	0.03
Diluted earnings per share of Class B common stock	0.03	0.02
	Nine Months Ended	
	September 30, 2014	September 30, 2013
	(In thousands, except per share amounts)	
Basic and diluted earnings per share:		
Numerator:		
Net income	\$4,671	3,987
Net income allocated to Class A common stock	\$4,624	3,947
Net income allocated to Class B common stock	47	40
Net income	\$4,671	3,987
Denominator:		
Weighted average shares of Class A outstanding - basic	49,080	49,080
Weighted average shares of Class A outstanding - diluted	49,080	49,080
Weighted average shares of Class B outstanding - basic and diluted	1,002	1,002
Basic earnings per share of Class A common stock	\$0.09	0.08
Basic earnings per share of Class B common stock	0.05	0.04
Diluted earnings per share of Class A common stock	0.09	0.08
Diluted earnings per share of Class B common stock	0.05	0.04



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

## (5) Investments

The Company invests primarily in fixed maturity securities, which totaled 84.0% of total cash, cash equivalents and investments at September 30, 2014.

	September 30, 2014		December 31, 2013		
	Carrying Value	% of Total Carrying Value	Carrying Value	% of Total Carrying Value	
	(\$ In thousands)				
Fixed maturity securities	\$911,888	84.0	% \$832,952	83.9	%
Equity securities	55,643	5.1	% 47,259	4.8	%
Mortgage loans	641	0.1	% 671	0.1	%
Policy loans	52,575	4.8	% 48,868	4.8	%
Real estate and other long-term investments	8,310	0.8	% 8,485	0.9	%
Cash and cash equivalents	56,986	5.2	% 54,593	5.5	%
Total cash, cash equivalents and investments	\$1,086,043	100.0	% \$992,828	100.0	%

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

The following tables represent the cost, gross unrealized gains and losses and fair value for fixed maturities and equity securities as of the periods indicated.

	September 30, 2014			
	Cost or Amortized Cost (In thousands)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed maturities:				
Available-for-sale:				
U.S. Treasury securities	\$10,071	2,656	—	12,727
U.S. Government-sponsored enterprises States and political subdivisions	38,539	1,817	1	40,355
Foreign governments	384,239	15,344	2,422	397,161
Corporate	104	29	—	133
Commercial mortgage-backed	210,715	17,063	417	227,361
Residential mortgage-backed	243	8	—	251
Total available-for-sale securities	3,346	260	3	3,603
Held-to-maturity securities:	647,257	37,177	2,843	681,591
U.S. Government-sponsored enterprises	5,783	212	—	5,995
States and political subdivisions	189,125	6,072	1,098	194,099
Corporate	35,389	924	242	36,071
Total held-to-maturity securities	230,297	7,208	1,340	236,165
Total fixed maturities	\$877,554	44,385	4,183	917,756
Equity securities:				
Stock mutual funds	\$15,738	1,801	30	17,509
Bond mutual funds	35,704	—	280	35,424
Common stock	723	21	11	733
Preferred stock	1,741	236	—	1,977
Total equity securities	\$53,906	2,058	321	55,643

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

	December 31, 2013			
	Cost or	Gross	Gross	Fair
	Amortized	Unrealized	Unrealized	Value
	Cost	Gains	Losses	
	(In thousands)			
Fixed maturities:				
Available-for-sale securities:				
U.S. Treasury securities	\$10,115	2,348	—	12,463
U.S. Government-sponsored enterprises	53,587	1,209	228	54,568
States and political subdivisions	341,673	6,242	11,449	336,466
Foreign governments	104	23	—	127
Corporate	186,671	12,289	1,399	197,561
Commercial mortgage-backed	300	9	—	309
Residential mortgage-backed	3,494	270	2	3,762
Total available-for-sale securities	595,944	22,390	13,078	605,256
Held-to-maturity securities:				
U.S. Government-sponsored enterprises	8,877	197	3	9,071
States and political subdivisions	181,246	1,633	6,412	176,467
Corporate	37,573	771	349	37,995
Total held-to-maturity securities	227,696	2,601	6,764	223,533
Total fixed maturity securities	\$823,640	24,991	19,842	828,789
Equity securities:				
Stock mutual funds	\$10,463	1,506	—	11,969
Bond mutual funds	35,080	—	417	34,663
Common stock	17	—	5	12
Preferred stock	323	292	—	615
Total equity securities	\$45,883	1,798	422	47,259

Mortgage-backed securities are also referred to as securities not due at a single maturity date throughout this report. The majority of the Company's equity securities are diversified stock and bond mutual funds.

## Valuation of Investments in Fixed Maturity and Equity Securities

Held-to-maturity securities are reported in the financial statements at amortized cost and available-for-sale securities are reported at fair value.

The Company monitors all debt and equity securities on an on-going basis relative to changes in credit ratings, market prices, earnings trends and financial performance, in addition to specific region or industry reviews. The assessment of whether impairments have occurred is based on a case-by-case evaluation of underlying reasons for the decline in fair value. The Company determines other-than-temporary impairment by reviewing relevant evidence related to the specific security issuer as well as the Company's intent to sell the security, or if it is more likely than not that the Company would be required to sell a security before recovery of its amortized cost.

When an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be



required to sell the security before recovery of its amortized cost basis. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the investment's cost and its fair value at the balance sheet date. If the Company does not intend to sell

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

the security and it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is separated into the following: (a) the amount representing the credit loss; and (b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings becomes the new amortized cost basis of the investment. The new amortized cost basis is not adjusted for subsequent recoveries in fair value.

The Company evaluates whether a credit impairment exists for debt securities by considering primarily the following factors: (a) changes in the financial condition of the security's underlying collateral; (b) whether the issuer is current on contractually obligated interest and principal payments; (c) changes in the financial condition, credit rating and near-term prospects of the issuer; (d) the length of time to which the fair value has been less than the amortized cost of the security; and (e) the payment structure of the security. The Company's best estimate of expected future cash flows used to determine the credit loss amount is a quantitative and qualitative process. Quantitative review includes information received from third party sources such as financial statements, pricing and rating changes, liquidity and other statistical information. Qualitative factors include judgments related to business strategies, economic impacts on the issuer and overall judgment related to estimates and industry factors. The Company's best estimate of future cash flows involves assumptions including, but not limited to, various performance indicators, such as historical and projected default and recovery rates, credit ratings, and current delinquency rates. These assumptions require the use of significant management judgment and include the probability of issuer default and estimates regarding timing and amount of expected recoveries, which may include estimating the underlying collateral value. In addition, projections of expected future debt security cash flows may change based upon new information regarding the performance of the issuer.

The primary factors considered in evaluating whether an impairment exists for an equity security include, but are not limited to: (a) the length of time and the extent to which the fair value has been less than the cost of the security; (b) changes in the financial condition, credit rating and near-term prospects of the issuer; (c) whether the issuer is current on contractually obligated payments; and (d) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery.

The Company recognized other-than-temporary impairments during the three and nine months ended September 30, 2014 of \$0.3 million based upon the fact that there is no longer an intent to hold these securities. No other-than-temporary impairments were recognized during the three and nine months ended in 2013.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

The following tables present the fair values and gross unrealized losses of fixed maturities and equity securities that have remained in a continuous unrealized loss position for the periods indicated.

	September 30, 2014								
	Less than 12 months			Greater than 12 months			Total		
	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities
(In thousands, except for # of securities)									
Fixed maturities:									
Available-for-sale securities:									
U.S.									
Government-sponsored enterprises	\$159	1	1	—	—	—	159	1	1
States and political subdivisions	46,146	508	50	58,380	1,914	50	104,526	2,422	100
Corporate	22,950	324	21	2,681	93	2	25,631	417	23
Residential mortgage-backed	169	2	7	82	1	2	251	3	9
Total available-for-sale securities	69,424	835	79	61,143	2,008	54	130,567	2,843	133
Held-to-maturity securities:									
States and political subdivisions	14,143	93	13	43,699	1,005	45	57,842	1,098	58
Corporate	2,368	178	2	2,958	64	2	5,326	242	4
Total held-to-maturity securities	16,511	271	15	46,657	1,069	47	63,168	1,340	62
Total fixed maturities	\$85,935	1,106	94	107,800	3,077	101	193,735	4,183	195
Equity securities:									
Stock mutual funds	\$1,970	30	2	—	—	—	1,970	30	2
Bond mutual funds	15,720	280	2	—	—	—	15,720	280	2
Common stocks	—	—	—	6	11	1	6	11	1
Preferred stocks	—	—	—	—	—	—	—	—	—
Total equities	\$17,690	310	4	6	11	1	17,696	321	5

As of September 30, 2014, the Company had 54 available-for-sale securities and 47 held-to-maturity securities that were in an unrealized loss position for greater than 12 months. We reported 1 common stock holding in an unrealized loss position for greater than 12 months as of September 30, 2014.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

	December 31, 2013								
	Less than 12 months			Greater than 12 months			Total		
	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities
	(In thousands, except for # of securities)								
Fixed maturities:									
Available-for-sale securities:									
U.S.									
Government-sponsored enterprises	\$14,032	228	12	—	—	—	14,032	228	12
States and political subdivisions	183,280	9,872	203	15,673	1,577	16	198,953	11,449	219
Corporate	35,789	1,048	25	2,426	351	2	38,215	1,399	27
Residential mortgage-backed	57	1	3	42	1	1	99	2	4
Total available-for-sale securities	233,158	11,149	243	18,141	1,929	19	251,299	13,078	262
Held-to-maturity securities:									
U.S.									
Government-sponsored enterprises	2,997	3	1	—	—	—	2,997	3	1
States and political subdivisions	100,153	5,236	118	14,797	1,176	17	114,950	6,412	135
Corporate	5,225	349	4	—	—	—	5,225	349	4
Total held-to-maturity securities	108,375	5,588	123	14,797	1,176	17	123,172	6,764	140
Total fixed maturities	\$341,533	16,737	366	32,938	3,105	36	374,471	19,842	402
Equity securities:									
Bond mutual funds	\$34,663	417	7	—	—	—	34,663	417	7
Common stock	12	5	1	—	—	—	12	5	1
Total equities	\$34,675	422	8	—	—	—	34,675	422	8

We have reviewed these securities for the periods ended September 30, 2014 and December 31, 2013 and determined that no other-than-temporary impairment exists that have not been recognized based on our evaluation of the credit worthiness of the issuers and the fact that we do not intend to sell the investments nor is it likely that we will be required to sell the securities before recovery of their amortized cost bases which may be maturity. We continue to monitor all securities on an on-going basis, and future information may become available which could result in impairments being recorded.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

The amortized cost and fair value of fixed maturity securities at September 30, 2014 by contractual maturity are shown in the table below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date have been reflected based upon final stated maturity.

	September 30, 2014	
	Amortized Cost	Fair Value
	(In thousands)	
Available-for-sale securities:		
Due in one year or less	\$35,959	36,529
Due after one year through five years	112,116	118,976
Due after five years through ten years	92,456	97,519
Due after ten years	406,726	428,567
Total available-for-sale securities	647,257	681,591
Held-to-maturity securities:		
Due in one year or less	18,069	18,198
Due after one year through five years	24,252	24,927
Due after five years through ten years	56,641	58,762
Due after ten years	131,335	134,278
Total held-to-maturity securities	230,297	236,165
Total fixed maturities	\$877,554	917,756

The Company uses the specific identification method of the individual security to determine the cost basis used in the calculation of realized gains and losses related to security sales. Proceeds and gross realized gains and losses from sales of securities for the three and nine months ended September 30, 2014 and 2013 are summarized as follows.

	Fixed Maturities Available-for-Sale				Equity Securities			
	Three Months Ended September 30,		Nine Months Ended September 30,		Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013	2014	2013	2014	2013
	(In thousands)							
Proceeds	\$100	259	680	317	3,924	—	15,029	—
Gross realized gains	\$5	7	26	8	55	—	118	—
Gross realized losses	\$—	1	—	1	—	—	169	—

There was 1 equity bond mutual fund sold at a loss during the nine month period ended September 30, 2014 as higher yielding bond mutual fund alternatives became more attractive than these U.S. Government backed funds as circumstances changed in the current environment. There were no sales for the three and nine month periods in 2013. There were no securities sold from the held-to-maturity portfolio for the three and nine months ended September 30, 2014 or 2013.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

(6) Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We hold available-for-sale fixed maturity securities and equity securities, which are carried at fair value.

Fair value measurements are generally based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our view of market assumptions in the absence of observable market information. We utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. All assets and liabilities carried at fair value are required to be classified and disclosed in one of the following three categories:

Level 1 - Quoted prices for identical instruments in active markets.

Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs or whose significant value drivers are observable.

Level 3 - Instruments whose significant value drivers are unobservable.

Level 1 primarily consists of financial instruments whose value is based on quoted market prices such as U.S. Treasury securities and actively traded mutual fund and stock investments.

Level 2 includes those financial instruments that are valued by independent pricing services or broker quotes. These models are primarily industry-standard models that consider various inputs, such as interest rates, credit spreads and foreign exchange rates for the underlying financial instruments. All significant inputs are observable, or derived from observable information in the marketplace or are supported by observable levels at which transactions are executed in the marketplace. Financial instruments in this category primarily include corporate securities, U.S. Government-sponsored enterprise securities, municipal securities and certain mortgage and asset-backed securities.

Level 3 is comprised of financial instruments whose fair value is estimated based on non-binding broker prices utilizing significant inputs not based on or corroborated by readily available market information. This category consists of two private placement mortgage-backed securities.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

The following tables set forth our assets and liabilities that are measured at fair value on a recurring basis as of the dates indicated.

Available-for-sale investments	September 30, 2014			Total Fair Value
	Level 1	Level 2	Level 3	
	(In thousands)			
Financial assets:				
Fixed maturities:				
U.S. Treasury and U.S. Government-sponsored enterprises	\$ 12,727	40,355	—	53,082
States and political subdivisions	—	397,161	—	397,161
Corporate	—	227,361	—	227,361
Commercial mortgage-backed	—	—	251	251
Residential mortgage-backed	—	3,603	—	3,603
Foreign governments	—	133	—	133
Total fixed maturities	12,727	668,613	251	681,591
Equity securities:				
Stock mutual funds	17,509	—	—	17,509
Bond mutual funds	35,424	—	—	35,424
Common stock	733	—	—	733
Preferred stock	1,977	—	—	1,977
Total equity securities	55,643	—	—	55,643
Total financial assets	\$68,370	668,613	251	737,234
	December 31, 2013			
Available-for-sale investments	Level 1	Level 2	Level 3	Total Fair Value
	(In thousands)			
Financial assets:				
Fixed maturities:				
U.S. Treasury and U.S. Government-sponsored enterprises	\$ 12,463	54,568	—	67,031
States and political subdivisions	—	336,466	—	336,466
Corporate	—	197,561	—	197,561
Commercial mortgage-backed	—	—	309	309
Residential mortgage-backed	—	3,762	—	3,762
Foreign governments	—	127	—	127
Total fixed maturities	12,463	592,484	309	605,256
Equity securities:				
Stock mutual funds	11,969	—	—	11,969
Bond mutual funds	34,663	—	—	34,663
Common stock	12	—	—	12
Preferred stock	615	—	—	615
Total equity securities	47,259	—	—	47,259
Total financial assets	\$59,722	592,484	309	652,515





Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

## Financial Instruments Valuation

Fixed maturity securities, available-for-sale. At September 30, 2014, our fixed maturity securities, valued using a third-party pricing source, totaled \$668.6 million for Level 2 assets and comprised 90.7% of total reported fair value of our financial assets. The Level 1 and Level 2 valuations are reviewed and updated quarterly through random testing by comparisons to separate pricing models, other third-party pricing services, and back tested to recent trades. In addition, we obtain information relative to the third-party pricing models and review model parameters for reasonableness. Fair values for Level 3 assets are based upon unadjusted broker quotes that are non-binding, and consist of two private placement mortgage-backed securities with a total value of \$0.3 million. Our Level 3 assets are current relative to principal and interest payments and are considered immaterial to our financial statements. For the nine months ended September 30, 2014, there were no material changes to the valuation methods or assumptions used to determine fair values, and no broker or third party prices were changed from the values received.

Equity securities, available-for-sale. Our available-for-sale equity securities are classified as Level 1 assets as their fair values are based upon quoted market prices.

The following table presents additional information about fixed maturity securities measured at fair value on a recurring basis that are classified as Level 3 assets and for which we have utilized significant unobservable inputs to determine fair value.

	September 30, 2014	December 31, 2013
	(In thousands)	
Balance at beginning of period	\$ 309	387
Total realized and unrealized gains (losses)		
Included in net income	—	—
Included in other comprehensive income	(1	) (7
Principal paydowns	(57	) (71
Transfer in and (out) of Level 3	—	—
Balance at end of period	\$ 251	309

We review the fair value hierarchy classifications each reporting period. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets. Such reclassifications are reported as transfers in and out of Level 3 at the beginning fair value for the reporting period in which the changes occur. There were no transfers in or out of Level 1 or 2.

## Financial Instruments not Carried at Fair Value

Estimates of fair values are made at a specific point in time, based on relevant market prices and information about the financial instruments. The estimated fair values of financial instruments presented below are not necessarily indicative of the amounts the Company might realize in actual market transactions.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

The carrying amount and fair value for the financial assets and liabilities on the consolidated balance sheets not otherwise disclosed for the periods indicated are as follows:

	September 30, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(In thousands)			
Financial assets:				
Fixed maturities, held-to-maturity	\$230,297	236,165	227,696	223,533
Mortgage loans	641	664	671	695
Policy loans	52,575	52,575	48,868	48,868
Cash and cash equivalents	56,986	56,986	54,593	54,593
Financial liabilities:				
Annuity - investment contracts	42,112	45,202	39,469	44,960

Fair values for fixed income securities, which are characterized as Level 2 assets in the fair value hierarchy, are based on quoted market prices for the same or similar securities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other assumptions, including a discount rate and estimates of future cash flows.

Mortgage loans are secured principally by residential and commercial properties. Weighted average interest rates for these loans were approximately 6.3% as of September 30, 2014 and December 31, 2013, with maturities ranging from 1 to 30 years. Management estimated the fair value using an annual interest rate of 6.25% at September 30, 2014. Our mortgage loans are considered Level 3 assets in the fair value hierarchy.

Policy loans had a weighted average annual interest rate of 7.7% as of September 30, 2014 and December 31, 2013, and no specified maturity dates. The aggregate fair value of policy loans approximates the carrying value reflected on the consolidated balance sheets. These loans typically carry an interest rate that is tied to the crediting rate applied to the related policy and contract reserves. Policy loans are an integral part of the life insurance policies we have in force, cannot be valued separately and are not marketable. Therefore, the fair value of policy loans approximates the carrying value and policy loans are considered Level 3 assets in the fair value hierarchy.

The fair value of short-term investments approximate carrying value due to their short-term nature. Our short-term investments are considered Level 2 assets in the fair value hierarchy.

The fair value of cash and cash equivalents approximate carrying value and are characterized as Level 1 assets in the fair value hierarchy.

The fair value of the Company's liabilities under annuity contract policies, which are considered Level 3 assets, was estimated at September 30, 2014 using discounted cash flows based upon a swap rate curve with interest rates ranging from 1.02% to 4.88% based upon swap rates adjusted for various risk adjustments. The fair value of liabilities under all insurance contracts are taken into consideration in the overall management of interest rate risk, which seeks to minimize exposure to changing interest rates through the matching of investment maturities with amounts due under insurance contracts.

## (7) Commitments and Contingencies

The Company is currently performing an internal audit related to unclaimed property for all legal reporting entities. Based upon internal findings to date our exposure appears to be primarily in the state of Louisiana, related to conversion processes surrounding the SPLIC acquisition. The Company had been informed by the Louisiana Department of Treasury, Arkansas Auditor of State and

25

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Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

the Texas State Comptroller, that they authorized an audit of Citizens, Inc. and its affiliates for compliance with unclaimed property laws. This audit is being conducted by Verus Financial LLC on behalf of the states.

These internal and external audits may result in additional payments to beneficiaries, additional escheatment of funds deemed abandoned under state laws, administrative penalties, interest, and changes to the Company's procedures for the identification and escheatment of abandoned property. The Company believes additional escheatment of funds in Arkansas or Texas will not be material to our financial condition or results. However, additional escheatment of funds in Louisiana, which may subsequently be deemed abandoned under the Louisiana Department of Treasury's audit, could be substantial for SPLIC if the Louisiana Department of Treasury chooses to disregard recent unclaimed property litigation in favor of the insurance industry. At this time, the Company is not able to estimate any of these possible amounts. For more information about the risks related to these external unclaimed property audits please see the Risk Factor in Item 1A titled "We are a defendant in lawsuits, which may adversely affect our financial condition and detract from the time our management is able to devote to our business, and we are subject to risks related to litigation and regulatory matters."

From time to time we are subject to legal and regulatory actions relating to our business. We defend all claims vigorously. As a result, we incur defense costs, including attorneys' fees, other direct litigation costs and the expenditure of management time that otherwise would be devoted to our business. For more information about the risks related to the Company's litigation, please see "Item 1 Legal Proceedings" and the risk factor titled "We are a defendant in lawsuits, which may adversely affect our financial condition and detract from the time our management is able to devote to our business, and we are subject to risks related to litigation and regulatory matters." in Item 1A. Risk Factors.

(8) Income Taxes

The effective tax rate was 29.1% and 30.3% for the three months and 27.9% and 27.8% for the nine months of 2014 and 2013, respectively. In periods where our effective tax rate is lower than the statutory tax rate of 35%, the difference is primarily due to tax-exempt state and local bonds. The effective tax rate has remained relatively flat from year to year.

(9) Related Party Transactions

The Company has various routine related party transactions in conjunction with our holding company structure, such as a management service agreement related to costs incurred, a tax sharing agreement between entities, and inter-company dividends and capital contributions. There were no changes related to these relationships during the nine months ended September 30, 2014. See our Annual Report on Form 10-K as of December 31, 2013 for a comprehensive discussion of related party transactions.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-Q 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 us 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," "assumes," "estimates," "plans," "projects," "could," "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 are subject to known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those contemplated by the forward-looking statements. Factors that could cause the Company's future results to differ materially from expected results include, but are not limited to:

- Changes in foreign and U.S. general economic, market, and political conditions, including the performance of financial markets and interest rates;
- Changes in consumer behavior, which may affect the Company's ability to sell its products and retain business;
- The timely development of and acceptance of new products of the Company and perceived overall value of these products and services by existing and potential customers;
- Fluctuations in experience regarding current mortality, morbidity, persistency and interest rates relative to expected amounts used in pricing and actuarial valuation of the Company's products;
- The performance of our investment portfolio, which may be adversely affected by changes in interest rates, adverse developments and ratings of issuers whose debt securities we may hold, and other adverse macroeconomic events;
- Results of litigation we may be involved in;
- Changes in assumptions related to deferred acquisition costs and the value of any businesses we may acquire;
- Regulatory, accounting or tax changes that may affect the cost of, or the demand for, the Company's products or services;
- Our concentration of business from persons residing in Latin America and the Pacific Rim;
- Changes in tax laws;
- Effects of acquisitions and restructuring, including possible difficulties in integrating and realizing the projected results of acquisitions;
- Changes in statutory or U.S. GAAP accounting principles, policies or practices; and
- Our success at managing risks involved in the foregoing; and
- The risk factors discussed in "Part II. - Item 1A - Risk Factors." of this report

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.

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

27

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Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

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 Quarterly Report on Form 10-Q.

Overview

Citizens is an insurance holding company serving the life insurance needs of individuals in the United States since 1969 and internationally since 1975. Through our insurance subsidiaries, we pursue a strategy of offering traditional insurance products in niche markets where we believe we are able to achieve competitive advantages. As of September 30, 2014, we had approximately \$1.3 billion of total assets and approximately \$5.0 billion of insurance in force. Our core insurance operations include issuing and servicing:

U.S. Dollar-denominated ordinary whole life insurance and endowment policies predominantly to high net worth, high income residents of foreign countries, principally in Latin America and the Pacific Rim through independent marketing consultants;  
ordinary whole life insurance policies to middle income households concentrated in the Midwest and southern United States through independent marketing consultants; and  
final expense and limited liability property policies to middle and lower income households in Louisiana, Arkansas and Mississippi through employee and independent agents in our home service distribution channel and funeral homes.

We were formed in 1969 by our Chairman, Harold E. Riley. Prior to our formation, Mr. Riley had many years of experience in the international and domestic life insurance business. Our Company has experienced significant growth through acquisitions in the domestic market and through market expansion in the international market. We seek to capitalize on the experience of our management team in marketing and operations as we strive to generate bottom line return using knowledge of our niche markets and our well-established distribution channels. We believe our underwriting processes, policy terms, pricing practices and proprietary administrative systems enable us to be competitive in our current markets, while protecting our shareholders and servicing our policyholders.

Current Financial Highlights

Financial highlights for the three and nine month periods ended September 30, 2014, compared to the same periods in 2013 were:

Insurance premiums rose for the three and nine month periods ended September 30, 2014 to \$46.9 million and \$136.3 million in 2014 from \$43.7 million and \$128.5 million for the corresponding periods in 2013, an increase of 7.3% and 6.0% driven primarily from first year and renewal premiums in our life insurance segment.

Net investment income increased 8.5% and 11.6% for the three and nine month periods ended September 30, 2014 compared to the corresponding periods in 2013. The average yield on the consolidated portfolio as of the nine months ended September 30, 2014 increased to an annualized rate of 4.22% up from 4.10% for the same period in 2013.

Claims and surrenders expense increased 3.4% and 4.6% for the three and nine months ended in 2014 compared to 2013 as surrender benefits reported in both insurance segments increased in the current year compared to 2013 levels.

Changes in reserves resulted in liability increases due to the increased sales of endowment products that build up reserves at a faster pace than whole life longer-term mortality based products.

We completed the acquisition of MGLIC in the first quarter and the related results have been included in our financial results for September 30, 2014. MGLIC is now a wholly owned subsidiary of SPLIC and is reported with the home service segment.





Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

## Our Operating Segments

Our business is comprised of three operating business segments, as detailed below.

- ☒ Life Insurance

- ☒ Home Service Insurance

- Other Non-Insurance Enterprises

Our insurance operations are the primary focus of the Company, as those operations generate the majority of our income. See the discussion under Segment Operations for detailed analysis. The amount of insurance, number of policies, and average face amounts of ordinary life policies issued during the periods indicated are shown below.

	Nine Months Ended September 30, 2014			2013		
	Amount of Insurance Issued	Number of Policies Issued	Average Policy Face Amount Issued	Amount of Insurance Issued	Number of Policies Issued	Average Policy Face Amount Issued
Life	\$272,101,881	4,546	\$59,855	\$262,191,318	4,418	\$59,346
Home Service	146,472,655	21,830	6,710	141,523,143	20,617	6,864

Note: All discussions below compare or state results for the three and nine-month periods ended September 30, 2014 compared to the three and nine-month periods ended September 30, 2013.

## Consolidated Results of Operations

A discussion of consolidated results is presented below, followed by a discussion of segment operations and financial results by segment.

## Revenues

Revenues are generated primarily by insurance premiums and investment income on invested assets.

	Three Months Ended September 30, 2014		Nine Months Ended September 30, 2014	
	2014	2013	2014	2013
(In thousands)				
Revenues:				
Premiums:				
Life insurance	\$45,234	42,091	\$131,298	123,728
Accident and health insurance	394	380	1,135	1,135
Property insurance	1,295	1,276	3,832	3,658
Net investment income	10,384	9,570	30,373	27,224
Realized investment gains (losses), net	(222	) 30	(351	) 143
Other income	145	269	477	882
Total revenues	\$57,230	53,616	\$166,764	156,770

Premium Income. Premium income derived from life, accident and health, and property insurance sales increased 7.3% and 6.0% for the three and nine month periods ended September 30, 2014 compared to the same periods ended September 30, 2013. The increase is generated primarily from an increase in the life segment first year and renewal business and premium income of \$1.4 million recorded due to the acquisition of MGLIC.

Net investment income performance is summarized as follows.

	September 30, 2014	December 31, 2013	September 30, 2013	
	(In thousands, except for %)			
Net investment income, annualized	\$40,498	36,597	36,299	
Average invested assets, at amortized cost	960,266	891,215	886,157	
Annualized yield on average invested assets	4.22	% 4.11	% 4.10	%

Yields have been slowly rising as we reinvest calls and new premium money into higher yielding bonds compared to the historically low rates experienced over the past several years.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Investment income from debt securities accounted for approximately 85.3% of total investment income for the nine months ended September 30, 2014.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Gross investment income:				
Fixed maturity securities	\$9,189	8,634	\$27,317	24,330
Equity securities	510	420	1,356	1,345
Mortgage loans	10	10	32	58
Policy loans	1,049	956	3,080	2,660
Long-term investments	73	60	218	170
Other investment income	12	12	36	50
Total investment income	10,843	10,092	32,039	28,613
Investment expenses	(459	) (522	) (1,666	) (1,389
Net investment income	\$10,384	9,570	\$30,373	27,224

The consolidated invested asset portfolio has increased approximately 9.7% from year end 2013 to September 30, 2014 with, primarily, investments in the fixed maturity securities portfolio accounting for the most significant increase in investment income. Bond mutual funds are the primary source of dividend income in the equity securities holdings. In addition, the increase in policy loans, which represents policyholders utilizing their accumulated policy cash value, contributed to the increase to investment income.

Realized Investment Gains (Losses), Net. Losses of \$0.3 million were recorded in the current three month period due to other than temporary impairments that were recognized related to 2 short-term bond mutual fund issues that we anticipate disposing of in the near future if interest rates rise. In addition, we have sold three bond mutual fund issues totaling \$15.0 million that resulted in a net loss of \$51,000 for the nine months ended September 30, 2014. In addition, the nine month results in 2014 also include sinking par calls on bonds purchased at a premium which resulted in a loss. The losses are offset by issuer calls and redemptions that result in gains.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

## Benefits and Expenses

	Three Months Ended September 30, 2014		Nine Months Ended September 30, 2014	
	2013	2013	2013	2013
	(In thousands)			
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	\$17,326	16,763	\$50,451	48,229
Increase in future policy benefit reserves	19,307	17,398	56,984	52,253
Policyholders' dividends	2,573	2,362	7,087	6,671
Total insurance benefits paid or provided	39,206	36,523	114,522	107,153
Commissions	11,116	9,940	31,429	29,427
Other general expenses	6,029	6,163	19,979	20,204
Capitalization of deferred policy acquisition costs	(8,126)	(7,067)	(22,617)	(21,101)
Amortization of deferred policy acquisition costs	5,276	4,758	15,378	13,747
Amortization of cost of customer relationships acquired	453	681	1,598	1,819
Total benefits and expenses	\$53,954	50,998	\$160,289	151,249

Claims and Surrenders. A detail of claims and surrender benefits is provided below.

	Three Months Ended September 30, 2014		Nine Months Ended September 30, 2014	
	2013	2013	2013	2013
	(In thousands)			
Death claims	\$5,039	5,494	\$16,581	16,418
Surrender benefits	7,091	6,028	18,141	16,525
Endowments	4,023	3,927	12,110	11,515
Property claims	439	613	1,153	1,582
Accident and health benefits	111	117	386	284
Other policy benefits	623	584	2,080	1,905
Total claims and surrenders	\$17,326	16,763	\$50,451	48,229

Death claims decreased 8.3% and increased slightly for the three and nine months ended September 30, 2014 as we experienced favorable claims development in the current quarter for both the life and home service segments.

Mortality experience is closely monitored by the Company and the activity is within expected levels.

Surrenders increased by 17.6% and 9.8% in the three and nine periods primarily due to activity in the life segment.

Increase in Future Policy Benefit Reserves. The increase in future policy benefit reserves for the three and nine months ended September 30, 2014, is due to continued growth in new sales of endowment products, which require higher initial reserve levels than whole life products. Endowments have been our top selling products for the last several years as policyholders favor the guaranteed values of this product.

Policyholder Dividends. The majority of our international policies are participating, and the dividends are factored into the premium rates charged. As policy provisioned dividend rates generally increase each year that a policy is in force, dividend expense is expected to increase as this block of insurance becomes more seasoned.



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Commissions. Commission expense is directly related to new and renewal insurance premium fluctuations and production levels by agents and associates. Commission expense for the three and nine months ended September 30, 2014 fluctuated directly in relation to the decrease and increase of first year and renewal premiums in the life segment compared to premium levels for the three and nine months ended September 30, 2013.

Capitalized and Amortized Deferred Policy Acquisition Costs. Costs capitalized under current accounting guidance include certain commissions, policy issuance costs, and underwriting and agency expenses that relate to successful sales efforts for insurance contracts. The increase for the three and nine months ended September 30, 2014, compared to the same periods in 2013 was the result of an increase in first year premium production in the current periods, which increased capitalized amounts. Though premium revenue increased in 2014, it was primarily related to an increase in renewal premiums compared to the prior year. Commissions paid on renewal premiums are significantly lower than those paid on first year business.

Amortization for the three and nine months ended September 30, 2014, increased compared to the same periods in 2013. Amortization of deferred policy acquisition costs is impacted by persistency and may fluctuate from year to year.

Federal Income Tax. The effective tax rate was 29.1% and 30.3% for the three months and 27.9% and 27.8% for the nine months ended September 30, 2014 and 2013, respectively. Differences between our effective tax rate and the statutory tax rate result from income and expense items that are treated differently for financial reporting and tax purposes. See Note 8 - Income Taxes in the consolidated financial statements for further discussion.

## Segment Operations

The Company has three reportable segments: Life Insurance, Home Service Insurance and Other Non-Insurance Enterprises. These segments are reported in accordance with U.S. GAAP. The Company evaluates profit and loss performance of its segments based on net income or loss before income taxes.

	Three Months Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
	(In thousands)			
Life Insurance	\$1,192	1,165	\$2,276	2,008
Home Service Insurance	2,075	1,274	4,943	4,395
Other Non-Insurance Enterprises	9	179	(744	) (882
Total	\$3,276	2,618	\$6,475	5,521

## Life Insurance

Our Life Insurance segment issues ordinary whole life insurance domestically and U.S. Dollar-denominated ordinary whole-life policies to foreign residents. These contracts are designed to provide a fixed amount of insurance coverage over the life of the insured. Additionally, the Company issues endowment contracts, which are principally accumulation contracts that incorporate an element of life insurance protection. For the majority of our business, we retain only the first \$100,000 of risk on any one life. We operate this segment through our CICA and CNLIC insurance subsidiaries.



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

International Sales

We focus our sales of U.S. Dollar-denominated ordinary whole life insurance and endowment policies to high net worth, high income residents in Latin America and the Pacific Rim. We have successfully participated in the foreign marketplace since 1975, and we continue to seek opportunities for expansion of our foreign operations. We believe positive attributes of our international insurance business include:

- larger face amount policies typically issued when compared to our U.S. operations, which results in lower underwriting and administrative costs per unit of coverage;
- premiums typically paid annually rather than monthly or quarterly, which reduces our administrative expenses, accelerates cash flow and results in lower policy lapse rates than premiums with more frequently scheduled payments; and
- comparable persistency levels and mortality rates as experienced with U.S. policies.

International Products

We offer several ordinary whole life insurance and endowment products designed to meet the needs of our non-U.S. policyowners. These policies have been structured to provide:

- U.S. Dollar-denominated cash values that accumulate, beginning in the first policy year, to a policyholder during his or her lifetime;
- premium 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 investment in the United States' more secure economic environment; and
- lifetime income guarantees for an insured or for surviving beneficiaries.

Our international products have living benefit features. Every policy contains guaranteed cash values and most are participating (i.e., provides for cash dividends as apportioned by the board of directors). Once a policyowner pays the annual premium and the policy is issued, we immediately pay the owner a cash dividend as well as an annual guaranteed endowment, if elected. The policyowner has several options with regard to the dividend and annual guaranteed endowments, including the right to assign policy values to our stock investment plan, registered under the Securities Act of 1933 (the "Securities Act") and administered in the United States by our unaffiliated transfer agent.



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

The following table sets forth, by country, our direct premiums from our international life insurance business for the periods indicated.

Country	Three Months Ended September 30, 2014		Nine Months Ended September 30, 2014	
	2014	2013	2014	2013
	(In thousands)			
Venezuela	\$7,984	6,590	\$22,523	20,363
Colombia	7,268	6,291	20,065	17,908
Taiwan	3,392	3,182	11,460	10,771
Ecuador	3,559	3,607	11,077	10,812
Argentina	2,226	2,464	6,270	6,654
Other Non-U.S.	9,362	8,898	26,049	24,381
Total	\$33,791	31,032	\$97,444	90,889

We continue to report increased sales from our top producing countries as noted above. Our international business and premium collections could be impacted by future changes relative to laws, regulations or economic events in the countries from which we accept applications.

## Domestic Sales

In the Midwest, Mountain West and the southern United States, we seek to serve middle income households through the sale of cash accumulation ordinary whole life insurance products. The majority of our inforce business results from blocks of business of insurance companies we have acquired over the past fifteen years.

## Domestic Products

Our domestic life insurance products focus primarily on living needs and provide benefits focused toward accumulating money for living benefits while providing a modest death benefit for the policyowner. The features of our domestic life insurance products include:

- cash accumulation/living benefits;
- tax-deferred annuity interest earnings;
- guaranteed lifetime income or monthly income options for the policyowner or surviving family members;
- accidental death benefit coverage options; and
- an option to waive premium payments in the event of disability.

Our life insurance products are principally designed to address the insured's concern about outliving his or her monthly income, while at the same time providing death benefits. The primary purpose of our product portfolio is to help the insured create capital for needs such as retirement income, children's higher education funds, business opportunities, emergencies and extraordinary health care needs.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

The following table sets forth our direct premiums by state for the periods indicated.

State	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Texas	\$564	703	\$ 1,746	2,041
Indiana	353	401	1,040	1,099
Kentucky	107	108	337	350
Florida	166	145	429	401
Missouri	80	127	330	412
Other States	612	(12	) 1,582	1,388
Total	\$1,882	1,472	\$ 5,464	5,691

A number of domestic life insurance companies we acquired had blocks of accident and health insurance policies, which we did not consider to be a core part of our business. We have ceded the majority of our accident and health insurance business to Puritan Life Insurance Company ("Puritan"), an unaffiliated insurance company under a coinsurance agreement.

The results of operations for the life insurance segment for the periods indicated are as follows.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Revenue:				
Premiums	\$35,359	32,800	\$ 101,739	95,767
Net investment income	6,660	5,924	19,409	16,412
Realized investment gains (losses), net	(159	) 23	(271	) 104
Other income	130	261	406	675
Total revenue	41,990	39,008	121,283	112,958
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	12,205	11,249	34,183	32,016
Increase in future policy benefit reserves	18,314	16,756	54,139	49,845
Policyholders' dividends	2,560	2,343	7,043	6,618
Total insurance benefits paid or provided	33,079	30,348	95,365	88,479
Commissions	7,351	6,282	20,073	18,558
Other general expenses	2,464	2,780	8,269	8,560
Capitalization of deferred policy acquisition costs	(6,708	) (5,685	) (18,215	) (16,941
Amortization of deferred policy acquisition costs	4,449	3,947	13,061	11,802
Amortization of cost of customer relationships acquired	163	171	454	492
Total benefits and expenses	40,798	37,843	119,007	110,950
Income before income tax expense	\$1,192	1,165	\$ 2,276	2,008



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Premiums. Premium revenues increased for the three and nine month periods ended September 30, 2014, compared to the same periods in 2013 due primarily to international new and renewal business showing positive growth and strong persistency as this block of insurance ages. First year premium revenues for the quarter ended September 30, 2014, reflected sales internationally with endowment to age sixty-five and the twenty-year endowment products continuing as the top performers in the current year.

Life insurance premium breakout is detailed below.

	Three Months Ended September 30, 2014		2013		Nine Months Ended September 30, 2014		2013	
	(In thousands)							
Premiums:								
First year	\$5,709	4,703			\$ 14,984	13,736		
Renewal	29,650	28,097			86,755	82,031		
Total premiums	\$35,359	32,800			\$ 101,739	95,767		

Net Investment Income. Net investment income increased as the impact of the sustained low interest rate environment has leveled and yields are beginning to rise modestly.

	Nine Months Ended September 30, 2014		Year Ended December 31, 2013		Nine Months Ended September 30, 2013	
	(In thousands, except for %)					
Net investment income, annualized	\$25,879		22,237		21,883	
Average invested assets, at amortized cost	611,257		549,578		541,937	
Annualized yield on average invested assets	4.23		% 4.05		% 4.04	%

Realized Investment Gains (Losses), Net. Losses of \$0.2 million were recorded in the current three month period ended September 30, 2014 due to other than temporary impairments that were recognized related to 2 short-term bond mutual fund issues that we anticipate disposing of in the near future if interest rates rise. Losses recorded for the nine month period ended September 30, 2014 related to sales of three bond mutual funds totaling \$12.1 million and resulting in a net loss of approximately \$25,000. The nine months ended September 30, 2014 also includes sinking par calls on bonds purchased at a premium which resulted in a loss offset by gains from issuer calls and redemptions.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Claims and Surrenders. These amounts fluctuate from period to period but were within anticipated ranges based upon management's expectations.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
	(In thousands)			
Death claims	\$ 1,378	1,587	\$ 4,353	4,301
Surrender benefits	6,208	5,180	15,750	14,447
Endowment benefits	4,014	3,923	12,094	11,502
Accident and health benefits	81	82	200	192
Other policy benefits	524	477	1,786	1,574
Total claims and surrenders	\$ 12,205	11,249	\$ 34,183	32,016

Death claims expense was favorable for the three months and relatively flat for the nine months ended September 30, 2014 based upon reported claims. Mortality experience is closely monitored by the Company as a key performance indicator and these amounts were within expected levels.

Surrenders increased in the three and nine month periods ended in 2014 by 19.8% and 9.0%. The majority of policy surrender benefits paid is attributable to our international business and was related to policies that have been in force nearly twenty years, where surrender charges are no longer applicable.

Endowment benefit expense primarily results from the election by policyholders of a product feature providing an annual guaranteed benefit. This is a fixed benefit over the life of the contract, thus this expense will increase with new sales and improved persistency.

Other policy benefits resulted primarily from interest paid on premium deposits and policy benefit accumulations and increased as these policy liabilities also increased.

Increase in Future Policy Benefit Reserves. Policy benefit reserves increased for the three and nine months ended September 30, 2014 compared to the same periods in 2013, primarily from growth in new sales of endowment products, which require higher initial reserve levels than whole life products. Endowment sales have become more popular with our international clients in the past few years, representing approximately 83% and 77% of total new first year premium in the nine months ended September 30, 2014 and 2013, respectively.

Commissions. Commission expense increased for the three and nine months ended September 30, 2014, compared to the same periods in 2013. This expense fluctuates directly with new premium revenues and commission rates paid are higher on first year premium sales, which were up for the three and nine months ended September 30, 2014, compared to the same periods in 2013. Renewal premiums for the three and nine months, for which we pay commissions at lower rates, were also up from the prior year.

Other General Expenses. These expenses are allocated by segment, based upon an annual expense study performed by the Company, and were down slightly for the three and nine months ended September 30, 2014, compared to the same periods in 2013.

Capitalization of Deferred Policy Acquisition Costs ("DAC"). Capitalized costs fluctuate in direct relation to commissions increasing for the three and nine months ended September 30, 2014, based upon first year and renewal premiums and commissions paid compared to 2013.

Amortization of Deferred Policy Acquisition Costs. Amortization for the three and nine months ended September 30, 2014 increased and was impacted by overall lower persistency related to this segment. As previously noted,

persistence is monitored closely by the Company and was within expectations.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

## Home Service Insurance

We operate in the Home Service insurance market through our subsidiaries Security Plan Life Insurance Company ("SPLIC"), Magnolia Guaranty Life Insurance Company ("MGLIC") and Security Plan Fire Insurance Company ("SPFIC"), and focus on the life insurance needs of the middle and lower income markets, primarily in Louisiana, Mississippi and Arkansas. Our policies are sold and serviced through a home service marketing distribution system of employee-agents who work full time on a route system and through funeral homes that sell policies, collect premiums and service policyholders.

In March of the current year we completed the acquisition of MGLIC which is now a wholly owned subsidiary of SPLIC. MGLIC is licensed in Mississippi and customarily sells policies through independent funeral homes. Together, we anticipate Mississippi clients will experience enhanced support from the affiliated companies.

The following table sets forth our direct premiums by state for the periods indicated.

State	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Louisiana	\$10,559	10,463	\$ 31,614	31,319
Arkansas	413	419	1,242	1,280
Mississippi	643	126	1,803	366
Other States	194	228	614	665
Total	\$11,809	11,236	\$ 35,273	33,630

We recorded approximately \$1.4 million of additional premium in Mississippi for the nine months ended September 30, 2014 due to the purchase of MGLIC.

## Home Service Insurance Products

Our home service insurance products consist primarily of small face amount ordinary whole life and pre-need policies, which are designed to fund final expenses for the insured, primarily consisting of funeral and burial costs. To a much lesser extent, our home service insurance segment sells limited-liability, named-peril property policies covering dwellings and contents. We provide \$30,000 maximum coverage on any one dwelling and contents, while content only coverage and dwelling only coverage is limited to \$20,000, respectively.

We provide final expense ordinary life insurance and annuity products primarily to middle and lower income individuals in Louisiana, Mississippi and Arkansas.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

The results of operations for the home service insurance segment for the periods indicated are as follows.

	Three Months Ended September 30, 2014		2013		Nine Months Ended September 30, 2014		2013	
	(In thousands)							
Revenue:								
Premiums	\$ 11,564		10,947		\$ 34,526		32,754	
Net investment income	3,389		3,309		9,958		9,830	
Realized investment gains (losses), net	(63	)	2		(81	)	33	
Other income	3		(7	)	7		129	
Total revenue	14,893		14,251		44,410		42,746	
Benefits and expenses:								
Insurance benefits paid or provided:								
Claims and surrenders	5,121		5,514		16,268		16,213	
Increase in future policy benefit reserves	993		642		2,845		2,408	
Policyholders' dividends	13		19		44		53	
Total insurance benefits paid or provided	6,127		6,175		19,157		18,674	
Commissions	3,765		3,658		11,356		10,869	
Other general expenses	3,227		3,205		9,895		9,696	
Capitalization of deferred policy acquisition costs	(1,418	)	(1,382	)	(4,402	)	(4,160	)
Amortization of deferred policy acquisition costs	827		811		2,317		1,945	
Amortization of cost of customer relationships acquired	290		510		1,144		1,327	
Total benefits and expenses	12,818		12,977		39,467		38,351	
Income before income tax expense	\$ 2,075		1,274		\$ 4,943		4,395	

Premiums. Premiums increased 5.6% and 5.4% for the three and nine month periods ended September 30, 2014, compared to 2013 primarily from \$0.6 million and \$1.4 million of premiums recorded in the current three and nine month periods related to MGLIC.

Net Investment Income. Net investment income for our home service insurance segment was as follows.

	Nine Months Ended September 30, 2014		Year Ended December 31, 2013		Nine Months Ended September 30, 2013	
	(In thousands, except for %)					
Net investment income, annualized	\$ 13,299		13,075		13,107	
Average invested assets, at amortized cost	293,887		290,340		293,071	
Annualized yield on average invested assets	4.53		% 4.50		% 4.47	%

Realized Investment Gains (Losses), Net. Losses of \$0.1 million were recorded in the current three month period ended September 30, 2014 due to other than temporary impairments that were recognized related to 2 short-term bond mutual fund issues that we anticipate disposing of in the near future if interest rates rise. In addition, net realized losses for the nine months ended September 30, 2014 resulted from the sale of two bond mutual funds totaling \$3.0 million with a net realized loss of \$26,000 to





Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

move into more attractive funds in the current environment. The losses are offset by gains from issuer calls of debt securities which we experienced in 2014 and 2013.

Claims and Surrenders. Claims and surrenders decreased for the three months and remained flat for the nine months ended September 30, 2014, compared to the same periods in 2013, based upon reported claims compared to the prior year, but were within expected ranges.

	Three Months Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
	(In thousands)			
Death claims	\$3,661	3,907	\$ 12,228	12,117
Surrender benefits	883	848	2,391	2,078
Endowment benefits	9	4	16	13
Property claims	439	613	1,153	1,582
Accident and health benefits	30	35	186	92
Other policy benefits	99	107	294	331
Total claims and surrenders	\$5,121	5,514	\$ 16,268	16,213

Death claims expense fluctuates based upon reported claims. Mortality experience is closely monitored by the Company as a key performance indicator and amounts were within expected levels.

Surrender benefits increased 4.1% and 15.1% for the three and nine months ended in 2014 compared to the same periods in 2013 as decisions are made by policyholders electing to cash in their policy values.

Property claims decreased 28.4% and 27.1% for the three and nine months ended September 30, 2014 as we had experienced more weather related claims in 2013.

Increase in Future Policy Benefit Reserves. The Company recorded an increase in future policy benefit reserves for the three and nine months ended September 30, 2014, compared to the corresponding periods in 2013 with the addition of MGLIC policies in the current year.

Commissions. Commission expense fluctuated for the three and nine months ended September 30, 2014, compared to the same periods in 2013 as premium collections varied. Commission expense related to MGLIC totaled \$131,000 and \$326,000 for the three and nine months ended September 30, 2014.

Other General Expenses. Expenses are allocated by segment based upon an annual expense study performed by the Company and increased between 2014 and 2013.

Capitalization of Deferred Policy Acquisition Costs ("DAC"). Capitalized costs increased slightly for the three and nine months ended September 30, 2014, as commission expense also increased during the period. DAC capitalization is directly correlated to fluctuations in new business and commissions.

Amortization of Deferred Policy Acquisition Costs. Amortization for the three and nine months ended September 30, 2014 increased compared to the corresponding period in 2013 as this segment experienced lower persistency compared to the prior year, which results in higher amortization.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

## Other Non-Insurance Enterprises

This segment represents the administrative support entities to the insurance operations whose revenues are primarily intercompany and have been eliminated in consolidation under GAAP. The segment loss reported for the first nine months of 2014 and 2013 is typical since the elimination of intercompany revenue is its primary source of revenue.

## Investments

The administration of our investment portfolios is handled by our management, pursuant to board-approved investment guidelines, with all trading activity approved by a committee of each entity's respective boards of directors. The guidelines used require that fixed maturities, both government and corporate, are investment grade and comprise a majority of the investment portfolio. 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, mortgage loans and real estate within certain specified percentages. The assets 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.

The following table shows the carrying value of our investments by investment category and cash and cash equivalents, and the percentage of each to total invested cash, cash equivalents and investments.

	September 30, 2014		December 31, 2013	
	Carrying Value (In thousands)	% of Total Carrying Value	Carrying Value (In thousands)	% of Total Carrying Value
Marketable securities:				
U.S. Treasury and U.S. Government-sponsored enterprises	\$58,865	5.4	\$75,908	7.7
States and political subdivisions	586,286	54.0	517,712	52.1
Corporate	262,750	24.2	235,134	23.7
Mortgage-backed <sup>(1)</sup>	3,854	0.4	4,071	0.4
Foreign governments	133	—	127	—
Total marketable securities	911,888	84.0	832,952	83.9
Cash and cash equivalents	56,986	5.2	54,593	5.5
Other investments:				
Policy loans	52,575	4.8	48,868	4.8
Equity securities	55,643	5.1	47,259	4.8
Mortgage loans	641	0.1	671	0.1
Real estate	8,174	0.8	8,440	0.9
Other long-term investments	136	—	45	—
Total cash, cash equivalents and investments	\$1,086,043	100.0	\$992,828	100.0

<sup>(1)</sup> Includes \$3.1 million and \$3.8 million of U.S. Government-sponsored enterprises at September 30, 2014, and December 31, 2013, respectively.

Cash and cash equivalents increased as of September 30, 2014 due to timing of cash inflows and investment into marketable securities.

The held-to-maturity portfolio as of September 30, 2014 represented 25.3% of the total fixed maturity securities owned based upon carrying values, with the remaining 74.7% classified as available-for-sale. Held-to-maturity securities are reported in the financial statements at amortized cost and available-for-sale securities are reported at fair value.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

The following table sets forth the distribution of the credit ratings of our portfolio of fixed maturity securities by carrying value as of September 30, 2014 and December 31, 2013.

	September 30, 2014		December 31, 2013	
	Carrying Value (In thousands)	% of Total Carrying Value	Carrying Value (In thousands)	% of Total Carrying Value
AAA	\$61,663	6.8	\$55,093	6.6
AA	416,971	45.7	391,054	46.9
A	251,337	27.6	231,004	27.7
BBB	145,741	16.0	125,597	15.1
BB and other	36,176	3.9	30,204	3.7
Totals	\$911,888	100.0	\$832,952	100.0

Credit ratings reported for the periods indicated are assigned by a Nationally Recognized Statistical Rating Organization (“NRSRO”) such as Moody’s Investors Service, Standard & Poor’s or Fitch Ratings. A credit rating assigned by an NRSRO is a quality based rating, with AAA representing the highest quality and D the lowest, with BBB and above being considered investment grade. In addition, the Company may use credit ratings of the National Association of Insurance Commissioners (“NAIC”) Securities Valuation Office (“SVO”) as assigned, if there is no NRSRO rating. Securities rated by the SVO are grouped in the equivalent NRSRO category as stated by the SVO and securities that are not rated by an NRSRO are included in the “other” category.

The Company has no direct sovereign European debt exposure as of September 30, 2014. We do have indirect exposure in one bond mutual fund holding, but the amount is deemed immaterial to the current investment holdings and consolidated financials.

As of September 30, 2014, the Company held municipal securities that include third party guarantees. Detailed below is a presentation by NRSRO rating of our municipal holdings by funding type.

Municipals shown including third party guarantees

	September 30, 2014						Total	% Based on Amortized Cost	
	General Obligation		Special Revenue		Other				
	Fair Value (In thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	
AAA	\$43,405	41,194	16,103	15,436	—	—	59,508	56,630	9.8
AA	127,512	123,320	196,688	188,594	14,768	14,048	338,968	325,962	56.9
A	41,574	41,883	112,316	110,295	6,678	6,707	160,568	158,885	27.7
BBB	2,746	2,793	19,586	19,007	—	—	22,332	21,800	3.8
BB and other	547	495	8,801	9,012	536	580	9,884	10,087	1.8
Total	\$215,784	209,685	353,494	342,344	21,982	21,335	591,260	573,364	100.0

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Municipals shown excluding third party guarantees

September 30, 2014

	General Obligation		Special Revenue		Other		Total		% Based on
	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Amortized Cost
	(In thousands)								
AAA	\$15,635	15,404	3,793	3,714	—	—	19,428	19,118	3.3
AA	109,861	106,137	140,392	134,130	11,734	11,012	261,987	251,279	43.8
A	41,307	39,818	139,307	135,560	8,306	8,361	188,920	183,739	32.0
BBB	7,120	7,729	21,934	20,954	—	—	29,054	28,683	5.0
BB and other	41,861	40,597	48,068	47,986	1,942	1,962	91,871	90,545	15.9
Total	\$215,784	209,685	353,494	342,344	21,982	21,335	591,260	573,364	100.0

The Company held investments in special revenue bonds that had a greater than 10% exposure based upon activity as noted in the table below.

	Fair Value	Amortized Cost	% of Total Fair Value
	(In thousands)		
Utilities	\$110,307	113,774	18.5

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

The tables below represent the Company's exposure of municipal holdings in Louisiana and Texas, which exceed 10% of the total municipal portfolio as of September 30, 2014.

	September 30, 2014							
	General Obligation		Special Revenue		Other		Total	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost
(In thousands)								
Louisiana securities including third party guarantees								
AAA	\$455	452	—	—	—	—	455	452
AA	6,594	6,369	27,124	25,913	—	—	33,718	32,282
A	6,286	6,200	7,804	7,576	4,062	3,578	18,152	17,354
BBB	1,693	1,705	—	—	—	—	1,693	1,705
BB and other	—	—	4,445	4,718	—	—	4,445	4,718
Total	\$15,028	14,726	39,373	38,207	4,062	3,578	58,463	56,511
Louisiana securities excluding third party guarantees								
AAA	\$455	452	—	—	—	—	455	452
AA	12,384	12,082	22,864	21,917	—	—	35,248	33,999
A	1,195	1,169	9,596	9,264	1,012	1,010	11,803	11,443
BBB	499	497	2,468	2,308	—	—	2,967	2,805
BB and other	495	526	4,445	4,718	3,050	2,568	7,990	7,812
Total	\$15,028	14,726	39,373	38,207	4,062	3,578	58,463	56,511
Texas securities including third party guarantees								
AAA	\$42,294	40,143	9,293	8,867	—	—	51,587	49,010
AA	38,315	37,613	20,979	20,297	—	—	59,294	57,910
A	3,488	3,455	20,897	20,267	3,050	2,568	27,435	26,290
BBB	—	—	10,323	9,886	—	—	10,323	9,886
BB and other	—	—	—	—	—	—	—	—
Total	\$84,097	81,211	61,492	59,317	3,050	2,568	148,639	143,096
Texas securities excluding third party guarantees								
AAA	\$15,635	15,404	2,230	2,211	—	—	17,865	17,615
AA	50,266	47,945	21,351	20,347	—	—	71,617	68,292
A	9,112	8,952	23,167	22,493	—	—	32,279	31,445
BBB	—	—	8,055	7,637	—	—	8,055	7,637
BB and other	9,084	8,910	6,689	6,629	3,050	2,568	18,823	18,107
Total	\$84,097	81,211	61,492	59,317	3,050	2,568	148,639	143,096

The Company invests in municipal securities of issuers in the state of Louisiana and receives a credit that reduces its premium tax liability in that state. At September 30, 2014, total holdings of municipal securities in Louisiana represented 9.9% of all municipal holdings based upon fair value. The Company also holds 25.1% of its municipal holdings in Texas issuers. There were no other states or individual issuer holdings that represented or exceeded 10% of the total municipal portfolio as of September 30, 2014.



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Valuation of Investments

We evaluate the carrying value of our fixed maturity and equity securities at least quarterly. The Company monitors all debt and equity securities on an on-going basis relative to changes in credit ratings, market prices, earnings trends and financial performance, in addition to specific region or industry reviews. The assessment of whether impairments have occurred is based on a case-by-case evaluation of underlying reasons for the decline in fair value. The Company determines other-than-temporary impairment by reviewing all relevant evidence related to the specific security issuer as well as the Company's intent to sell the security, or if it is more likely than not that the Company would be required to sell a security before recovery of its amortized cost.

When an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the investment's cost and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is separated into the following: a) the amount representing the credit loss; and b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings becomes the new amortized cost basis of the investment. The new amortized cost basis is not adjusted for subsequent recoveries in fair value.

The Company recognized other-than-temporary impairments during the three and nine months ended September 30, 2014 of \$0.3 million based upon the fact that there is no longer an intent to hold these securities. The Company did not recognize any other-than-temporary impairments for the three and nine months ended September 30, 2013.

Liquidity and Capital Resources

Liquidity refers to a company's ability to generate sufficient cash flows to meet the needs of its operations. Liquidity is managed on insurance operations and seeks to ensure stable and reliable sources of cash flows to meet obligations provided by a variety of sources.

Liquidity requirements of the Company are met primarily by funds provided from operations. Premium deposits and revenues, investment income and investment maturities are the primary sources of funds, while investment purchases, policy benefits, and operating expenses are the primary uses of funds. We historically have not had to liquidate investments relative to our insurance operations to provide cash flow and did not do so during the first nine months of 2014. Our investments as of September 30, 2014, consist of 66.2% of marketable debt securities classified as available-for-sale that could be readily converted to cash for liquidity needs.

A primary liquidity concern is the risk of an extraordinary level of early policyholder withdrawals. We include provisions within our insurance policies, such as surrender charges, that help limit and discourage early withdrawals. Since these contractual withdrawals, as well as the level of surrenders experienced, were largely consistent with our assumptions in asset liability management, our associated cash outflows have, to date, not had an adverse impact on our overall liquidity. Individual life insurance policies are less susceptible to withdrawal than annuity reserves and deposit liabilities because policyholders may incur surrender charges and undergo a new

underwriting process in order to obtain a new insurance policy. Cash flow projections and cash flow tests under various market interest rate scenarios are also performed annually to assist in evaluating liquidity needs and adequacy. We currently anticipate that available liquidity sources and future cash flows will be adequate to meet our needs for funds.

Cash flows from our insurance operations have been sufficient to meet current needs. Cash flows from operating activities were \$66.9 million and \$54.3 million for the nine months ended September 30, 2014 and 2013, respectively. We have traditionally also had significant cash flows from both scheduled and unscheduled investment security maturities, redemptions, and

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

prepayments. These cash flows, for the most part, are reinvested in fixed income securities. Net cash outflows from investing activities totaled \$66.1 million and \$69.9 million for the nine months ended September 30, 2014 and 2013, respectively. The investing activities fluctuate from period to period due to timing of securities activities such as calls and maturities and reinvestment of those funds.

CICA declared and paid a dividend to Citizens Inc. of \$5.3 million and SPLIC declared and paid a dividend of \$2.3 million to CICA during September of 2014. Dividends are declared and paid from time to time from the insurance affiliates as determined by their respective boards.

The NAIC has established minimum capital requirements in the form of Risk-Based Capital ("RBC"). RBC factors the type of business written by an insurance company, the quality of its assets, and various other aspects of an insurance company's business to develop a minimum level of capital called "authorized control level risk-based capital" and compares this level to adjusted statutory capital that includes capital and surplus as reported under statutory accounting principles, plus certain investment reserves. Should the ratio of adjusted statutory capital to control level RBC fall below 200%, a series of remedial actions by the affected company would be required.

All insurance subsidiaries were above the RBC minimums at December 31, 2013. The ratios of adjusted statutory capital to control level RBC are shown below.

	December 31, 2013	
CICA	635	%
CNLIC	2,363	%
SPFIC	421	%
SPLIC	1,306	%
MGLIC	1,210	%

## Contractual Obligations and Off-balance Sheet Arrangements

There have been no material changes in contractual obligations from those reported in the Company's Form 10-K for the year ended December 31, 2013. The Company does not have off-balance sheet arrangements at September 30, 2014. We do not utilize special purpose entities as investment vehicles, nor are there any such entities in which we have an investment that engage in speculative activities of any nature, and we do not use such investments to hedge our investment positions.

## Parent Company Liquidity and Capital Resources

Citizens is a holding company and has had minimal operations of its own. Its assets consist primarily of the capital stock of its subsidiaries, cash, fixed income securities, mutual funds and investment real estate. Accordingly, Citizens' cash flows depend upon the availability of statutorily permissible payments, primarily payments under management agreements from its two primary life insurance subsidiaries, CICA and SPLIC. The ability to make payments is limited by applicable laws and regulations of Colorado, CICA's state of domicile, and Louisiana, SPLIC's state of domicile, which subject insurance operations to significant regulatory restriction. These laws and regulations require, among other things, that these insurance subsidiaries maintain minimum solvency requirements and limit the amount of dividends these subsidiaries can pay to the holding company. Citizens historically has not relied upon dividends from subsidiaries for its cash flow needs. However, CICA and SPLIC do dividend available funds from time to time

in relation to new acquisition target strategies. CICA declared and paid a dividend to Citizens Inc. of \$5.3 million and SPLIC declared and paid a dividend of \$2.3 million to CICA during September of 2014.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

## Critical Accounting Policies

We have prepared a current assessment of our critical accounting policies and estimates in connection with preparing our interim unaudited consolidated financial statements as of and for the three and nine months ended September 30, 2014 and 2013. We believe that the accounting policies set forth in the Notes to our Consolidated Financial Statements and "Critical Accounting Policies and Estimates" in the Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2013 continue to describe the significant judgments and estimates used in the preparation of our consolidated financial statements.

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

## General

The nature of our business exposes us to market risk relative to our invested assets and policy liabilities. Market risk is the risk of loss that may occur when changes in interest rates and public equity prices adversely affect the value of our invested assets. Interest rate risk is our primary market risk exposure. Substantial and sustained increases and decreases in market interest rates can affect the fair value of our investments. The fair value of our fixed maturity portfolio generally increases when interest rates decrease and decreases when interest rates increase. For additional information regarding market risks to which we are subject, see "Item 1 Financial Statements - Note 5. Investments - Valuation of Investments in Fixed Maturity and Equity Securities" above.

The following table summarizes net unrealized gains and losses as of the dates indicated.

	September 30, 2014		Net Unrealized Gains (Losses)	December 31, 2013		Net Unrealized Gains (Losses)
	Amortized Cost	Fair Value		Amortized Cost	Fair Value	
	(In thousands)					
Fixed maturities, available-for-sale	\$647,257	681,591	34,334	595,944	605,256	9,312
Fixed maturities, held-to-maturity	230,297	236,165	5,868	227,696	223,533	(4,163)
Total fixed maturities	\$877,554	917,756	40,202	823,640	828,789	5,149
Total equity securities	\$53,906	55,643	1,737	45,883	47,259	1,376

## Market Risk Related to Interest Rates

Our exposure to interest rate changes results from our significant holdings of fixed maturity investments, which comprised 88.6% of our investment portfolio based on carrying value as of September 30, 2014. These investments are mainly exposed to changes in U.S. Treasury rates. Our fixed maturity investments include U.S. Government-sponsored enterprises, U.S. Government bonds, securities issued by government agencies, municipal bonds and corporate bonds.

To manage interest rate risk, we perform periodic projections of asset and liability cash flows to evaluate the potential sensitivity of our investments and liabilities. We assess interest rate sensitivity annually with respect to our available-for-sale fixed maturities investments using hypothetical test scenarios that assume either upward or

downward shifts in the prevailing interest rates. The changes in fair values of our debt and equity securities as of September 30, 2014 were within the expected range of this analysis.

Changes in interest rates typically have a sizable effect on the fair values of our debt and equity securities. The interest rate of the ten-year U.S. Treasury bond decreased to 2.5% during the quarter ended September 30, 2014, from 3.0% at December 31, 2013. Net

47

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Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

unrealized gains on fixed maturity securities totaled \$40.2 million at September 30, 2014, compared to \$5.1 million at December 31, 2013.

The fixed maturity portfolio is exposed to call risk, as a significant portion of the current bond holdings are callable. A decreasing interest rate environment can result in increased call activity as experienced over the past several years, and an increasing rate environment will likely result in securities being paid at their stated maturity.

There are no fixed maturities or other investments classified as trading instruments. Approximately 74.3% of fixed maturities were held in available-for-sale and 25.7% in held-to-maturity based upon fair value at September 30, 2014. At September 30, 2014 and December 31, 2013, we had no investments in derivative instruments, nor did we have any subprime or collateralized debt obligation risk.

Market Risk Related to Equity Prices

Changes in the level or volatility of equity prices affect the value of equity securities we hold as investments. Our equity investments portfolio represented 5.4% of our total investments at September 30, 2014, with 95.1% invested in diversified equity and bond mutual funds. We believe that significant decreases in the equity markets would not have a material adverse impact on our total investment portfolio.

Item 4. CONTROLS AND PROCEDURES

We have established disclosure controls and procedures to ensure, among other things, that material information relating to our Company, including its consolidated subsidiaries, is made known to our officers who certify our financial reports and to the other members of our senior management and the Board of Directors.

Our Chief Executive Officer, Vice Chairman and Chief Financial Officer are responsible for establishing and maintaining our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based upon an evaluation at the end of the period covered by this report, the Chief Executive Officer, Vice Chairman and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

During the three months ended September 30, 2014, there were no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting (as defined in rules 13a-15(f) and 15d-15(f) under the Exchange Act).

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

In the normal course of business, the Company is subject to various legal and regulatory actions which are immaterial to the Company's financial statements. For more information about the risks related to litigation and regulatory actions, please see the risk factor titled "We are a defendant in lawsuits, which may adversely affect our financial condition and detract from the time our management is able to devote to our business, and we are subject to risks related to litigation and regulatory matters." in Item 1A. Risk Factors.

Since August 6, 1999, the Company has been a defendant in a lawsuit filed in an Austin, Texas District Court, styled Delia Bolanos Andrade, et al., Plaintiffs, v. Citizens Insurance Company of America, et al., Defendants. In consideration of a Texas Supreme Court ruling on the case, the District Court ruled in December of 2009 the plaintiffs must proceed individually, and not as a class, if they intend to pursue their claims against us. There are 17 plaintiffs in the case. The plaintiffs' underlying claims allege that certain life insurance policies CICA made available to non-U.S. residents were actually offers and sales of securities that occurred in Texas by unregistered dealers in violation of the Texas securities laws. The remedy sought is rescission and return of the insurance premium payments. The total net insurance premium for the 17 plaintiffs is approximately \$150,000. Since the December 2009 trial court ruling, no individual cases have been pursued by the plaintiffs making the probability of the plaintiffs further pursuing their cases individually unlikely. For the reasons described above, the Company no longer believes this matter meets the definition of a material legal proceeding as such term is defined in Item 103 of Regulation S-K but has included the foregoing description solely due to the history and unresolved nature of the case. An estimate of any possible loss or range of losses cannot be made at this time in regard to individuals pursuing claims. However, should the plaintiffs further pursue their claims individually; we intend to vigorously defend any proceedings.

Item 1A. RISK FACTORS

Investing in our Company involves certain risks. Set forth below are certain risks with respect to our Company. Readers should carefully 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 believed to be not material, if they were to actually occur, could result in a significant adverse impact on our business, operating results, prospects or financial condition. References in the risk factors below to "we," "us," "our," "Citizens" and like terms relate to Citizens, Inc. and its subsidiaries on a U.S. GAAP consolidated financial statement basis, unless specifically identified otherwise. We operate our subsidiaries as separate and distinct entities with respect to corporate formalities.

Risks Relating to Our Business

A substantial amount of our revenue comes from residents of foreign countries and is subject to risks associated with widespread political instability, foreign insurance laws and asset transfer restrictions.

A substantial part of our insurance policy sales are from foreign countries, primarily those in Latin America and the Pacific Rim. There is a risk that we may lose a significant portion of these sales should widespread political instability occur in these countries. We cannot confidently predict what impact we might see relative to widespread



political instability in the foreign countries we operate, but it could significantly impact our business.

Traditionally, we have sought to address risks associated with foreign countries by, among other things, not accepting insurance applications outside of the U.S., maintaining all of our assets in the U.S. and requiring policy premiums be paid to us in U.S. Dollars drawn on U.S. financial institutions. Accordingly, we have never qualified to do business in any foreign country and have never submitted our insurance policies issued to residents of foreign countries for approval by any foreign or domestic insurance regulatory agency. We sell our policies to residents of foreign countries using foreign independent marketing firms and independent consultants, and we rely on those persons to comply with applicable laws in marketing our insurance products.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

The Company's future sales and financial results are dependent upon avoiding significant regulatory interruptions in receiving insurance policy applications for residents outside of the United States. Currency control laws in foreign countries, if implemented, could materially adversely affect our revenues by imposing restrictions on asset transfers outside of a country where our insureds reside. There can be no assurance that such situations will not occur and that our revenues, results of operations and financial condition will not be materially, adversely affected if they do occur. The government of a foreign country could also determine its residents may not buy life insurance from us unless we became qualified to do business in that country or unless our policies purchased by its residents receive prior approval from its insurance regulators. Also, new laws or regulations could be implemented or new applications of existing laws or regulations could occur, which could result in the cessation of marketing activities by our independent marketing firms and consultants. From time to time we have become aware of new foreign laws, regulations or new interpretations of foreign laws or regulations that may have an adverse effect on the marketing efforts of our foreign independent marketing firms and consultants.

Although we believe foreign regulatory authorities have no jurisdiction over us and any actions, including fines, would be unenforceable against us, we cannot assure you any of these laws, regulations, or application of them by foreign regulatory authorities will not have an adverse effect on the marketing efforts of our independent marketing consultants and, in turn, on our revenues. Further, there is no assurance we would be able to qualify to do business in any foreign country or that its insurance regulatory authorities would approve our policies if we decided to submit our insurance policies for approval. Any of the foregoing could reduce our revenues and materially adversely affect our results of operations and financial condition. Also, we do not determine whether our independent consultants are required to be licensed to sell insurance in the countries in which they market our policies. If our independent consultants were not in compliance with applicable laws, including licensing laws, they could be required to cease operations, which would reduce our revenues. We are unable to quantify the effect of foreign regulation on our business if regulation were to be imposed on us due to the lack of uniformity of regulation in our foreign markets, but we believe we could expend time and incur expense in assessing and complying with foreign regulation which we deem may impact our business in a particular country. Consequently, we may decide to remove ourselves from or avoid a market if foreign regulation were deemed untenable.

The majority of our foreign policyholders elect to invest their policies' annually payable cash benefits in our Class A common stock through the Citizens, Inc. Stock Investment Plan (the "Plan"), a stock investment plan registered with the United States Securities and Exchange Commission ("SEC"). If a securities regulatory authority were to deem the Plan's operation contrary to securities laws, a reduction in the amount of Class A common stock purchased on the open market through the Plan could occur.

On or about April 2001, the Company adopted the Plan, as amended and restated from time to time. The Plan is registered with the SEC pursuant to a Registration Statement on Form S-3 of the Securities Exchange Act of 1933. For further information on the filing history of the Plan's Registration Statement, please see the risk factor directly below titled "The previous Registration Statement covering the Plan was not declared effective under the Securities Act of 1933."

The general purpose of the Plan is to provide a convenient and economical means for new investors to make an initial investment in our Class A common stock and for existing investors to purchase additional shares of our Class A common stock. Specifically, the Plan offers employees, agents, policyholders, independent consultants and potential investors stock purchase opportunities of the Company's Class A common stock, no par value per share ("Common Stock"). It also offers security holders the ability to maintain registered ownership of their securities in a manner which facilitates efficient purchases and sales of Citizens Class A common stock in the open market. The Plan is administered by Computershare Trust Company, N.A., located in Canton Massachusetts, ("Computershare"), a company

which operates in 20 countries around the globe and also serves as our transfer agent. Computershare is deemed an independent agent of the Company. Computershare satisfies applicable U.S. legal requirements (including, without limitation, the requirements of Regulation M under the Securities Exchange Act of 1934), and facilitates open market purchases and sales of Citizens Class A common stock under the Plan through registered brokers and dealers. Additional disclosures concerning the Plan's impact on our Capital Stock can be found in our Item 1A. Risk Factors under the heading, "Risks Relating to Our Capital Stock."

Any electing person who has met the requirements to participate in the Plan and has not revoked such election to participate in the Plan is considered a "Plan Participant." More than 89% percent of the shares of Class A common stock that have been purchased under the Plan have been purchased by foreign holders of life insurance policies (or related brokers); the remaining shares of Class A common stock that have been purchased under the Plan have been purchased by approximately 1,400 participants, mostly our employees, resident in the United States. International holders of life insurance policies underwritten by the Company may assign annually payable cash benefits from their insurance policies to the Plan and employees participating in the Plan may allocate a

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

portion of their compensation to the Plan and the Company remits these amounts to Computershare. Computershare uses these proceeds to purchase shares of Class A common stock in the open market from time to time through independent broker dealers selected by the Computershare. None of the shares of Class A common stock purchased by the Plan Participants is issued by the Company, and the Company does not receive any proceeds from these purchases. An international policyholder must first consent in writing to be contacted by Citizens regarding the Plan before they are given the option to assign annually payable cash benefits from their insurance policies to the Plan. At the point of introduction to the Plan, international policyholders receive a copy of the Plan prospectus explaining the risks associated with purchasing Citizens Class A common stock through the Plan.

Since the distribution of our Class A common stock is registered and publicly traded in the U.S. and because we believe that foreign regulatory authorities have no jurisdiction over us, the offer and sale of our Class A common stock through the Plan is not registered under the laws of any foreign jurisdiction. If a foreign securities regulatory authority were to determine the offer and sale of our Class A common stock under the Plan were contrary to applicable laws and regulations of its jurisdiction, such authority may issue or assert a fine, penalty or cease and desist order against us. While we would vigorously dispute the ability of such authority to assert jurisdiction over us, such a dispute may distract from our business and may have a material adverse impact on our financial position. Additionally, in such a situation participation in the Plan by our international policyholders in that foreign jurisdiction could decrease. This also could materially reduce the amount of our Class A common stock purchased and sold in the open market under the Plan, as historically a significant volume of shares have been purchased under the Plan by policyholders through annually payable cash benefits assigned to the Plan.

In December 2012 it was discovered, the original Registration Statement on Form S-3 covering the Plan and filed with the SEC was not declared effective under the Securities Act of 1933, due to a technical error in the 2001 filing. As such, sales under the Plan may not have fully complied with an exemption from registration under that Act. This technical error could grant security holders who purchased shares of Class A common stock a right to rescind their purchases or other damages.

In 2001, we filed with the SEC a Registration Statement on Form S-3 under the Securities Act of 1933 ("Securities Act") covering the sale of shares of Class A common stock ("2001 Registration Statement"). On December 18, 2006, and again on December 18, 2009, the 2001 Registration Statement was amended (the "Amendments").

The 2001 Registration Statement and the Amendments treated the Plan and its predecessors as a Dividend or Interest Reinvestment Plan (a "DRIP") as defined in Rule 405 of the Securities Act and, accordingly, the 2001 Registration Statement and the Amendments checked the DRIP box on Form S-3 and we treated the Registration Statement and Amendments as effective immediately upon filing with the SEC. In connection with the preparation of a further amendment to the Registration Statement to be filed on December 18, 2012, and further analysis of the Plan, the Company came to believe that the characterization of the Plan solely as a DRIP may not be appropriate. As a result, the Company determined not to file a further amendment to the Registration Statement but instead to file a new registration statement covering a Rule 415 continuous offering under the Plan. On December 18, 2012, we suspended operation of the Plan with respect to the purchase of Class A common stock. On December 21, 2012, we filed with the SEC a new registration statement pursuant to Rule 415 on Form S-3 with respect to the Plan (the "New Registration Statement"), which was declared effective by the SEC on January 14, 2013.

If and to the extent participants purchased shares of Class A common stock in the open market that were not effectively registered under the Securities Act, or exempt from such registration, prior to the time the New Registration Statement was declared effective such participants could have certain remedies available to them, including claims for rescission and damages. In the 12 months prior to December 19, 2012, a total of approximately

1,544,250 shares of Class A common stock were purchased in the open market under the Plan for participants in the Plan for an aggregate of approximately \$15,210,000, or an average of \$9.85 per share. In addition, despite our full disclosure of this technical error in 2012 to the SEC, the SEC could commence an enforcement action against us seeking injunctive or other relief and civil damages. Should a significant number of these purchasers bring claims for rescission or damages, or should the SEC commence an enforcement action, it could have a material and adverse effect on our business and reputation and our results of operations and financial condition.

We face financial and capital market risks in our operations.

As an insurance holding company with significant investment exposure, we face material financial and capital markets risk in our operations. Due to the low interest rate environment over the past three years, we experienced significant call activity on our fixed income portfolio that decreased our investment yields compared to prior years. Also, we recorded other-than-temporary impairments in the past several years due to credit related market declines

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Economic uncertainty has recently been exacerbated by the increased potential for default by one or more European sovereign debt issuers, the potential partial or complete dissolution of the Eurozone and its common currency and the negative impact of such events on global financial institutions and capital markets generally. Actions or inactions of European governments may impact these actual or perceived risks. In the recent past, one rating agency downgraded the U.S.'s long-term debt credit rating from AAA. Future actions or inactions of the United States government, including a shutdown of the federal government, could increase the actual or perceived risk that the U.S. may not ultimately pay its obligations when due and may disrupt financial markets.

Changes in market interest rates may significantly affect our profitability.

Some of our products, principally traditional whole life insurance with annuity riders, expose us to the risk that changes in interest rates will reduce our "spread," or the difference between the amounts we are required to pay under our contracts to policyholders and the rate of return we are able to earn on our investments intended to support obligations under the contracts. Our spread is an integral component of our net income.

As interest rates decrease or remain at low levels, we may be forced to reinvest proceeds from investments that have matured, prepaid, been sold, or called at lower yields, reducing our investment margin. Our fixed income bond portfolio is exposed to interest rate risk as a significant portion of the portfolio is callable. Lowering interest crediting rates can help offset decreases in investment margins on some of our products. However, our ability to lower these rates could be limited by competition or contractually guaranteed minimum rates, and may not match the timing or magnitude of changes in asset yields. Our expectation of future spreads is an important component in amortization of deferred acquisition costs and significantly lower spreads may result in increasing amortization, thereby reducing net income for the period.

Our investment portfolio is subject to various risks that may result in realized investment losses. In particular, decreases in the fair value of fixed maturities may significantly reduce the value of our investments, and as a result, our financial condition may suffer.

We are subject to credit risk in our investment portfolio. Defaults by third parties in the payment or performance of their obligations under these securities could reduce our investment income and realized investment gains or result in the recognition of investment losses. The value of our investments may be materially adversely affected by increases in interest rates, downgrades in the bonds included in our portfolio and by other factors that may result in the recognition of other-than-temporary impairments. Each of these events may cause us to reduce the carrying value of our investment portfolio.

In particular, at September 30, 2014, fixed maturities represented \$911.9 million or 84.0% of our total investments and cash of \$1,086.0 million. The fair value of fixed maturities and the related investment income fluctuates depending on general economic and market conditions. The fair value of these investments generally increases or decreases in an inverse relationship with fluctuations in interest rates, while net investment income realized by us will generally increase or decrease in line with changes in market 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. An investment has prepayment risk when there is a risk that the timing of cash flows resulting from the repayment of principal might occur earlier than anticipated because of declining interest rates or later than anticipated because of rising interest rates. The impact of value fluctuations affects our consolidated financial statements, as a large portion of our fixed maturities are classified as available-for-sale, with changes in fair value reflected in our stockholders' equity (accumulated other comprehensive income or loss). No similar adjustment is made for liabilities to reflect a change in

interest rates. Therefore, interest rate fluctuations and economic conditions could adversely affect our stockholders' equity, total comprehensive income and/or cash flows. For mortgage-backed securities, credit risk exists if mortgagees default on the underlying mortgages. Although at September 30, 2014, approximately 96.1% of our fixed maturities were investment grade with 80.1% rated A or above, all of our fixed maturities are subject to credit risk. If any of the issuers of our fixed maturities suffer financial setbacks, the ratings on the fixed maturities could fall (with a concurrent fall in fair value) and, in a worst case scenario, the issuer could default on its financial obligations. If the issuer defaults, we could have realized losses associated with the impairment of the securities.

A portion of our investment portfolio is concentrated in U.S. Government sponsored corporations and agencies.

At September 30, 2014, we had investments with a carrying value of \$46.1 million (4.3% of our total invested assets) in U.S. Government sponsored corporations and agencies, including the Federal Home Loan Mortgage Corporation ("Freddie") and the Federal National Mortgage Association ("Fannie"). Both Freddie and Fannie are currently in conservatorship, certain of their

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

operations are being combined and the federal government is considering proposals to phase them out, or allow them to continue as private corporations, among other things. If they are wound down, it is not clear how investments sponsored by them might be affected; however, the direct and indirect impact on our investment portfolio could be material and could be adverse.

Gross unrealized losses on fixed maturity and equity securities may be realized or result in future impairments, resulting in a reduction in our net income.

Fixed maturity and equity securities classified as available-for-sale are reported at fair value. Unrealized gains and losses on available-for-sale securities are recognized as a component of other comprehensive income (loss) and are, therefore, excluded from our net income. Our total gross unrealized losses on our available-for-sale securities portfolio at September 30, 2014 were \$2.8 million. The accumulated change in estimated fair value of these securities is recognized in net income when the gain or loss is realized upon sale of the security or in the event that the decline in estimated fair value is determined to be other-than-temporary and an impairment charge to earnings is taken. Realized losses or impairments may have a material adverse effect on our net income in a particular quarterly or annual period.

Our actual claims losses may exceed our reserves for claims and we may be required to establish additional reserves, which in turn may adversely impact our results of operations and financial condition.

We maintain reserves to cover our estimated exposure for claims relating to our issued insurance policies. Reserves, whether calculated under U.S. generally accepted accounting principles ("U.S. GAAP") or statutory accounting practices prescribed by various state insurance regulators, 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 authorities. 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, and adjustments to reserves are reflected in our statements of operations for the period in which such estimates are updated. Because establishing reserves is an inherently uncertain process involving estimates of future losses, future developments may require us to increase claims reserves, which may have a material adverse effect on our results of operations and financial condition in the periods in which such increases occur.

We may be required to accelerate the amortization of deferred acquisition costs and the costs of customer relationships acquired, which would increase our expenses and adversely affect our results of operations and financial condition.

At September 30, 2014, we had \$153.7 million of deferred policy acquisition costs, or DAC. DAC represents costs that vary with and are primarily related to the successful sale and issuance of our insurance policies and 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 costs 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 CCRA, represents the actuarially estimated present value of future cash flows from the acquired policies. At September 30, 2014, we had \$24.2 million of CCRA. We amortize the value of this intangible asset in a manner similar to the amortization of DAC.



Our amortization of DAC and CCRA generally depends upon anticipated profits from investments, surrender and other policy charges, mortality, morbidity, persistency and maintenance expense margins. For example, if our insurance policy lapse and surrender rates were to exceed the assumptions upon which we priced our insurance policies, or if actual persistency proves to be less than our persistency assumptions, especially in the early years of a policy, we would be required to accelerate the amortization of expenses we deferred in connection with the acquisition of the policy. We regularly review the quality of our DAC and CCRA 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.

Unfavorable experience with regard to expected expenses, investment returns, surrender and other policy charges, mortality, morbidity, lapses or persistency may cause us to increase the amortization of DAC or CCRA, or both, or to record a current period

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

expense to increase benefit reserves, any of which could have a material adverse effect on our results of operations and financial condition.

We may be required to recognize an impairment on the value of our goodwill, which would increase our expenses and materially adversely affect our results of operations and financial condition.

Goodwill represents the excess of the amount paid by us 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 that is 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 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, which could have a material adverse effect on our results of operations and financial condition. Goodwill in our consolidated financial statements was \$17.3 million as of September 30, 2014.

We are a defendant in lawsuits, which may adversely affect our financial condition and detract from the time our management is able to devote to our business, and we are subject to risks related to litigation and regulatory matters.

We may from time to time be subject to a variety of legal and regulatory actions relating to our business operations, including, but not limited to:

- disputes over insurance coverage or claims adjudication;
- regulatory compliance with state laws;
- regulatory compliance with insurance and securities laws;
- disputes with our marketing firms, consultants and employee-agents over compensation, termination of contracts and related claims;
- disputes regarding our tax liabilities;
- disputes relating to reinsurance and coinsurance agreements; and
- disputes relating to businesses acquired and operated by us.

In the absence of countervailing considerations, we would expect to defend any such claims vigorously. However, in doing so, we could incur significant defense costs, including attorneys' fees, other direct litigation costs and the expenditure of substantial amounts of management time that otherwise would be devoted to our business. Further, if we suffer an adverse judgment as a result of any claim, it could have a material adverse effect on our business, results of operations and financial condition.

A number of U.S. jurisdictions have been investigating life insurer practices for compliance with unclaimed property laws. In highly publicized incidents, the practice by certain companies of using data available on the U.S. Social Security Administration's Death Master File or a similar data base in order to avoid paying periodic benefits under annuity contracts but not using the same data base to determine when death benefits were owed was disclosed. This asymmetric conduct by certain insurers has led a number of jurisdictions to require life insurers to use this same data to identify instances where amounts under life insurance policies and annuity contracts are payable and to locate and pay beneficiaries under such contracts. The National Conference of Insurance Legislators ("NCOIL") has adopted the Model Unclaimed Life Insurance Benefits Act ("Model Act") and several states have adopted legislation that is substantially similar to the Model Act adopted by NCOIL. The Model Act imposes new requirements on insurers to

periodically compare their in force life insurance and annuity policies against the Death Master File, investigate any identified matches to confirm the death of the insured and determine whether benefits are due and attempt to locate the beneficiaries or, if no beneficiary can be located, escheat the policy benefit to the respective state government as unclaimed property. The Model Act could result in additional payments to beneficiaries, additional escheatment of funds deemed abandoned under state laws, and/or administrative penalties. It is also possible that life insurers may be subject to claims regarding their business practices as a result given the legal uncertainty in this area. However, recent court decisions in West Virginia and Florida have upheld the well established insurance law principal that life insurance policies are not due and payable until the insurance company receives due proof of death, and have further held an insurance company has no duty to search the Death Master File or other databases to determine whether deaths have occurred that have not been reported to the company.

Despite the fact we have no history of the asymmetric conduct in question, we have received notices from Louisiana Department of Treasury, Arkansas Auditor of State and the Texas State Comptroller, indicating they intend to audit Citizens, Inc. and certain

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

of its affiliates for compliance with unclaimed property laws. The audits may result in additional payments to beneficiaries, additional escheatment of funds deemed abandoned under state laws, administrative penalties, interest, and changes to the Company's procedures for the identification and escheatment of abandoned property. The Company believes additional escheatment of funds in Arkansas or Texas will not be material to our financial condition or results. However, additional escheatment of funds in Louisiana, which may subsequently be deemed abandoned under the Louisiana Department of Treasury's audit, could be substantial for SPLIC. At this time, the Company is not able to estimate any of these possible amounts.

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

We reinsure certain risks underwritten by our various insurance subsidiaries. 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 results of operations and financial condition.

Our reinsurance facilities are generally subject to annual renewal. We may not be able to maintain our current reinsurance facilities and, even if highly desirable or necessary, we may not be able to obtain replacement reinsurance facilities in adequate amounts or at rates economic to us. 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. In addition, our reinsurance facilities may be canceled, pursuant to their terms, upon the occurrence of certain specified events, including a change of control of our Company (generally defined as the acquisition of 10% or more of our voting equity securities) or the failure of our insurance company subsidiaries to maintain the minimum required levels of statutory surplus. Any of these potential developments could materially adversely affect our revenues, results of operations and financial condition.

In 2013, we reinsured \$467.5 million of face amount of our life insurance policies. Amounts reinsured in 2013 represented 9.9% of the face amount of direct life insurance in force in that year. 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 our cost of reinsurance were to increase, we might not be able to recover these increased costs, and our results of operations and financial condition could be materially adversely affected. See Note 5 to the Company's Consolidated Financial Statements.

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 as a result of our past or any future acquisitions.

We have acquired 17 U.S. life insurance companies since 1987. 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 realizing certain operating efficiencies associated with economies of scale.

We evaluate possible acquisitions of other insurance companies on an ongoing basis. While our business model is not dependent primarily upon acquisitions, the time frame for achieving or further improving our market positions can be shortened through acquisitions. There can be no assurance that suitable acquisitions presenting opportunities for continued growth and operating efficiencies will be available to us, or that we will realize the anticipated financial results from completed acquisitions. In addition, we face intense competition in seeking to make acquisitions, much of which is from companies with greater financial and operational resources than we have.

Even if we identify and complete insurance company acquisitions, we may be unable to integrate them on an economically favorable basis. Implementation of an acquisition strategy entails a number of risks, including, among others, inaccurate assessment of assets, liabilities or contingent liabilities and the failure to achieve anticipated operating efficiencies, revenues, earnings or cash flow. The occurrence of any of these events could have a material adverse effect on our results of operations and financial condition.

Our international and domestic operations face significant competition.

Our international marketing plan focuses on making available U.S. Dollar-denominated life insurance products to high net worth, high income individuals residing in more than 30 countries. New competition could increase the supply of available insurance, which could affect our ability to price our products at attractive profitable rates to us, thereby adversely affecting our revenues, results of operations and financial condition. Existing barriers to entry in the foreign markets we serve may not be sufficient to impede potential competitors from entering such markets. In connection with our business with foreign nationals, we experience

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

competition primarily from the following sources, many of which have substantially greater financial, marketing and other resources than we have:

• Foreign operated companies with U.S. Dollar policies. We face direct competition from companies that operate in the same manner as we operate in our international markets.

• Companies foreign to the countries in which their policies are sold but that issue local currency policies. Another group of our competitors in the international marketplace consists of companies that are foreign to the countries in which their policies are sold but issue life insurance policies denominated in 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.

• 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 they primarily 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. As a result, the cost of insurance from these companies tends to be higher than ours. Although these companies typically market their policies to a broader section of the population than do our independent marketing firms and independent consultants, there can be no assurance that these companies will not endeavor to place a greater emphasis on our target market and compete more directly with us.

In the United States, we compete with more than 1,000 other life insurance companies of various sizes. The life insurance business in the United States is highly competitive, in part because it is a mature industry that, in recent years, has experienced little to no growth in life insurance sales. Many domestic life insurance companies have substantially greater financial resources, longer business histories and more diversified lines of insurance coverage than we do. These companies also have larger sales forces than we have. Competition in the United States has also increased recently because the life insurance industry is consolidating, with larger, more efficient organizations emerging from the consolidation.

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.

There can be no assurance that we will be able to compete effectively in any of our markets. If we do not, our business, results of operations and financial condition will be materially adversely affected.

Sales of our products may be reduced if we are unable to (i) establish and maintain commercial relationships with independent marketing firms and independent consultants (ii) attract and retain employee agents or (iii) develop and maintain our distribution sources.

We distribute our insurance products through several distribution channels, including independent marketing firms and independent consultants and our employee agents. These relationships are significant for both our revenues and our profits. In our life insurance segment, we depend almost exclusively on the services of independent marketing firms and independent consultants. In our home service insurance segment, we depend on employee agents whose role in our distribution process is integral to developing and maintaining relationships with policyholders. Significant competition exists among insurers in attracting and maintaining marketers of demonstrated ability. Some of our

competitors may offer better compensation packages for marketing firms, independent consultants and agents and broader arrays of products and have a greater diversity of distribution resources, better brand recognition, more competitive pricing, lower cost structures and greater financial strength or claims paying ratings than we do. We compete with other insurers for marketing firms, independent consultants and employee agents primarily on the basis of our compensation and support services. Any reduction in our ability to attract and retain effective sales representatives could materially adversely affect our revenues, results of operations and financial condition.

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 participation of our Chairman of the Board and Chief Executive Officer, Harold E. Riley (age 86), and our Vice Chairman of the Board and President, Rick D. Riley (age 61), in connection with the development and execution of our operating and marketing plans and strategy for expanding our business. We anticipate that their expertise will continue to be of substantial

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

value in connection with our operations. The loss of the services of either of these individuals could have a significant adverse effect on our business and prospects. We do not have an employment agreement with either of these persons nor do we carry a key-man insurance policy on either of their lives.

We are subject to extensive governmental regulation in the United States, which increases our costs of doing business and could restrict the conduct of our business.

We are subject to extensive regulation and supervision in U.S. jurisdictions wherein we do business, as well as anti-money laundering regulations adopted under the USA Patriot Act. Insurance company regulation is generally designed to protect the interests of policyholders, with substantially lesser protections to shareholders of the regulated insurance companies. To that end, all the states in which we do business have insurance regulatory agencies with broad powers under law with respect to such things as: licensing companies to transact business; mandating capital and surplus requirements; regulating trade and claims practices; approving policy forms; and restricting companies' ability to enter and exit markets.

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

Most insurance regulatory authorities have broad discretion to grant, renew, suspend and revoke licenses and approvals, and could preclude or temporarily suspend us from carrying on some or all of our activities, including acquisitions of other insurance companies, require us to add capital to our insurance company subsidiaries, or fine us. If we are unable to maintain all required licenses and approvals, or if our insurance business is determined not to comply fully with the wide variety of applicable laws and regulations and their interpretations, including the USA Patriot Act, our revenues, results of operations and financial condition could be materially adversely affected.

Although the U.S. federal government has not historically regulated the insurance business, the Dodd-Frank Act, enacted in July 2010, expands the federal presence in insurance oversight. The Act's requirements include streamlining the state-based regulation of reinsurance and non-admitted insurance (also known as surplus lines insurance, which is property or casualty insurance written by a company that is not licensed to sell policies of insurance in a given state). This legislation also establishes a new Federal Insurance Office within the U.S. Department of the Treasury with powers over all lines of insurance except health insurance, certain long-term care insurance and crop insurance. The Federal Insurance Office is authorized to, among other things, gather data and information to monitor aspects of the insurance industry, identify issues in the regulation of insurers about insurance matters and preempt state insurance measures under certain circumstances. As this Act calls for numerous studies and contemplates further regulation, the future impact of the Act on our results of operations or our financial condition cannot be determined at this time, but could have an adverse impact on profitable operations.

Changes in U.S. regulation may adversely affect our results of operations and financial condition and limit our prospective growth.

Currently, the U.S. Federal Government does not directly regulate the insurance business, although initiatives for Federal regulation of insurance are proposed by members of the U.S. Congress from time to time. However, Federal legislation and administrative policies in several other areas can materially and adversely affect insurance companies, including our business. These areas include the USA Patriot Act, financial services regulation, securities regulation,



including the Sarbanes-Oxley Act of 2002, the Dodd-Frank Act, pension regulation, privacy, tort reform legislation and taxation. In addition, various forms of direct federal regulation of insurance have been proposed from time to time.

Our failure to maintain effective information systems could adversely affect our 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. If we do not maintain adequate systems, we could experience adverse consequences, including products acquired through acquisition, inadequate information on which to base pricing, underwriting and reserve decisions, regulatory problems, failure to meet prompt payment obligations, increases in administrative expenses and loss of customers.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Some of our information technology systems and software are mainframe-based, legacy-type systems that require an ongoing commitment of resources to maintain current standards. Our systems utilize proprietary code requiring highly skilled personnel. Due to the unique nature of our proprietary operating environment, we could have difficulty finding personnel with the skills required to provide ongoing system maintenance and development as we seek to keep pace with changes in our products and business models, information processing technology, evolving industry and regulatory standards and policyholder needs. Our success is dependent upon, among other things, maintaining and enhancing the effectiveness of existing systems, as well as continuing to integrate, develop and enhance our information systems to support business processes in a cost-effective manner.

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.

Our failure to protect confidential information and privacy could result in the loss of customers, subject us to fines and penalties and adversely affect our results of operations and financial condition.

Our insurance subsidiaries are subject to privacy regulations. The actions we take to protect confidential information include among other things: monitoring our record retention plans and policies and any changes in state or federal privacy and compliance requirements; maintaining secure storage facilities for tangible records; and limiting access to electronic information in order to safeguard certain information.

In addition, the Gramm-Leach-Bliley Act requires that we deliver a notice regarding our privacy policy both at the delivery of an insurance policy and annually thereafter. Certain exceptions are allowed for sharing of information under joint marketing agreements. However, certain state laws may require us to obtain a policyholder's consent before we share information.

We have a written information security program with appropriate administrative, technical and physical safeguards to protect such confidential information. Cyber security attacks are on the rise throughout the World and while we believe we have taken reasonable steps to secure our customer information we could experience a breach of data. If we do not comply with privacy regulations and protect confidential information, we could experience adverse consequences, including regulatory sanctions, loss of reputation and litigation, any of which could have a material adverse effect on our business, results of operations and financial condition.

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

We interface with and distribute our products to individual consumers. There may be a perception that certain U.S. 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 the insurance industry to periodic negative publicity. We may also be negatively impacted if other insurance companies engage in practices resulting in increased public attention to our businesses. Negative publicity may result in lower sales of insurance, lower persistency of our insurance products, increased regulation and legislative scrutiny of industry practices as well as increased litigation, which may further increase our costs of doing business and impede our ability to market our products. As a result, our business, results of operations and financial condition could be materially adversely affected.

General economic, financial market and political conditions may materially 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 United States and in the foreign countries where our policyowners reside. These conditions include economic cycles such as: levels of consumer spending; levels of inflation; movements of the financial markets; availability of credit; fluctuations in interest rates, monetary policy or demographics; and legislative and competitive changes.

During periods of economic downturn, such as the ones recently experienced, our insureds may choose not to purchase our insurance products, may terminate existing policies, permit policies to lapse or may choose to reduce the amount of coverage purchased, any of which could have a material adverse effect on our results of operations and financial condition. Also, our sales of new insurance policies might decrease.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Our insurance subsidiaries are restricted by applicable laws and regulations in the amounts of fees, dividends and other distributions they may make to us. The inability of our subsidiaries to make payments to us in sufficient amounts for us to conduct our operations could adversely affect our ability to meet our obligations or expand our business.

As a holding company, our principal asset is the stock of our subsidiaries. We rely primarily on statutorily permissible payments from our insurance company subsidiaries, principally through service agreements we have with our subsidiaries, to meet our working capital and other corporate expenses. The ability of our insurance company subsidiaries to make payments to us is subject to regulation by the states in which they are domiciled, and these payments depend primarily on approved service agreements between us and these subsidiaries and, to a lesser extent, the statutory surplus (which is the excess of assets over liabilities as determined under statutory accounting practices prescribed by an insurance company's state of domicile), future statutory earnings (which are earnings as determined in accordance with statutory accounting practices) and regulatory restrictions.

Generally, the net assets of our insurance company subsidiaries available for dividends are limited to either the lesser or greater (depending on the state of domicile) of the subsidiary's net gain from operations during the preceding year and 10% of the subsidiary's net statutory surplus as of the end of the preceding year as determined in accordance with accounting practices prescribed by insurance regulatory authorities.

Except to the extent that we are a 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 and shareholders. If any of our subsidiaries becomes insolvent, liquidates or otherwise reorganizes, our creditors and shareholders will have no right to proceed in their own right 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.

Adverse capital and credit market conditions may significantly affect our access to debt and equity capital and our cost of capital in seeking to expand our business.

The capital and credit markets experienced extreme volatility over the past several years. In some cases, the markets exerted significant downward pressure on availability of debt and equity capital for certain issuers (including short term liquidity and credit capacity). We believe the availability of debt and equity capital has decreased significantly compared to prior years.

The availability of equity and debt financing to us will depend on a variety of factors such as market conditions, the general availability of credit, the overall availability of credit to the financial services industry, our credit capacity, as well as the possibility that investors or lenders could develop a negative perception of our long- or short-term financial prospects. Disruptions, uncertainty or volatility in the capital markets may also limit our access to equity capital for us to seek to expand our business. As such, we may be forced to delay raising debt or equity capital, or bear an unattractive cost of capital, which could adversely affect our ability to seek any acquisitions and negatively impact profitability of an acquisition.

Unexpected losses in future reporting periods may require us to adjust the valuation allowance against our deferred tax assets.

We evaluate our deferred tax asset ("DTA") quarterly for recoverability based on available evidence. This process involves management's judgment about assumptions, which are subject to change from period to period due to tax rate

changes or variances between our projected operating performance and our actual results. Ultimately, future adjustments to the DTA valuation allowance, if any, will be determined based upon changes in the expected realization of the net deferred tax assets. The realization of the deferred tax assets depends on the existence of sufficient taxable income in either the carry back or carry forward periods under applicable tax law. Due to significant estimates utilized in establishing the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that we may be required to record a valuation allowance in future reporting periods. Such an adjustment could have a material adverse effect on our results of operation, financial condition and capital position.

#### Risks Relating to Our Capital Stock

The price of our Class A common stock may be adversely affected by decreased participation in the Citizens, Inc. Stock Investment Plan (the "Plan").

Most all of our international policyholders participate in the Plan and they invest their policy dividends and benefits in our Class A common stock pursuant to the Plan. Once a policyholder elects to participate in the Plan, his or her policy benefits are assigned

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

to purchase Citizens Class A common stock under the Plan in the open market. There is a risk our Class A common stock price could be negatively impacted by a decrease in participation in the Plan. If fewer policyholders elect to participate in the Plan, or our international premium collections were to decrease as a result of regulatory, economic, or marketing impediments, the trading volume of our Class A stock may decline from its present levels and the demand for our Class A common stock could be negatively impacted.

Control of our Company, through the ownership of our Class B Common Stock, may transfer from our Founder to a 501(c)(3) charitable foundation established by our Founder and we cannot determine whether any change in our management, operations, or operating strategies will occur as a result of such an ownership change.

Harold E. Riley, our Founder, Chairman and CEO, is the beneficial owner of 100% of the Citizens Class B common stock, which is held in the name of the Harold E. Riley Trust ("Trust"), of which he serves as Trustee. Citizens' Class A and Class B common stock are identical in all respects, except the Class B common stock elects a simple majority of the Board and receives one-half of any cash dividends paid, on a per share basis, to the Class A shares. Therefore, Mr. Riley controls our Company. The Class A common stock elects the remainder of the Board. The Trust documents provide that upon Mr. Riley's death, the Class B common stock will be transferred from the Trust to the Harold E. Riley Foundation, a charitable organization established under 501(c)(3) of the Internal Revenue Code (the "Foundation"). In addition, the Trust documents provide that Mr. Riley may at any time transfer the Class B common stock held by the Trust to the Foundation. It is unclear what, if any, changes would occur to our board, management structure, or corporate operating strategies as a result of different ownership of our Class B common stock.

There are a substantial number of our shares of Class A common stock issued to our executive officers, directors and management which are eligible for future sale in the public market. The sale of these shares could cause the market price of our Class A common stock to fall.

There were 49,080,114 shares of our Class A common stock issued as of December 31, 2013. Our executive officers, directors and management owned approximately 3,340,597 shares of our Class A common stock as of December 31, 2013, representing approximately 7% of our then outstanding Class A common stock. Almost all of these shares have been registered for public resale and generally may be sold freely. In the event of a sale of some or all of these shares or the perceived sale of these shares, the market price of our Class A common stock could fall substantially.

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

Our Class A common stock price has historically fluctuated and is likely to fluctuate in the future and could decline materially because of the volatility of the stock market in general, decreased participation in the Plan referred to above or a variety of other factors, many of which are beyond our control, including: quarterly or annual variations in actual or anticipated results of our operations; interest rate fluctuations; changes in financial estimates by securities analysts; competition and other factors affecting the life insurance business generally; and conditions in the U.S. and world economies.

Our Class A common shareholders do not control us and have a limited ability to influence our business policies and corporate actions and are not by themselves able to elect any of our directors.

It is difficult for Class A common shareholders to elect any of our directors or otherwise exert any significant influence over our business. The sole holder of our outstanding Class B common stock is entitled to elect a simple majority of our board of directors and therefore controls us. All of our Class B common stock is currently owned by the Harold E. Riley Trust, of which Harold E. Riley, our founder, Chairman of the Board and Chief Executive Officer,

is the sole trustee. Additionally, Harold E. Riley beneficially owns approximately 4% of the issued shares of our Class A common stock.

Our articles of incorporation and bylaws, as well as applicable state insurance laws, may discourage takeovers and business combinations that our shareholders might consider to be in their best interests.

Our articles of incorporation and bylaws, as well as various state insurance laws, may delay, deter, render more difficult or prevent a takeover attempt our shareholders might consider in their best interests. As a result, our shareholders will be prevented from receiving the benefit from any premium to the market price of our Class A common stock that may be offered by a bidder in a takeover context. Even in the absence of a takeover attempt, the existence of these provisions may adversely affect the prevailing market price of our Class A common stock if they are viewed as discouraging takeover attempts in the future.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

The following provisions in our articles of incorporation and bylaws make it difficult for our Class A shareholders to replace or remove our directors and have other anti-takeover effects that may delay, deter or prevent a takeover attempt:

• holders of shares of our Class B common stock elect a simple majority of our board of directors, and all of these shares are owned by the Harold E. Riley Trust; and  
• our board of directors may issue one or more series of preferred stock without the approval of our shareholders.

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 proposed acquirer, the integrity of the proposed acquirer's board of directors and executive officers, the proposed 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 state insurance requirements may delay, deter or prevent our ability to complete an acquisition.

We have never paid any cash dividends on our Class A common stock and do not anticipate doing so in the foreseeable future.

We have never paid cash dividends on our Class A common stock, as it is our policy to retain earnings for use in the operation and expansion of our business. We do not expect to pay cash dividends on our Class A common stock for the foreseeable future.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. OTHER INFORMATION

On November 5, 2014, the Company issued a news release (the "Release") reporting, among things, results of operations for its third quarter of 2014. A copy of the Release is furnished as Exhibit 99.1 to this Quarterly Report on Form 10-Q. Citizens also announced that it would hold a conference call to discuss its financial results at 10:00 a.m. Central Time on Thursday, November 6, 2014.

Item 6. EXHIBITS

Exhibit Number The following exhibits are filed herewith:

11	Statement re: Computation of per share earnings (see financial statements)
31.1	Certification of Chief Executive Officer and Vice Chairman pursuant to Section 302 of the Sarbanes-Oxley Act*
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act*
32.1	Certification of Chief Executive Officer and Vice Chairman pursuant to Section 906 of the Sarbanes-Oxley Act*
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act*
99.1	News Release reporting third quarter results issued on November 5, 2014 (furnished herewith)
101.INS	XBRL Instance Document (furnished herewith)
101.SCH	XBRL Taxonomy Extension Schema (furnished herewith)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase (furnished herewith)
101.DEF	XBRL Taxonomy Extension Definition Linkbase (furnished herewith)
101.LAB	XBRL Taxonomy Extension Label Linkbase (furnished herewith)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase (furnished herewith)

\* Filed herewith.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CITIZENS, INC.

By: /s/ Harold E. Riley  
Harold E. Riley  
Chairman and Chief Executive Officer

By: /s/ Rick D. Riley  
Rick D. Riley  
Vice Chairman and President

By: /s/ Kay E. Osbourn  
Kay E. Osbourn  
Executive Vice President, Chief Financial Officer  
and Treasurer

Date: November 5, 2014