CITIZENS INC
Form 10-Q
August 09, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

____

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2016
or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission File Number: 000-16509
CITIZENS, INC.
(Exact name of registrant as specified in its charter)

Colorado	84-0755371
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
400 East Anderson Lane, Austin, TX	78752
(Address of principal executive offices)	(Zip Code)

(512) 837-7100
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes x No

As of July 29, 2016, the Registrant had 49,080,114 shares of Class A common stock, no par value, outstanding and 1,001,714 shares of Class B common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Consolidated Statements of Financial Position
(In thousands)

Assets	June 30, 2016 (Unaudited)	December 31, 2015
Investments:		
Fixed maturities available-for-sale, at fair value (cost: $784,934 and $714,137 in 2016 and 2015, respectively)	$ 835,473	735,648
Fixed maturities held-to-maturity, at amortized cost (fair value: $270,051 and $264,966 in 2016 and 2015, respectively)	256,165	259,953
Equity securities available-for-sale, at fair value (cost: $22,729 and $23,727 in 2016 and 2015, respectively)	23,234	23,438
Mortgage loans on real estate	468	594
Policy loans	63,157	60,166
Real estate held for investment (less $1,795 and $1,721 accumulated depreciation in 2016 and 2015, respectively)	7,869	7,956
Other long-term investments	75	75
Short-term investments	521	251
Total investments	1,186,962	1,088,081
Cash and cash equivalents	52,937	82,827
Accrued investment income	16,719	15,406
Receivable for securities	653	—
Reinsurance recoverable	4,068	4,166
Deferred policy acquisition costs	165,860	165,362
Cost of customer relationships acquired	20,173	21,585
Goodwill	17,255	17,255
Other intangible assets	969	971
Deferred tax asset	60,874	68,764
Property and equipment, net	6,546	6,338
Due premiums, net (less $1,446 and $1,490 allowance for doubtful accounts in 2016 and 2015, respectively)	11,485	11,819
Prepaid expenses	1,215	162
Other assets	1,286	1,304
Total assets	$ 1,547,002	1,484,040

(Continued)

See accompanying notes to consolidated financial statements.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Consolidated Statements of Financial Position
(In thousands, except share amounts)

Liabilities and Stockholders' Equity	June 30, 2016 (Unaudited)	December 31, 2015
Liabilities:		
Policy liabilities:		
Future policy benefit reserves:		
Life insurance	$1,026,980	995,972
Annuities	67,200	64,933
Accident and health	1,075	1,118
Dividend accumulations	19,362	18,465
Premiums paid in advance	45,180	43,220
Policy claims payable	9,400	9,653
Other policyholders' funds	7,230	7,518
Total policy liabilities	1,176,427	1,140,879
Commissions payable	2,424	2,757
Federal income tax payable	73,473	71,225
Payable for securities in process of settlement	7,363	2,457
Other liabilities	26,238	24,205
Total liabilities	1,285,925	1,241,523
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Class A, no par value, 100,000,000 shares authorized, 52,215,852 shares issued and outstanding in 2015 and 2014, including shares in treasury of 3,135,738 in 2015 and 2014	259,383	259,383
Class B, no par value, 2,000,000 shares authorized, 1,001,714 shares issued and outstanding in 2015 and 2014	3,184	3,184
Accumulated deficit	(23,256)	(22,626)
Accumulated other comprehensive income:		
Unrealized gains on securities, net of tax	32,777	13,587
Treasury stock, at cost	(11,011)	(11,011)
Total stockholders' equity	261,077	242,517
Total liabilities and stockholders' equity	$1,547,002	1,484,040

See accompanying notes to consolidated financial statements.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Consolidated Statements of Comprehensive Income
Three Months Ended June 30,
(In thousands, except per share amounts)
(Unaudited)

	2016	2015
Revenues:		
Premiums:		
Life insurance	$47,351	46,748
Accident and health insurance	395	421
Property insurance	1,261	1,291
Net investment income	12,000	11,201
Realized investment losses, net	(26)	(8)
Other income	256	426
Total revenues	61,237	60,079
Benefits and expenses:		
Insurance benefits paid or provided:		
Claims and surrenders	20,969	19,240
Increase in future policy benefit reserves	17,675	19,760
Policyholders' dividends	1,816	2,540
Total insurance benefits paid or provided	40,460	41,540
Commissions	10,777	10,805
Other general expenses	8,566	10,445
Capitalization of deferred policy acquisition costs	(8,103)	(8,036)
Amortization of deferred policy acquisition costs	6,827	5,647
Amortization of cost of customer relationships acquired	402	516
Total benefits and expenses	58,929	60,917
Income (loss) before federal income tax	2,308	(838)
Federal income tax expense	989	1,076
Net income (loss)	1,319	(1,914)
Per Share Amounts:		
Basic earnings per share of Class A common stock	$0.03	(0.04)
Basic earnings per share of Class B common stock	0.01	(0.02)
Diluted earnings per share of Class A common stock	0.03	(0.04)
Diluted earnings per share of Class B common stock	0.01	(0.02)
Other comprehensive income (loss):		
Unrealized gains (losses) on available-for-sale securities:		
Unrealized holding gains (losses) arising during period	16,374	(16,778)
Reclassification adjustment for losses included in net income	20	8
Unrealized gains (losses) on available-for-sale securities, net	16,394	(16,770)
Income tax expense (benefit) on unrealized gains (losses) on available-for-sale securities	5,738	(5,869)
Other comprehensive income (loss)	10,656	(10,901)
Comprehensive income (loss)	$11,975	(12,815)

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Consolidated Statements of Comprehensive Income
Six Months Ended June 30,
(In thousands, except per share amounts)
(Unaudited)

	2016	2015
Revenues:		
Premiums:		
Life insurance	$90,124	89,647
Accident and health insurance	785	796
Property insurance	2,537	2,583
Net investment income	23,731	22,270
Realized investment losses, net	(1,822)	(79)
Other income	407	722
Total revenues	115,762	115,939
Benefits and expenses:		
Insurance benefits paid or provided:		
Claims and surrenders	39,974	38,643
Increase in future policy benefit reserves	33,665	37,058
Policyholders' dividends	3,365	4,849
Total insurance benefits paid or provided	77,004	80,550
Commissions	20,245	20,664
Other general expenses	17,884	17,996
Capitalization of deferred policy acquisition costs	(14,367)	(14,892)
Amortization of deferred policy acquisition costs	13,535	10,946
Amortization of cost of customer relationships acquired	947	1,163
Total benefits and expenses	115,248	116,427
Income (loss) before federal income tax	514	(488)
Federal income tax expense	1,144	1,001
Net loss	(630)	(1,489)
Per Share Amounts:		
Basic losses per share of Class A common stock	$(0.01)	$(0.03)
Basic losses per share of Class B common stock	(0.01)	(0.02)
Diluted losses per share of Class A common stock	(0.01)	(0.03)
Diluted losses per share of Class B common stock	(0.01)	(0.02)
Other comprehensive income (loss):		
Unrealized gains (losses) on available-for-sale securities:		
Unrealized holding gains (losses) arising during period	27,707	(11,771)
Reclassification adjustment for losses included in net income	1,816	44
Unrealized gains (losses) on available-for-sale securities, net	29,523	(11,727)
Income tax expense (benefit) on unrealized gains on available-for-sale securities	10,333	(4,104)
Other comprehensive income (loss)	19,190	(7,623)
Comprehensive income (loss)	$18,560	(9,112)

See accompanying notes to consolidated financial statements.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Consolidated Statements of Cash Flows
Six Months Ended June 30,
(In thousands)
(Unaudited)

	2016	2015
Cash flows from operating activities:		
Net loss	$ (630)	(1,489)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Realized losses on sale of investments and other assets	1,822	79
Net deferred policy acquisition costs	(832)	(3,946)
Amortization of cost of customer relationships acquired	947	1,163
Depreciation	405	386
Amortization of premiums and discounts on investments	6,966	5,583
Deferred federal income tax expense (benefit)	(2,442)	957
Change in:		
Accrued investment income	(1,313)	(970)
Reinsurance recoverable	98	63
Due premiums	334	(367)
Future policy benefit reserves	32,457	36,925
Other policyholders' liabilities	2,316	5,385
Federal income tax payable	2,248	(3,256)
Commissions payable and other liabilities	1,700	554
Other, net	(1,031)	(1,244)
Net cash provided by operating activities	43,045	39,823
Cash flows from investing activities:		
Maturities and calls of fixed maturities, available-for-sale	37,625	19,024
Maturities and calls of fixed maturities, held-to-maturity	6,275	9,975
Purchase of fixed maturities, available-for-sale	(109,613)	(57,065)
Purchase of fixed maturities, held-to-maturity	(5,507)	(22,959)
Sale of equity securities, available-for-sale	403	—
Calls of equity securities, available-for-sale	273	150
Purchase of equity securities, available-for-sale	—	(602)
Principal payments on mortgage loans	126	18
Increase in policy loans, net	(2,991)	(2,620)
Sale of other long-term investments	—	58
Purchase of property and equipment	(527)	(123)
Maturity of short-term investments	250	—
Purchase of short-term investments	(522)	—
Net cash used in investing activities	(74,208)	(54,144)

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Consolidated Statements of Cash Flows, Continued
Six Months Ended June 30,
(In thousands)
(Unaudited)

	2016	2015
Cash flows from financing activities:		
Annuity deposits	$3,980	3,995
Annuity withdrawals	(2,707)	(2,562)
Net cash provided by financing activities	1,273	1,433
Net decrease in cash and cash equivalents	(29,890)	(12,888)
Cash and cash equivalents at beginning of year	82,827	50,708
Cash and cash equivalents at end of period	$52,937	37,820
Supplemental disclosures of operating activities:		
Cash paid during the period for income taxes, net	$1,339	3,300

Supplemental Disclosures of Non-Cash Investing Activities:
None.

See accompanying notes to consolidated financial statements.

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements
June 30, 2016
(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 statement of financial position for June 30, 2016, and the consolidated statements of comprehensive income (loss) for the three and six months ended June 30, 2016 and 2015 and cash flows for the six-month periods ended June 30, 2016 and 2015, 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 June 30, 2016 and for comparative periods have been made. The consolidated financial statements have been prepared in accordance with U.S. GAAP 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, 2015. 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.

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.

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.

Significant Accounting Policies

For a description of significant accounting policies, see Note 1 of the notes to consolidated financial statements included in our 2015 Form 10-K Annual Report, which should be read in conjunction with these accompanying consolidated financial statements.

(2) Accounting Pronouncements

Accounting Standards Recently Adopted

None.

Accounting Standards Not Yet Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") Accounting Standards Update ("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, 2017, 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.

On May 21, 2015, the FASB issued ASU 2015-09, Disclosures about Short-Duration Contracts, addressing enhanced disclosure requirements for insurers relating to short-duration insurance contract claims and the unpaid claims liability rollforward for long and short-duration contracts. The disclosures are intended to provide users of financial statements with more transparent information about an insurance entity's initial claim estimates and subsequent adjustments to those estimates, the methodologies and judgments used to estimate claims, and the timing, frequency, and severity of claims. The new disclosures may require the accumulation and reporting of new and different groupings of claims data by insurers from what is currently captured for U.S. statutory and other reporting purposes. For public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. The Company is currently assessing the new disclosure requirements related to short-duration contracts.

The FASB's new lease accounting standard, ASU 2016-02, Leases (Topic 842), was issued on February 25, 2016. The ASU will require organizations that lease assets, referred to as "lessees", to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. The accounting by organizations that own the assets leased by the lessee, also known as lessor accounting, will remain largely unchanged from current GAAP. However, the ASU contains some targeted improvements that are intended to align, where necessary, lessor accounting with the lessee accounting model and with the updated revenue recognition guidance issued in 2014. The ASU on leases will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company will begin assessing the impact of this new standard in the second half of 2016.

On June 10, 2016, the National Association of Insurance Commissioners (“NAIC”) Executive Committee and Plenary voted to adopt a recommendation for January 1, 2017 as the operative date for the implementation of Principles-Based Reserves (“PBR”) as a national standard for life insurance products. Although this NAIC standard does not change the reserving requirements under U.S. GAAP, it can be significant for many life insurers. PBR replaces the current formulaic approach to determining policy reserves with an approach that more closely reflects the risks of highly complex products. Companies will be expected to develop “right-sized” reserves that better align with their specific product features, their observed actuarial experience, and their overall risk management procedures. There is a three-year transition period where PBR is optional until PBR becomes required on January 1, 2020. The Company has begun to assess the impact that this standard will have on its statutory reserving.

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2016
(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 June 30, 2016			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	$37,111	11,896	—	49,007
Net investment income	8,107	3,505	388	12,000
Realized investment gains (losses), net	208	(234)	—	(26)
Other income	256	—	—	256
Total revenue	45,682	15,167	388	61,237
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	15,157	5,812	—	20,969
Increase in future policy benefit reserves	16,319	1,356	—	17,675
Policyholders' dividends	1,802	14	—	1,816
Total insurance benefits paid or provided	33,278	7,182	—	40,460
Commissions	6,768	4,009	—	10,777
Other general expenses	4,041	3,557	968	8,566
Capitalization of deferred policy acquisition costs	(6,492)	(1,611)	—	(8,103)
Amortization of deferred policy acquisition costs	6,062	765	—	6,827
Amortization of cost of customer relationships acquired	130	272	—	402
Total benefits and expenses	43,787	14,174	968	58,929
Income (loss) before income tax expense	$1,895	993	(580)	2,308

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2016
(Unaudited)

	Six Months Ended June 30, 2016			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	$69,959	23,487	—	93,446
Net investment income	16,061	6,919	751	23,731
Realized investment losses, net	(660)	(1,162)	—	(1,822)
Other income	371	3	33	407
Total revenue	85,731	29,247	784	115,762
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	28,621	11,353	—	39,974
Increase in future policy benefit reserves	31,163	2,502	—	33,665
Policyholders' dividends	3,338	27	—	3,365
Total insurance benefits paid or provided	63,122	13,882	—	77,004
Commissions	12,571	7,674	—	20,245
Other general expenses	8,125	7,747	2,012	17,884
Capitalization of deferred policy acquisition costs	(11,418)	(2,949)	—	(14,367)
Amortization of deferred policy acquisition costs	11,943	1,592	—	13,535
Amortization of cost of customer relationships acquired	300	647	—	947
Total benefits and expenses	84,643	28,593	2,012	115,248
Income (loss) before income tax expense	$1,088	654	(1,228)	514

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2016
(Unaudited)

	Three Months Ended June 30, 2015			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	$36,707	11,753	—	48,460
Net investment income	7,387	3,441	373	11,201
Realized investment losses, net	(2)	(6)	—	(8)
Other income	160	22	244	426
Total revenue	44,252	15,210	617	60,079
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	13,465	5,775	—	19,240
Increase in future policy benefit reserves	18,490	1,270	—	19,760
Policyholders' dividends	2,527	13	—	2,540
Total insurance benefits paid or provided	34,482	7,058	—	41,540
Commissions	6,815	3,990	—	10,805
Other general expenses	4,872	4,459	1,114	10,445
Capitalization of deferred policy acquisition costs	(6,423)	(1,613)	—	(8,036)
Amortization of deferred policy acquisition costs	4,941	706	—	5,647
Amortization of cost of customer relationships acquired	122	394	—	516
Total benefits and expenses	44,809	14,994	1,114	60,917
Income (loss) before income tax expense	$(557)	216	(497)	(838)

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2016
(Unaudited)

	Six Months Ended June 30, 2015			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	$69,686	23,340	—	93,026
Net investment income	14,618	6,905	747	22,270
Realized investment losses, net	(58)	(21)	—	(79)
Other income	374	70	278	722
Total revenue	84,620	30,294	1,025	115,939
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	27,025	11,618	—	38,643
Increase in future policy benefit reserves	34,627	2,431	—	37,058
Policyholders' dividends	4,822	27	—	4,849
Total insurance benefits paid or provided	66,474	14,076	—	80,550
Commissions	12,841	7,823	—	20,664
Other general expenses	8,031	8,289	1,676	17,996
Capitalization of deferred policy acquisition costs	(11,766)	(3,126)	—	(14,892)
Amortization of deferred policy acquisition costs	9,490	1,456	—	10,946
Amortization of cost of customer relationships acquired	322	841	—	1,163
Total benefits and expenses	85,392	29,359	1,676	116,427
Income (loss) before income tax expense	$(772)	935	(651)	(488)

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2016
(Unaudited)

(4) Earnings Per Share

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

	Three Months Ended	
	June 30, 2016	June 30, 2015
	(In thousands, except per share amounts)	
Basic and diluted earnings per share:		
Numerator:		
Net income (loss)	$ 1,319	(1,914)
Net income (loss) allocated to Class A common stock	$ 1,305	(1,895)
Net income (loss) allocated to Class B common stock	14	(19)
Net income (loss)	$ 1,319	(1,914)
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 (losses) per share of Class A common stock	$ 0.03	(0.04)
Basic earnings (losses) per share of Class B common stock	0.01	(0.02)
Diluted earnings (losses) per share of Class A common stock	0.03	(0.04)
Diluted earnings (losses) per share of Class B common stock	0.01	(0.02)

	Six Months Ended	
	June 30, 2016	June 30, 2015
	(In thousands, except per share amounts)	
Basic and diluted earnings per share:		
Numerator:		
Net loss	$ (630)	(1,489)
Net loss allocated to Class A common stock	$ (624)	(1,474)
Net loss allocated to Class B common stock	(6)	(15)
Net loss	$ (630)	(1,489)
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 losses per share of Class A common stock	$ (0.01)	(0.03)
Basic losses per share of Class B common stock	(0.01)	(0.02)
Diluted losses per share of Class A common stock	(0.01)	(0.03)

Diluted losses per share of Class B common stock	(0.01)	(0.02)

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(5) Investments

The Company invests primarily in fixed maturity securities, which totaled 88.0% of total cash, cash equivalents and investments at June 30, 2016.

	June 30, 2016		December 31, 2015	
	Carrying Value	% of Total Carrying Value	Carrying Value	% of Total Carrying Value
	($ In thousands)			
Fixed maturity securities	$1,091,638	88.0	$995,601	85.0
Equity securities	23,234	1.9	23,438	2.0
Mortgage loans	468	—	594	0.1
Policy loans	63,157	5.1	60,166	5.1
Real estate and other long-term investments	7,944	0.7	8,031	0.7
Short-term investments	521	—	251	—
Cash and cash equivalents	52,937	4.3	82,827	7.1
Total cash, cash equivalents and investments	$1,239,899	100.0	$1,170,908	100.0

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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.

	June 30, 2016			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Fixed maturities:				
Available-for-sale:				
U.S. Treasury securities	$9,962	3,151	—	13,113
U.S. Government-sponsored enterprises	7,701	1,328	—	9,029
States and political subdivisions	514,576	30,297	1,522	543,351
Foreign governments	103	31	—	134
Corporate	250,041	18,334	1,310	267,065
Commercial mortgage-backed	103	5	—	108
Residential mortgage-backed	2,448	228	3	2,673
Total available-for-sale securities	784,934	53,374	2,835	835,473
Held-to-maturity securities:				
U.S. Government-sponsored enterprises	2,006	84	—	2,090
States and political subdivisions	233,058	13,708	96	246,670
Corporate	21,101	1,043	853	21,291
Total held-to-maturity securities	256,165	14,835	949	270,051
Total fixed maturities	$1,041,099	68,209	3,784	1,105,524
Short-term investments	$521	—	—	521
Equity securities:				
Stock mutual funds	$2,867	—	1	2,866
Bond mutual funds	18,451	301	—	18,752
Common stock	39	4	17	26
Preferred stock	1,372	218	—	1,590
Total equity securities	$22,729	523	18	23,234

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	December 31, 2015			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Fixed maturities:				
Available-for-sale securities:				
U.S. Treasury securities	$9,995	2,597	—	12,592
U.S. Government-sponsored enterprises	19,676	1,104	—	20,780
States and political subdivisions	470,319	15,815	3,085	483,049
Foreign governments	104	27	—	131
Corporate	211,245	9,683	4,847	216,081
Commercial mortgage-backed	140	5	—	145
Residential mortgage-backed	2,658	214	2	2,870
Total available-for-sale securities	714,137	29,445	7,934	735,648
Held-to-maturity securities:				
U.S. Government-sponsored enterprises	2,010	110	—	2,120
States and political subdivisions	236,776	6,756	883	242,649
Corporate	21,167	530	1,500	20,197
Total held-to-maturity securities	259,953	7,396	2,383	264,966
Total fixed maturity securities	$974,090	36,841	10,317	1,000,614
Short-term investments	$251	—	—	251
Equity securities:				
Stock mutual funds	$3,270	—	237	3,033
Bond mutual funds	18,798	55	349	18,504
Common stock	65	—	22	43
Preferred stock	1,594	266	2	1,858
Total equity securities	$23,727	321	610	23,438

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 other-than-temporary 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 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.

Other-than-temporary impairments ("OTTI") were recognized on investment securities during the three and six months ended June 30, 2016 totaling $0.4 million and$2.3 million, respectively. No other-than-temporary impairments were recognized during the three and six months ended June 30, 2015.

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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.

	June 30, 2016								
	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:									
States and political subdivisions	$14,100	72	13	$13,314	1,450	11	$27,414	1,522	24
Corporate	28,313	445	28	10,125	865	16	38,438	1,310	44
Residential mortgage-backed	101	2	2	108	1	2	209	3	4
Total available-for-sale securities	42,514	519	43	23,547	2,316	29	66,061	2,835	72
Held-to-maturity securities:									
States and political subdivisions	5,963	66	4	3,683	30	5	9,646	96	9
Corporate	—	—	—	5,027	853	4	5,027	853	4
Total held-to-maturity securities	5,963	66	4	8,710	883	9	14,673	949	13
Total fixed maturities	$48,477	585	47	$32,257	3,199	38	$80,734	3,784	85
Equity securities:									
Stock mutual funds	$999	1	1	$—	—	—	$999	1	1
Common stocks	—	—	—	18	17	1	18	17	1
Total equities	$999	1	1	$18	17	1	$1,017	18	2

As of June 30, 2016, the Company had 29 available-for-sale fixed maturity securities and 9 held-to-maturity fixed maturity securities that were in an unrealized loss position for greater than 12 months. We reported 1 equity security holding in an unrealized loss position for greater than 12 months as of June 30, 2016.

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	December 31, 2015								
	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:									
States and political subdivisions	$136,862	1,474	129	$12,633	1,611	12	$149,495	3,085	141
Corporate	70,081	4,330	69	3,308	517	3	73,389	4,847	72
Residential mortgage-backed	57	1	2	133	1	3	190	2	5
Total available-for-sale securities	207,000	5,805	200	16,074	2,129	18	223,074	7,934	218
Held-to-maturity securities:									
States and political subdivisions	74,628	774	59	2,404	109	5	77,032	883	64
Corporate	4,585	641	4	2,160	859	2	6,745	1,500	6
Total held-to-maturity securities	79,213	1,415	63	4,564	968	7	83,777	2,383	70
Total fixed maturities	$286,213	7,220	263	$20,638	3,097	25	$306,851	10,317	288
Equity securities:									
Stock mutual funds	$3,030	237	4	$2	—	1	$3,032	237	5
Bond mutual funds	10,158	318	2	108	31	1	10,266	349	3
Preferred stocks	101	1	1	1	1	1	102	2	2
Common stock	22	1	2	21	21	2	43	22	4
Total equities	$13,311	557	9	$132	53	5	$13,443	610	14

We have reviewed these securities for the periods ended June 30, 2016 and December 31, 2015 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 other-than-temporary impairments being recorded.

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The amortized cost and fair value of fixed maturity securities at June 30, 2016 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.

	June 30, 2016	
	Amortized Cost	Fair Value
	(In thousands)	
Available-for-sale securities:		
Due in one year or less	$38,553	39,140
Due after one year through five years	108,931	113,330
Due after five years through ten years	113,784	122,978
Due after ten years	523,666	560,025
Total available-for-sale securities	784,934	835,473
Held-to-maturity securities:		
Due in one year or less	4,185	4,206
Due after one year through five years	38,928	41,368
Due after five years through ten years	56,368	60,490
Due after ten years	156,684	163,987
Total held-to-maturity securities	256,165	270,051
Total fixed maturities	$1,041,099	1,105,524

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.

	Fixed Maturities Available-for-Sale				Equity Securities			
	Three Months Ended		Six Months Ended		Three Months Ended		Six Months Ended	
	June 30,		June 30,		June 30,		June 30	
	2016	2015	2016	2015	2016	2015	2016	2015
	(In thousands)							
Proceeds	$—	—	—	—	403	—	403	—
Gross realized gains	$—	—	—	—	40	—	40	—
Gross realized losses	$—	—	—	—	36	—	36	—

There were a small number of sales of equity securities in the second quarter of 2016, namely one equity security and three mutual funds. There were no sales of available-for-sale securities for the three and six month periods ended June 30, 2015. There were no securities sold from the held-to-maturity portfolio for the three and six months ended June 30, 2016 or 2015.

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(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.

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

	June 30, 2016			
Available-for-sale investments	Level 1	Level 2	Level 3	Fair Value
	(In thousands)			
Financial assets:				
Fixed maturities:				
U.S. Treasury and U.S. Government-sponsored enterprises	$13,113	9,029	—	22,142
States and political subdivisions	—	543,351	—	543,351
Corporate	—	267,065	—	267,065
Commercial mortgage-backed	—		108	108
Residential mortgage-backed	—	2,673	—	2,673
Foreign governments	—	134	—	134
Total fixed maturities	13,113	822,252	108	835,473
Equity securities:				
Stock mutual funds	2,866	—	—	2,866
Bond mutual funds	18,752	—	—	18,752
Common stock	26	—	—	26
Preferred stock	1,590	—	—	1,590
Total equity securities	23,234	—	—	23,234
Total financial assets	$36,347	822,252	108	858,707

	December 31, 2015			
Available-for-sale investments	Level 1	Level 2	Level 3	Fair Value
	(In thousands)			
Financial assets:				
Fixed maturities:				
U.S. Treasury and U.S. Government-sponsored enterprises	$12,592	20,780	—	33,372
States and political subdivisions	—	483,049	—	483,049
Corporate	—	216,081	—	216,081
Commercial mortgage-backed	—	—	145	145
Residential mortgage-backed	—	2,870	—	2,870
Foreign governments	—	131	—	131
Total fixed maturities	12,592	722,911	145	735,648
Equity securities:				
Stock mutual funds	3,033	—	—	3,033
Bond mutual funds	18,504	—	—	18,504
Common stock	43	—	—	43
Preferred stock	1,858	—	—	1,858
Total equity securities	23,438	—	—	23,438
Total financial assets	$36,030	722,911	145	759,086

Financial Instruments Valuation

Fixed maturity securities, available-for-sale. At June 30, 2016, our fixed maturity securities, valued using a third-party pricing source, totaled $822.3 million for Level 2 assets and comprised 95.8% 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 $0.1 million. Our Level 3 assets are current relative to principal and interest payments and are considered immaterial to our financial statements. For the six months ended June 30, 2016, 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.

	June 30, 2016	December 31, 2015
	(In thousands)	
Balance at beginning of period	$145	231
Total realized and unrealized gains (losses)		
Included in net income	—	—
Included in other comprehensive income	—	(2)
Principal paydowns	(37)	(84)
Transfer in and (out) of Level 3	—	—
Balance at end of period	$108	145

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.

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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:

	June 30, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(In thousands)			
Financial assets:				
Fixed maturities, held-to-maturity	$256,165	270,051	259,953	264,966
Mortgage loans	468	491	594	617
Policy loans	63,157	63,157	60,166	60,166
Short-term investments	521	521	251	251
Cash and cash equivalents	52,937	52,937	82,827	82,827
Financial liabilities:				
Annuity - investment contracts	48,776	49,820	47,222	46,905

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 6.2% as of June 30, 2016 and December 31, 2015, with maturities ranging from 1 to 26 years. Management estimated the fair value using an annual interest rate of 6.3% at June 30, 2016. 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 June 30, 2016 and December 31, 2015, 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 June 30, 2016 using discounted cash flows based upon a swap rate curve with interest rates ranging from 1.60% to 5.71% 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

Qualification of Life Products

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As of December 31, 2014, we determined that a portion of the life insurance policies issued by our subsidiary insurance companies failed to qualify for the favorable U.S. federal income tax treatment afforded by Sections 7702 of the Internal Revenue Code ("IRC") of 1986. This tax code section allows for qualifying products sold to clients to have favorable tax treatment such as the product's inside build up is not taxable. Because these policies were sold with the intention that they would qualify for this favorable tax treatment, holders of these policies and CICA may now be subject to additional tax liabilities. The policies at issue were sold most substantially to non-U.S. citizens residing abroad and to a lesser extent domestically. Based upon a review of the options available to the Company, we have determined we will not remediate our endowments and endowment-like products under IRC 7702 we have sold to non-U.S. citizens. We do intend to remediate the domestic products we have sold to U.S. citizens. In addition, as part of our continuing review, we determined in July 2015 that certain annuity contracts do not contain qualifying language under IRC 72(s) as intended that would have provided for favorable tax treatment of the annuities. This issue affects both our domestic and international contract holders. The Company has continued to refine the understanding of the tax failures as previously reported by preparing an individual policy calculation and has reflected the related exposure for the current reporting period as noted below. Failure of these policies to qualify under IRC Sections 7702 and 72(s) has resulted in additional liabilities and expenses as described below. The products have been and continue to be appropriately reported under U.S. GAAP for financial reporting.

The failure of these policies to qualify under Sections 7702 and 72(s) results in an estimated liability as of June 30, 2016 of $14.9 million, after tax, related to projected IRS toll charges and fees of $14.5 million as well as $0.4 million of reserve increases to bring policies into compliance. The estimated liability at June 30, 2016 is up $0.3 million from the estimated liability at March 31, 2016 and December 31, 2015 of $14.6 million, due to a continued refinement of our estimate. The probability weighted range of financial estimates relative to this issue is $7.0 million to $43.8 million, after tax. This estimated range includes projected toll charges and fees payable to the IRS, as well as estimated increased payout obligations to current and former holders of non-compliant domestic life insurance policies expected to result from remediation of those policies. The estimated liability and the estimated range will be updated as we continue to refine our estimates. The amount of our liabilities and expenses depends on a number of uncertainties, including the number of prior tax years for which we may be liable to the IRS, the number of domestic life insurance policies we will be required to remediate, and the methodology applicable to the calculation of taxable benefits under non-compliant policies. Given the range of potential outcomes and the significant variables assumed in establishing our estimates, actual amounts incurred may exceed our reserve and also could exceed the high end of our estimated range of liabilities and expenses. To the extent the amount reserved by the Company is insufficient to meet the actual amount of our liability and expenses, or if our estimates of those liabilities and expenses change in the future, our financial condition and results of operation may be materially adversely affected. Management believes that based upon current information we have recorded the best estimate liability to date.

Accruals for loss contingencies are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. The process of determining our best estimate and the estimated range is a complex undertaking, which includes insight from external consultants and involves management’s judgment based upon a variety of factors known at the time. We recorded additional general expenses of $1.0 million for the six months ended June 30, 2016 and $2.0 million for the twelve months ended December 31, 2015 related to our 7702 and 72(s) issues. Additional costs will be incurred in the second half of 2016 associated with these issues and we believe these costs will range from $1.0 million to $1.5 million, however, actual amounts incurred may differ from this estimate and changes will be recorded as they become probable and can be reasonably estimated.

Compliance

As part of our periodic review of our compliance controls, we completed an internal risk assessment of our compliance with the Bank Secrecy Act ("BSA") anti-money laundering requirements. We are in the process of enhancing our BSA compliance program with additional controls based on our risk assessment. Although we are not yet able to determine the extent of any potential losses related to our compliance program, we do not feel that non-compliance will have a material impact upon the Company.

Unclaimed Property Contingencies

The Company has been informed by the Louisiana Department of Treasury, Arkansas Auditor of State and 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.

The external audit 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 material 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.

Litigation

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.

(8) Income Taxes

The effective tax rate was 42.9% and (128.4)% for the three months and 222.6% and (205.1)% for the six months ended June 30, 2016 and 2015, respectively. Additionally there is $1.0 million and $0.7 million of tax expense recorded related to an uncertain tax position in the six months ended June 30, 2016 and June 30, 2015, respectively. In most periods where our effective tax rate is lower than the statutory tax rate of 35%, the difference, absent tax consequences of our 7702/72(s) issues, is primarily due to tax-exempt state and local bond income.

(9) Benefit Plans

The Company introduced a new employer-sponsored 401(k) plan to all eligible employees, effective March 1, 2016. This is an additional benefit offered to employees, which supplements the defined contribution profit-sharing plan which was already in existence. Employees with one year of service can participate in the new plan. Contributions are made by employees and the Company provides a matching contribution based upon the employee's level of contribution. The Company's expense related to the new 401(k) plan was not material to the Company's results of operations.

(10) 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 six months ended June 30, 2016. In June 2015 CICA made a $1 million cash capital contribution to CNLIC. See our Annual Report on Form 10-K as of December 31, 2015 for a comprehensive discussion of related party transactions.

Citizens, Inc. purchased Class A common shares in June 2016 that were held by CTI at market value as of the transaction date, which approximated $0.8 million. The transaction was eliminated for financial reporting purposes in accordance with consolidation accounting, but generated tax expense for the quarter ended June 30, 2016 totaling approximately $0.3 million.

During the second quarter of 2016, it was discovered that an ex officer of the Company, while serving as an officer, created an interest bearing deposit account associated with a company-issued life insurance policy using an interest rate in excess of normal Company limits. The excess interest was returned in the second quarter of 2016 and the ex-officer retired from the Company in all capacities at that time. The excess interest was an immaterial amount that had no material impact on the Company's financial statements.

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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 the application, interpretation or enforcement of foreign insurance laws that impact our business, which derives the majority of its revenues from residents of foreign countries;
- Potential changes in amounts reserved for in connection with the noncompliance of a portion of our insurance policies with Sections 7702 under the Internal Revenue Code and the failure of certain annuity contracts to qualify under Section 72(s) of the Internal Revenue Code;
- 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 or regulatory oversight, 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 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. Generally Accepted Accounting Principles (“U.S. GAAP”), policies or practices;

- Our success at managing risks involved in the foregoing;
- The risk factors discussed in "Part II. - Item 1A - Risk Factors." of this report; and
- Changes in leadership among our board and senior management team.

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 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 June 30, 2016, we had approximately $1.5 billion of total assets and approximately $4.5 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 sold to foreign residents, located 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, Mountain West 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 founder, 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.

Recent Developments

See Strategic Initiatives below for initiatives the Company began in 2015, which continue to be the main areas of focus for the executive management team in 2016.

On June 8, 2016, the Company's Board of Directors (the “Board”) appointed independent Board member Dr. Robert Sloan, as non-executive Chairman. Dr. Sloan succeeds Rick Riley who became Chairman of the Board in June 2015. Kay Osbourn, Citizens’ President at that time and former Chief Financial Officer, was also unanimously appointed by the Board as interim CEO.

On June 24, 2016, Rick D. Riley announced his retirement as a Citizens, Inc. employee and his resignation from the Citizens, Inc. Board.

On July 14, 2016, independent director Dr. Terry Maness was elected Chairman of the Audit Committee (the "Audit Committee") of the Board by the other members of the Audit Committee, succeeding Tim Timmerman. Effective July 14, 2016, Tim Timmerman resigned as a director and Chairman of the Audit Committee. Dr. Maness also serves as the qualified "audit committee financial expert," as that term is defined by the Securities and Exchange Commission, and will continue to serve on the Company's Compensation Committee and Nominating and Corporate Governance Committee.

Strategic Initiatives

The Company's Board of Directors and executive management team are currently assessing the Company's business model and business strategies with the assistance and support of external consultants and advisors. Specifically, we are evaluating certain elements and assumptions underlying the Company's historical business model to consider potential changes to align with our risk profile, the current economic and regulatory environment and sustainable business objectives. Incorporated in our business model review are analyses of (1) our products and profitability; (2) a potential restructuring of our international business and operations; (3) potential upgrades to our technology systems and operations with a strategic focus on our future business needs and cyber risk; and (4) potential additions to our executive management structure, personnel needs and compensation incentives.

A prolonged low interest rate period has forced us to revisit the benefits and dividends included under many policies offered internationally. In many cases, policyholders stand to benefit from significantly higher guarantees and dividends than the financial markets might otherwise offer. As such, the Company has responded to cut discretionary dividends on existing policies and revisit the structure of new policies sold internationally to better reflect the prolonged low interest rate environment that we face.

The Company also is revisiting its investment strategies for premiums received in order to augment its rate of return. By combining more conservative interest rate features in our insurance policies with a more flexible investment strategy to manage our investment portfolio, we intend to grow bottom line returns to shareholders. There is risk that these changes will result in lower demand for new policies, or that the financial markets will make our investment strategy more difficult. Despite the risks, the Company believes that such strategies are in the best interest of our shareholders.

The following pages describe the operations of our three business segments: Life Insurance, Home Service and Other Non-Insurance Enterprises. Revenues derived from any single customer did not exceed 10% of consolidated revenues in any of the last three years.

Current Financial Highlights

Financial highlights for the three and six month period ended June 30, 2016, compared to the same periods in 2015 were:

- Insurance premiums increased slightly for the three and six month periods ended June 30, 2016 to $49.0 million and $93.4 million from $48.5 million and $93.0 million for the corresponding periods in 2015, an increase of 1.1% and 0.5% driven primarily by an increase in renewal premiums, somewhat offset by a decrease in first year premiums in both our life insurance and home service segments.
- Net investment income increased 7.1% and 6.6% for the three and six month periods ended June 30, 2016, compared to the corresponding periods in 2015. The average yield on the consolidated portfolio as of the six months ended June 30, 2016 increased to an annualized rate of 4.31% up from 4.25% for the same period in 2015.
- Other-than-temporary impairments were recorded for the three and six month periods ended June 30, 2016 totaling $0.4 million and $2.3 million related to mutual fund impairments in the second quarter of 2016 and one available-for-sale fixed maturity security impairment in the first quarter of 2016.
- Claims and surrenders expense increased 9.0% and 3.4% for the three and six months ended 2016 compared to 2015 as surrender benefits increased in both periods in the life segment and death benefits reported in both insurance segments decreased year to date in the current year compared to 2015 levels.
-

- The change in reserves decreased in both the three and six month periods ended June 30, 2016 compared to the corresponding periods in 2015, primarily as a result of the increase in surrenders in both periods, while premiums remained relatively flat.
- General expenses decreased 18.0% and 0.6% for the three and six months ended June 30, 2016, respectively. The decrease for the three month period is primarily due to the $2.5 million expense recorded in the second quarter of 2015 related to our 72(s) tax compliance issue.

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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.

	Six Months Ended June 30,					
	2016			2015		
	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	$156,783,055	2,788	$56,235	$168,032,030	3,070	$54,734
Home Service	95,113,712	14,400	6,605	99,799,857	14,580	6,844

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Note: All discussions below compare or state results for the three and six-month periods ended June 30, 2016 compared to the three and six-month periods ended June 30, 2015.

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		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
	(In thousands)			
Revenues:				
Premiums:				
Life insurance	$47,351	46,748	90,124	89,647
Accident and health insurance	395	421	785	796
Property insurance	1,261	1,291	2,537	2,583
Net investment income	12,000	11,201	23,731	22,270
Realized investment losses, net	(26)	(8)	(1,822)	(79)
Other income	256	426	407	722
Total revenues	$61,237	60,079	115,762	115,939

Premium Income. Premium income derived from life, accident and health, and property insurance sales increased 1.1% and 0.5% for the three and six month periods ended June 30, 2016 compared to the same periods ended June 30, 2015. The increase is generated primarily from an increase in renewal premium, somewhat offset by an decrease in first year premium.

Net investment income performance is summarized as follows.

	June 30,	December 31,	June 30,
	2016	2015	2015
	(In thousands, except for %)		
Net investment income, annualized	$47,463	45,782	44,540
Average invested assets, at amortized cost	1,101,388	1,045,736	1,049,038
Annualized yield on average invested assets	4.31 %	4.38 %	4.25 %

The annualized yield has remained relatively consistent as a change in portfolio mix has mitigated the impact of reinvestment in the current low rate environment.

Investment income from debt securities accounted for approximately 87.2% of total investment income for the six months ended June 30, 2016.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(In thousands)			
Gross investment income:				
Fixed maturity securities	$10,827	9,814	21,448	19,577
Equity securities	264	671	388	1,267
Mortgage loans	8	9	17	18
Policy loans	1,285	1,113	2,550	2,230
Long-term investments	101	73	152	147
Other investment income	19	28	30	34
Total investment income	12,504	11,708	24,585	23,273
Investment expenses	(504)	(507)	(854)	(1,003)
Net investment income	$12,000	11,201	23,731	22,270

The consolidated invested asset portfolio has increased approximately 9.1% from year end 2015 to June 30, 2016 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. The decrease in equity securities investment income was due to sales of a portion of the bond mutual funds at the end of 2015. 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 Losses, Net. Other-than-temporary impairments were recorded for the three and six month periods ended June 30, 2016 totaling $0.4 million and $2.3 million, related to mutual fund impairments in the second quarter and impairment of one available-for-sale fixed maturity in the first quarter of 2016. Absent the impairments, the net gains generated for the three and six months ended 2015 were due to gains on issuer calls.

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Benefits and Expenses

Three Months Ended		Six Months Ended	
June 30,		June 30,	
2016	2015	2016	2015