COTTON STATES LIFE INSURANCE CO /
Form 10-Q
August 13, 2002

Table of Contents

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

Quarterly Report Under Section 13 or 15(d) of
The Securities Exchange Act of 1934

For the three months and six months ended June 30, 2002

Commission File Number 2-39729

COTTON STATES LIFE INSURANCE COMPANY

(Exact name of registrant as specified in its charter)

GEORGIA	58-0830929
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
244 Perimeter Center Parkway, N.E., Atlanta, Georgia	30346
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (770) 391-8600

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 twelve months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to the filing requirements for at least the past 90 days.

YES [X] NO [ ]

The Registrant as of June 30, 2002, has 6,339,837 shares of common stock outstanding.

TABLE OF CONTENTS

Table of Contents

COTTON STATES LIFE INSURANCE COMPANY

FORM 10-Q

FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2002

INDEX

Table of Contents

INDEPENDENT AUDITORS REPORT

To the Shareholders and Board of Directors
Cotton States Life Insurance Company, Inc.:

We have reviewed the consolidated condensed balance sheet of Cotton States Life Insurance Company, Inc. as of June 30, 2002, and the related consolidated condensed statements of earnings and comprehensive income for the three-month and six-month periods ended June 30, 2002 and 2001, and the consolidated condensed statements of cash flows for the six-month periods ended June 30, 2002 and 2001. These consolidated condensed financial statements are the responsibility of the Company s management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated condensed financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of Cotton States Life Insurance Company, Inc. as of December 31, 2001, and the related consolidated statements of earnings, shareholders equity, cash flows and comprehensive income for the year then ended (not presented herein); and in our report dated February 26, 2002, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated condensed balance sheet as of December 31, 2001, is fairly stated in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/S/ KPMG LLP

August 6, 2002
Atlanta, Georgia

Table of Contents

ITEM I CONSOLIDATED FINANCIAL STATEMENTS

COTTON STATES LIFE INSURANCE COMPANY
Consolidated Condensed Balance Sheets
June 30, 2002 and December 31, 2001

	2002	2001
	(unaudited)	
ASSETS		
Investments		
Fixed maturities, held for investment, at amortized cost (fair value $10,424,785 in 2002 and $11,960,104 in 2001)	$ 10,050,211	11,552,200
Fixed maturities, available for sale, at fair value (amortized cost $137,335,743 in 2002 and $130,303,801 in 2001)	139,507,247	131,964,810
Equity securities, at fair value (cost $3,693,616 in 2002 and $3,673,660 in 2001)	2,969,125	3,471,722
First mortgage loans on real estate	1,540,465	1,671,989
Policy loans	9,945,761	9,661,247
Other invested assets	1,000,000	1,000,000
Total Investments	165,012,809	159,321,968
Cash and cash equivalents	14,680,403	13,187,601
Accrued investment income	2,643,755	2,592,977
Premiums receivable	2,938,704	3,298,052
Reinsurance receivable	4,030,965	4,233,046
Deferred policy acquisition costs	54,775,419	51,660,808
Other assets	777,817	485,886
	$244,859,872	234,780,338
LIABILITIES AND SHAREHOLDERS EQUITY		
Policy liabilities and accruals:		
Future policy benefits	$153,104,665	145,737,310
Policy and contract claims	2,263,199	2,196,620
Federal income taxes	8,669,908	8,537,875
Other liabilities	7,438,873	7,774,011
Total Liabilities	171,476,645	164,245,816
Shareholders equity:		
Common Stock	6,754,504	6,754,504
Additional paid-in capital	1,539,882	1,496,417
Accumulated other comprehensive income	735,915	818,720
Retained earnings	68,461,549	65,746,656
Less:		
Unearned compensation-restricted stock	(724,181)	(858,781)
Treasury stock, at cost, (414,667 shares in 2002 and 419,076 in 2001)	(3,384,442)	(3,422,994)
Total Shareholders Equity	73,383,227	70,534,522
	$244,859,872	234,780,338

See accompanying notes to unaudited consolidated condensed financial statements.

Table of Contents

COTTON STATES LIFE INSURANCE COMPANY
Unaudited Consolidated Condensed Statements of Earnings
Three Months and Six Months ended June 30, 2002 and 2001

	Three months ended June 30,		Six months ended June 30,	
	2002	**2001**	**2002**	**2001**
Revenue:				
Premiums	$ 8,007,993	7,142,797	15,674,310	14,174,150
Investment income	2,427,037	2,566,579	4,898,973	5,114,971
Realized investment gains (losses)	(48,821)	79,962	108,151	88,947
Brokerage commissions	1,124,817	1,096,564	2,133,103	1,999,726
Total Revenue	11,511,026	10,885,902	22,814,537	21,377,794
Benefits and expenses:				
Benefits and claims	4,628,159	3,782,044	8,984,955	8,499,815
Interest credited	1,516,837	1,416,305	2,963,067	2,633,149
Amortization of policy acquisition costs	949,468	1,194,550	1,930,734	2,122,344
Operating expenses	2,132,222	2,202,366	4,422,525	4,234,405
Total Benefits and Expense	9,226,686	8,595,265	18,301,281	17,489,713
Income before income tax expense	2,284,340	2,290,637	4,513,256	3,888,081
Income tax expense	590,622	589,517	1,288,370	1,165,907
Net Income	$ 1,693,718	1,701,120	3,224,886	2,722,174
Basic income per share of common stock	$ 0.27	0.27	0.51	0.43
Diluted income per share of common stock	$ 0.26	0.26	0.50	0.42
Weighted average number of shares used in computing income per share				
Basic	6,339,964	6,345,428	6,337,709	6,345,428
Diluted	6,501,457	6,531,870	6,498,206	6,529,740

See accompanying notes to unaudited consolidated condensed financial statements.

Table of Contents

COTTON STATES LIFE INSURANCE COMPANY
Unaudited Consolidated Condensed Statements of Cash Flows
Six months ended June 30, 2002 and 2001

	2002	2001
Cash flows from operating activities:		
Net income	$ 3,224,886	2,722,174
Adjustments to reconcile net income to net cash provided from operating activities:		
Increase in policy liabilities and accruals	7,433,934	7,997,388
(Increase) in deferred policy acquisition costs	(3,189,458)	(2,711,123)
Increase in liability for income taxes	163,371	174,870
Decrease (Increase) in amounts receivable and amounts due from reinsurers	561,429	(1,813,303)
(Decrease) Increase in amounts due affiliate	(485,657)	583,804
Other, net	34,113	(499,127)
Net cash provided from operating activities	7,742,618	6,454,683
Cash flows from investing activities:		
Purchase of fixed maturities available for sale	(53,636,454)	(35,332,883)
Purchase of equity securities	(1,104,600)	(1,536,260)
Sale of fixed maturities held for investment	450,000	
Sale of fixed maturities available for sale	38,668,882	24,924,666
Sale of equity securities	1,084,643	1,399,018
Proceeds from maturities of fixed maturities held for investment	1,000,000	1,300,000
Proceeds from maturity and redemption of fixed maturities held for sale	7,822,348	2,650,598
Principal collected on first mortgage loans	131,524	191,637
Net increase in policy loans	(284,514)	(334,580)
Other, net	73,563	(58,137)
Net cash used in investing activities	(5,794,608)	(6,795,941)
Cash flows from financing activities:		
Cash dividends paid	(509,987)	(509,554)
Purchase of treasury stock	(10,453)	
Stock issued under executive compensation plans	65,232	
Net cash used by financing activities	(455,208)	(509,554)
Net increase (decrease) in cash and cash equivalents:	1,492,802	(850,812)
Cash and cash equivalents:		
Beginning of period	13,187,601	6,437,904
End of period	$ 14,680,403	5,587,092

See accompanying notes to unaudited consolidated condensed financial statements.

Table of Contents

COTTON STATES LIFE INSURANCE COMPANY
Unaudited Consolidated Condensed Statements of Comprehensive Income
Three Months and Six Months ended June 30, 2002 and 2001

	Three months ended June 30,		Six months ended June 30,	
	2002	**2001**	**2002**	**2001**
Net income	$1,693,718	1,701,120	3,224,886	2,722,174
Other comprehensive income (loss), before tax:				
Change in fair value of securities available for sale	2,073,243	(830,062)	29,446	1,313,789
Reclassification adjustment for realized losses (gains) included in net income	48,821	(79,962)	(108,151)	(88,947)
Total Other Comprehensive Income (Loss), Before Tax	2,122,064	(910,024)	(78,705)	1,224,842
Income tax expense (benefit) related to items of other comprehensive income	838,303	(353,967)	4,100	461,925
Other comprehensive income (loss), net of tax	1,283,761	(556,057)	(82,805)	762,917
Total Comprehensive Income	$2,977,479	1,145,063	3,142,081	3,485,091

See accompanying notes to unaudited consolidated condensed financial statements.

Table of Contents

Cotton States Life Insurance Company
Notes to Unaudited Consolidated Condensed Financial Statements
June 30, 2002 and December 31, 2001

Note 1 Basis of Presentation

The accompanying consolidated condensed financial statements include the accounts of Cotton States Life Insurance Company and its wholly owned subsidiaries CSI Brokerage Services, Inc., and CS Marketing Resources, Inc. Significant intercompany transactions and balances are eliminated in the consolidation.

The consolidated condensed financial statements for the three months and six months ended June 30, 2002 are unaudited and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These consolidated condensed financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in the Company s annual report on Form 10-K for the year ended December 31, 2001.

In the opinion of management, all adjustments and reclassifications necessary to present fairly the financial position and the results of operations and cash flows for the interim periods have been made. All such adjustments are of a normal and recurring nature. The results of operations for any interim period are not necessarily indicative of the results of operations that the Company may achieve for the entire year.

Note 2 Accounting Pronouncements

Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 133, as amended, Accounting for Derivative Instruments and Hedging Activities, became effective beginning January 1, 2001. However, due to the Company s limited use of derivative financial instruments, SFAS No. 133 had no impact on the Company s consolidated financial position, results of operations or cash flows.

The FASB issued four new accounting standards in 2001. SFAS No. 141, SFAS No. 142, SFAS No. 143, and SFAS No. 144 primarily address the accounting for goodwill, business combinations, and the impairment and disposition of long-lived assets. The adoption of these standards in 2002 either did not or will not have a material impact on the Company s financial position or results of operations.

Table of Contents

Note 3 Business Segments

The Company s operations include the following three major segments, differentiated primarily by their respective methods of distribution and the nature of related products: individual life insurance, guaranteed and simplified issue life insurance, and brokerage operations. The Company s operations in each segment are concentrated within its southeastern state geographic market. Individual life insurance products are distributed through the Company s multi-line exclusive agents, guaranteed and simplified issue products are distributed through independent agents as well as exclusive agents, and brokerage operations all involve third party products distributed through the Company s exclusive and independent agents.

Total revenue and net income by business segment are as follows:

	Three Months Ended June 30, (Dollars in thousands)		Six Months Ended June 30, (Dollars in thousands)	
	2002	2001	2002	2001
Individual life insurance:				
Premiums	$ 4,922	4,584	9,571	9,155
Investment income	2,192	2,366	4,439	4,723
Realized investment (losses) gains	(44)	74	98	82
Total revenue	$ 7,070	7,024	14,108	13,960
Net income	$ 1,119	1,027	2,063	1,521
Guaranteed and simplified issue life insurance:				
Premiums	$ 3,086	2,559	6,103	5,019
Investment income	230	215	450	386
Realized investment (losses) gains	(5)	6	10	7
Total revenue	$ 3,311	2,780	6,563	5,412
Net income	$ 20	154	126	243
Brokerage:				
Commission income	$ 1,125	1,070	2,133	1,974
Investment income	5	12	10	32
Total revenue	$ 1,130	1,082	2,143	2,006
Net income	$ 555	520	1,036	958
Total revenue	$11,511	10,886	22,814	21,378
Total net income	$ 1,694	1,701	3,225	2,722

Table of Contents

ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF CONSOLIDATED CONDENSED FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

Statements made in the following discussion that state the Company s or management s intentions, hopes, beliefs, expectations or predictions of the future are forward-looking statements. Without limiting the foregoing, forward-looking statements include statements which represent the Company s beliefs concerning future levels of sales and redemption of the Company s products, investment spreads and yields, or the earnings and profitability of the Company s activities.

Forward-looking statements are necessarily based on estimates and assumptions that are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond the Company s control and many of which are subject to change. These uncertainties and contingencies could cause actual results to differ materially from those expressed in any forward-looking statements made by, or on behalf of, the Company. Whether or not actual results differ materially from forward-looking statements may depend on numerous foreseeable and unforeseeable developments. Some may be national in scope, such as general economic conditions, changes in tax law and changes in interest rates. Some may be related to the insurance industry generally, such as pricing competition, regulatory developments and industry consolidation. Others may relate to the Company specifically, such as credit, volatility and other risks associated with the Company s investment portfolio. Investors are also directed to consider other risks and uncertainties discussed in Form 10-K filed by the Company with the Securities and Exchange Commission. If the Company s assumptions and estimates are incorrect or do not come to fruition, or if the Company does not achieve all of these key factors, then the Company s actual performance could vary materially from the forward-looking statements made herein. The Company disclaims any obligation to update forward-looking information.

Results of Operations

	Three Months Ended June 30, (Dollars in thousands)		
	2002	**2001**	**Increase**
Premiums			
Guaranteed and simplified issue life insurance	$ 3,086	2,559	21%
Individual life insurance:			
Traditional life	1,814	1,560	16%
Universal life	3,108	3,024	3%
Total individual life insurance	4,922	4,584	7%
Total premiums	$ 8,008	7,143	12%

Table of Contents

	Six Months Ended June 30, (Dollars in thousands) 2002	2001	Increase
Premiums			
Guaranteed and simplified issue life insurance	$ 6,103	5,019	22%
Individual life insurance:			
Traditional life	3,367	3,150	7%
Universal life	6,204	6,005	3%
Total individual life insurance	9,571	9,155	5%
Total premiums	$15,674	14,174	11%

Guaranteed and simplified issue life insurance premiums continued to show significant growth as a result of higher production by the independent agency force which had 4,200 agents under contract at June 30, 2002 and 2001. This product is also distributed by the Company s multi-line exclusive agents and is available for purchase over the Internet at the Company s home page.

Individual life insurance products are principally sold by the Company s exclusive agent producers. Growth in individual life premiums largely reflects the popularity of annual renewable term and universal life payroll deduction products. The exclusive agency force of 272 as of June 30, 2002 increased 4% compared to the same date last year.

Investment Income and Realized Gains and Losses

Investment income decreased 5% for the quarter and 4% compared to the first six months of 2001 due to a decrease in the annualized average yield to 6.0% compared to 6.6% for the first six months of 2001 due to lower interest rates.

During the second quarter of 2002 the Company realized an pre-tax investment loss of $850,000 from the write-down of the carrying value of a WorldCom, Inc. debt security. This write-down was the result of the Company determining that an other-than-temporary impairment had occurred.

Brokerage Commissions

Exclusive agents also sell products that the Cotton States Group does not underwrite (both life and property and casualty). Property and casualty business lines, principally non-standard auto, continue to show strong growth with commissions increasing 17% compared to the first six months of last year and met management expectations for the quarter.

Benefits and Claims

Life benefits and claims, including reserve increases on traditional life and guaranteed and simplified issue products are as follows:

Table of Contents

	Three Months Ended June 30, (Dollars in Thousands)			
	2002		2001	
	Benefits and Claims	% of Premium	Benefit and Claim	% of Premium
Benefits and Claims				
Guaranteed and simplified issue	$2,356	76%	1,777	69%
Individual life insurance				
Traditional life	1,272	70%	1,110	71%
Universal life	1,000	32%	895	30%
Total individual life insurance	2,272	46%	2,005	44%
Total benefits and claims	$4,628	58%	3,782	53%

	Six Months Ended June 30, (Dollars in Thousands)			
	2002		2001	
	Benefits and Claims	% of Premiums	Benefits and Claims	% of Premium
Benefits and Claims				
Guaranteed and simplified issue	$4,590	75%	3,584	71%
Individual life insurance				
Traditional life	2,273	68%	2,485	79%
Universal life	2,122	34%	2,431	40%
Total individual life insurance	4,395	46%	4,916	54%
Total benefits and claims	$8,985	57%	8,500	60%

Benefits and claims as a percentage of premium fluctuate within a normal range reflecting volatility in mortality, changes in mix of business, and age of policy holders. Guaranteed and simplified issue experience in 2002 and 2001 is more indicative of the Company s expectations as the block of business matures. Individual life insurance benefits and claims improved significantly in 2002 and met management s expectations for the three month and six month periods. The first quarter of 2001 reflected an unusual increase in mortality. Due to the Company s small size, quarterly fluctuations do and will occur. The Company offsets the effects of annual mortality fluctuations by routinely purchasing annual aggregate stop loss reinsurance coverage in excess of $10 million.

Table of Contents

Interest Credited to Policyholders

Interest credited to universal life contracts increased 13% for the six month period and 7% for the quarter reflecting strong growth in universal life policy accumulations. The annual interest rate credited to universal life contract accumulations was 6.2% for both the three month and six month periods of 2002 and 2001.

Amortization of Policy Acquisition Costs and Operating Expenses

The amortization of policy acquisition costs as a percentage of premiums was 12% for the three month and six months ended June 30, 2002 and 15% for the six months ended June 30, 2001 and 17% for the three months ended June 30, 2001. 2002 results are within the Company s expected range of 12-14%. 2001 results were slightly higher than the Company s expected range due to higher lapses in the traditional lines of business which reflected increased term rate competition in the market place.

Operating expense as a percentage of premiums were 28% for the first six months of 2002 compared to 30% for the same period last year. For the quarter, operating expenses as a percentage of premium were 27% compared to 31% for the comparable period of 2001. The Company s expectations are between 28-31%.

Income Tax Expense

The effective tax rate for the first six months of 2002 was 29% compared to 30% for the same period last year. The effective tax rate is based on the estimated annual rate.

Net Income

	Three Months Ended June 30, (Dollars in Thousands)		
	2002	2001	Increase (Decrease)
Net Income			
Guaranteed and simplified issue	$ 20	154	(87)%
Individual life insurance:			
Traditional	352	216	63%
Universal life	767	811	(5)%
Total individual life insurance	1,119	1,027	9%
Brokerage operations	555	520	7%
Net Income	$ 1,694	1,701	

Table of Contents

	Six Months Ended June 30, (Dollars in Thousands)		
	2002	2001	Increase (Decrease)
Net Income			
Guaranteed and simplified issue	$ 126	243	(48)%
Individual life insurance:			
Traditional	715	286	150%
Universal life	1,348	1,235	9%
Total individual life insurance	2,063	1,521	36%
Brokerage operations	1,036	958	8%
Net Income	$3,225	2,722	18%

Continued strong growth in premiums and mortality levels that met management s expectations and showed marked improvement over the first six months of 2001 accounted for the increase in net income for the first six months of 2002. Net income for the quarter ended June 30, 2002 compared to June 30, 2001 was flat due to a slight decrease in investment income and, although they met management s expectations, mortality levels were higher than the second quarter of 2001.

Critical Accounting Policies

The accounting policies described below are those the Company considers critical in preparing its consolidated financial statements. These polices include significant estimates made by management using information available at the time the estimates are made. However, as described below, these estimates could change materially if different information or assumptions were used.

Insurance Related Assets and Liabilities

The Company establishes an insurance related asset for deferred policy acquisition costs, and insurance related liabilities for future policy benefits and claims relating to its insurance policies under contract. Such asset and liabilities are developed using actuarial principles and assumptions which consider a number of factors, including: investment yields, withdrawal rates, mortality and morbidity. The Company accounts for its traditional individual life insurance policies using a net level premium method and assumptions as to the factors enumerated above. Generally, the Company s earnings in any given calendar year will not be impacted by differences in emerging experience on its traditional individual business unless such differences are severe enough to call into question the profitability of the entire block of traditional life business.

The Company does, however, experience fluctuations in its earnings as a result of current mortality experience differing from that expected in any given year. For the six months ended June 30, 2002 and 2001, the Company experienced emerged mortality of 86% and 95% of expected, respectively, related to its traditional individual life insurance business. The Company routinely purchases annual aggregate stop loss reinsurance coverage which limits experience to 120% of expected mortality in any one year.

The Company accounts for its interest-sensitive and universal life insurance polices and annuities under the provisions of SFAS No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments. SFAS No. 97 requires the remeasurement of the Company s deferred acquisition costs each period in a manner that amortizes such deferred costs as a level percentage of actual emerged profit over the expected gross profits.

Each period, the Company estimates the relevant factors, based primarily on its emerging experience and uses this information to determine the assumptions underlying its asset and liability calculations. An extensive degree of judgment is used in this estimation process.

Any adjustments required to properly state insurance assets and liabilities are charged or credited to benefit expense in the period in which the need for the adjustment becomes known.

Accounting for Income Taxes

The Company accounts for income taxes using the asset and liability method prescribed by SFAS No. 109, Accounting for Income Taxes. Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. Under SFAS No. 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Income tax expense recognized by the Company in any one year is impacted by the extent to which the Company qualifies for the small life company deduction. The small life company deduction is 60% of life insurance company taxable income up to a maximum taxable income of $3 million. This deduction is phased out on taxable income above $3 million up to and including a maximum of $15 million. To the extent, if any, that the Company s taxable income exceeds $3 million, its effective Federal income tax rate will increase.

Liquidity and Capital Resources

Cash Flow

The Company s insurance operations generate positive cash flows in excess of its immediate needs. Cash flows provided by operations were $7.7 million in the first six months of 2002 compared to $6.5 million for the comparable period last year.

Table of Contents

Operating cash flow is primarily used to purchase debt securities. The Company received proceeds of $8.8 million from investment maturities and repayments in 2002, adding to available cash flows. Such proceeds were $4.0 million in 2001. When market opportunities arise, the Company disposes of selected debt securities available for sale to improve future investment yields and/or improve duration matching of our assets and liabilities. Therefore, dispositions before maturity can vary significantly from year to year. Proceeds from sales prior to maturity were $39.1 million in 2002, and $24.9 million for the comparable period of 2001.

The Company s principal financing activity is payment of dividends to the Company s shareholders. Dividends are normally declared quarterly and must be approved by the Board of Directors. Under regulatory requirements, the amount of dividends that may be paid in 2002 by the Company to its shareholders without prior regulatory approval is approximately $3.0 million.

Other than noted above, the Company does not have any debt, lease obligations, purchase obligations, lines of credit, guarantees, off-balance sheet arrangements, trading activities involving non-exchange traded contracts accounted for at fair value or relationships with persons or entities that derive benefits from a non-independent relationship with the Company or the Company s related parties.

Liquidity

Liquidity pertains to a company s ability to meet the demand for cash requirements of its business operations and financial obligations. The Company s two sources of short-term liquidity include its positive cash flow from operations and its portfolio of marketable securities as described above. The Company believes that these sources are sufficient to meet its liquidity needs in fiscal year 2002.

Investments

Since December 31, 2001, there has not been a material change in mix or credit quality of the Company s investment portfolio. All bond purchases have been available for sale and over 88% of the holdings at June 30, 2002 and 91% in 2001 are rated A or better by Standard & Poor s Corporation. For all fixed maturities, 12% in 2002 and 9% in 2001 are rated BBB. Ratings of BBB and higher are considered investment grade by the rating services. Due to improvement in bond market conditions, the Company experienced an increase in the fair value of bonds of approximately $337,000, net of deferred taxes, in 2002.

During 2002 the Company sold a security out of its held-to-maturity portfolio due to evidence of a significant deterioration in the issuer s creditworthiness. At the time of sale the security had an amortized cost of $499,768. The Company realized a loss of $49,768 on the transaction.

Mortgage Loans

The Company s mortgage loan policy limits the amounts of loans to no more than 80% of the value on residential loans and no more than 75% of the value on commercial loans. The Company grants loans only to employees (excluding officers and directors) and agents.

Table of Contents

The geographic distribution of the loan portfolio is:

Number of Loans			Book Value (dollars in thousands)	
June 30, 2002	December 31, 2001	State	June 30, 2002	December 31, 2001
3	3	Alabama	$ 137	$ 113
6	6	Florida	302	320
28	30	Georgia	1,101	1,239
37	39		$1,540	$1,672

Two loans representing $91,000 in principal are over 30 days delinquent. The loan-to-value ratio on delinquent loans is 25%.

Recent Accounting Pronouncements

Financial Accounting Standards Board (FASB) SFAS No. 133, as amended, Accounting for Derivative Instruments and Hedging Activities, became effective beginning January 1, 2001. However, due to the Company s limited use of derivative financial instruments, SFAS No. 133 did not impact the Company s consolidated financial position, results of operations or cash flows in 2001.

The FASB issued four new accounting standards in 2001. SFAS No. 141, SFAS No. 142, SFAS No. 143 and SFAS No. 144 primarily address the accounting for goodwill, business combinations, and the impairment and disposition of long-lived assets. The adoption of these standards in 2002 will not have a material impact on the Company s financial position or results of operations.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Credit Risk

Credit risk is the risk that issuers of securities owned by the Company will default, or other parties, including reinsurers, which owe the Company money, will not pay. The Company attempts to minimize these risks by following a conservative investment strategy and by contracting with reinsuring companies that meet high standards for rating criteria and other qualifications. The Company invests principally in government, governmental agency and high quality corporate bonds having an A rating or better. The fixed maturity portfolio had an average rating of AA- as rated by Standard & Poor s Corporation at June 30, 2002 and 2001.

Table of Contents

Interest Rate Risk

Interest rate risk is the risk that interest rates will change and cause a decrease in the value of an insurer s investments. The Company s fixed maturity investments are subject to interest rate risk. The Company seeks to manage the impact of interest rate fluctuation through cash flow modeling, which attempts to match the maturity schedule of its assets with expected payout of its liabilities. Liabilities for interest sensitive products are carried at full account value. The fixed maturity portfolio at June 30, 2002 and June 30, 2001 had an effective duration of 4.3 years and 4.6 years, respectively.

The table below summarizes the Company s interest rate risk and shows the effect of a hypothetical 100 basis point increase/decrease in interest rates on the fair values of the fixed investment portfolio. The selection of 100 basis point increases/decrease in interest rates should not be construed as a prediction by the Company s management of future market events, but rather, to illustrate the potential impact of such events. These calculations may not fully capture the impact of the changes in the ratio of long-term rates to short-term rates.

		Estimated Value June 30, 2002	Estimated Change in Interest Rates (bp-Basis Points)	Estimated Fair Value After Hypothetical Change in Interest Rates	Hypothetical Percentage Increase (Decrease) In Shareholders' Equity
		(dollars in thousands)			
Fixed Maturities	Held for Investment	$ 10,425	100 bp decrease	10,542	N/A
			100 bp increase	10,310	N/A
Fixed Maturities for Sale	Available	$139,507	100 bp decrease	145,869	8.7%
			100 bp increase	133,243	(8.5)%

Table of Contents

PART II OTHER INFORMATION

Item 1. Legal Proceedings

The Company is a defendant in various actions incidental to the conduct of its business. The Company intends to vigorously defend the litigation and while the ultimate outcome of these matters cannot be estimated with certainty, management does not believe the actions will result in any material loss to the Company.

The Company has reached partial settlement of a $900,000 reinsurance policy law suit initiated in the third quarter of 2001. To date, the Company has received $475,000 and continues to seek additional recoveries through already existing legal channels.

Item 2. Changes in Securities and Use of Proceeds

NONE

Item 3. Defaults Upon Senior Securities

NONE

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

NONE

Item 5. Other Information

NONE

Item 6. Exhibits and Reports on Form 8-K

Exhibit 11 Statement re: Computation of Per Share Earnings

Exhibit 15 Letter Regarding Unaudited Interim Financial Information

Exhibit 99 Certification Pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C.§1350)

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.

COTTON STATES LIFE INSURANCE COMPANY
Registrant

Date: 08/12/02

/s/ J. Ridley Howard

J. Ridley Howard, Chairman
President and Chief Executive Officer

Date: 08/12/02

/s/ William J. Barlow

William J. Barlow
Vice President of Finance and Assistant Treasurer