

CITIZENS INC  
Form 10-Q  
November 06, 2009

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

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2009**

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, Texas

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.  Yes  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).  Yes  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. (Check one):

Large accelerated filer  Accelerated filer  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 Act).  Yes  No

As of November 6, 2009, the Registrant had 48,687,093 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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Exhibit 32.2

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES****Consolidated Statements of Financial Position****(In thousands)**

<b>Assets</b>	<b>September 30, 2009 (Unaudited)</b>	<b>December 31, 2008</b>
Investments:		
Fixed maturities available-for-sale, at fair value (cost: \$335,817 and \$494,034 in 2009 and 2008, respectively)	\$ 339,290	485,155
Fixed maturities held-to-maturity, at amortized cost (fair value:\$200,496 in 2009)	202,197	
Equity securities available-for-sale, at fair value (cost: \$42,414 and \$42,908 in 2009 and 2008, respectively)	52,894	43,000
Mortgage loans on real estate	1,462	339
Policy loans	31,860	28,955
Real estate held for sale	3,007	4,156
Real estate held for investment (less \$352 and \$283 accumulated depreciation in 2009 and 2008, respectively)	6,178	4,717
Other long-term investments	74	680
Short-term investments	2,556	2,250
<b>Total investments</b>	<b>639,518</b>	<b>569,252</b>
Cash and cash equivalents	77,916	63,792
Accrued investment income	7,037	7,423
Reinsurance recoverable	12,059	13,241
Deferred policy acquisition costs	113,656	109,114
Cost of customer relationships acquired	35,385	33,805
Goodwill	16,809	15,687
Other intangible assets	1,088	1,073
Federal income tax receivable		2,090
Property and equipment, net	6,151	6,466
Due premiums, net (less \$1,493 and \$2,217 allowance for doubtful accounts in 2009 and 2008, respectively)	8,152	8,958
Prepaid expenses	1,079	454
Other assets	970	921
<b>Total assets</b>	<b>\$ 919,820</b>	<b>832,276</b>

(Continued)

See accompanying notes to consolidated financial statements.

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

<b>Liabilities and Stockholders Equity</b>	<b>September 30, 2009 (Unaudited)</b>	<b>December 31, 2008</b>
Liabilities:		
Future policy benefit reserves:		
Life insurance	\$ 580,013	547,621
Annuities	36,585	34,025
Accident and health	6,734	7,442
Dividend accumulations	5,550	4,795
Premiums paid in advance	19,571	18,566
Policy claims payable	9,936	9,318
Other policyholders funds	7,974	7,929
Total policy liabilities	666,363	629,696
Commissions payable	1,893	2,350
Federal income tax payable	727	
Deferred Federal and state income tax	7,060	3,951
Payable for securities in process of settlement	13,793	
Warrants outstanding	1,892	4,973
Other liabilities	12,637	12,052
Total liabilities	704,365	653,022
Commitments and contingencies (Notes 8 and 10)		
Cumulative convertible preferred stock Series A (Series A-1 - \$1,000 stated value per share, 6,250 shares authorized, issued and outstanding in 2008; Series A-2 - \$935 stated value per share, 5,000 shares authorized, 4,014 issued and outstanding in 2008)		7,713
Stockholders Equity:		
Common stock:		
Class A, no par value, 100,000,000 shares authorized, 51,822,831 shares issued in 2009 and 48,781,753 shares issued in 2008, including shares in treasury of 3,135,738 in 2009 and 2008	256,703	240,511
Class B, no par value, 2,000,000 shares authorized, 1,001,714 shares issued and outstanding in 2009 and 2008	3,184	3,184
Retained deficit	(46,091)	(55,432)
Accumulated other comprehensive income (loss):		
Unrealized gains (losses) on available-for-sale securities, net of tax	12,670	(5,711)
Treasury stock, at cost	226,466 (11,011)	182,552 (11,011)
Total stockholders equity	215,455	171,541

Total liabilities and stockholders' equity	\$	919,820	832,276
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See accompanying notes to consolidated financial statements.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**Consolidated Statements of Operations**  
**Three Months Ended September 30,**  
**(In thousands, except per share amounts)**  
**(Unaudited)**

	<b>2009</b>	<b>2008</b>
Revenues:		
Premiums:		
Life insurance	\$ 34,589	32,837
Accident and health insurance	371	384
Property insurance	1,192	820
Net investment income	7,413	7,543
Realized gains (losses), net	1,006	(226)
Increase in fair value of warrants		(1,483)
Other income	273	288
<b>Total revenues</b>	<b>44,844</b>	<b>40,163</b>
Benefits and expenses:		
Insurance benefits paid or provided:		
Claims and surrenders	14,494	13,855
Increase in future policy benefit reserves	10,305	10,214
Policyholders dividends	1,827	1,636
<b>Total insurance benefits paid or provided</b>	<b>26,626</b>	<b>25,705</b>
Commissions	8,435	8,819
Other underwriting, acquisition and insurance expenses	6,772	7,312
Capitalization of deferred policy acquisition costs	(5,306)	(5,712)
Amortization of deferred policy acquisition costs	4,303	3,861
Amortization of cost of customer relationships acquired and other intangibles	946	676
<b>Total benefits and expenses</b>	<b>41,776</b>	<b>40,661</b>
Income (loss) before Federal income tax	3,068	(498)
Federal income tax expense	820	316
Net income (loss)	\$ 2,248	(814)
Net income (loss) applicable to common stockholders	\$ 2,091	(1,604)
<b>Per Share Amounts:</b>		
Basic and diluted earnings (loss) per share of Class A common stock	\$ 0.04	(0.04)
Basic and diluted earnings (loss) per share of Class B common stock	\$ 0.02	(0.02)



See accompanying notes to consolidated financial statements.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**Consolidated Statements of Operations**  
**Nine Months Ended September 30,**  
**(In thousands, except per share amounts)**  
**(Unaudited)**

	<b>2009</b>	<b>2008</b>
Revenues:		
Premiums:		
Life insurance	\$ 101,858	97,178
Accident and health insurance	1,135	1,178
Property insurance	3,501	3,559
Net investment income	21,733	22,487
Realized gains (losses), net	2,827	(210)
Decrease (increase) in fair value of warrants	3,081	(1,674)
Other income	796	852
<b>Total revenues</b>	<b>134,931</b>	<b>123,370</b>
Benefits and expenses:		
Insurance benefits paid or provided:		
Claims and surrenders	44,254	41,663
Increase in future policy benefit reserves	28,021	24,944
Policyholders dividends	4,742	4,590
<b>Total insurance benefits paid or provided</b>	<b>77,017</b>	<b>71,197</b>
Commissions	25,462	25,906
Other underwriting, acquisition and insurance expenses	21,889	21,243
Capitalization of deferred policy acquisition costs	(16,257)	(16,876)
Amortization of deferred policy acquisition costs	11,715	11,529
Amortization of cost of customer relationships acquired and other intangibles	2,630	2,155
<b>Total benefits and expenses</b>	<b>122,456</b>	<b>115,154</b>
Income before Federal income tax	12,475	8,216
Federal income tax expense	3,134	3,303
Net income	\$ 9,341	4,913
Net income applicable to common stockholders	\$ 6,836	3,112
<b>Per Share Amounts:</b>		
Basic earnings per share of Class A common stock	\$ 0.14	0.07
Basic earnings per share of Class B common stock	\$ 0.07	0.04

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Diluted earnings per share of Class A common stock	\$	0.09	0.07
Diluted earnings per share of Class B common stock	\$	0.04	0.04

See accompanying notes to consolidated financial statements.

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

	<b>2009</b>	<b>2008</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 9,341	4,913
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized (gains) losses on sale of investments and other assets	(2,827)	210
Net deferred policy acquisition costs	(4,542)	(5,347)
Amortization of cost of customer relationships acquired and other intangibles	2,630	2,155
(Decrease) increase in fair value of warrants	(3,081)	1,674
Depreciation	908	827
Amortization of premiums and discounts on fixed maturities and short-term investments	1,466	216
Deferred Federal income tax (benefit) expense	(819)	2,562
Change in:		
Accrued investment income	434	887
Reinsurance recoverable	1,258	456
Due premiums and other receivables	856	591
Future policy benefit reserves	27,171	21,372
Other policyholders' liabilities	1,187	7,911
Federal income tax receivable (payable)	2,827	(2,557)
Commissions payable and other liabilities	58	95
Other, net	(583)	(1,270)
Net cash provided by operating activities	36,284	34,695
<b>Cash flows from investing activities:</b>		
Purchase of fixed maturities, held-to-maturity	(202,286)	
Sale of fixed maturities, available-for-sale	72,148	237
Maturity and calls of fixed maturities, available-for-sale	276,058	130,800
Purchase of fixed maturities, available-for-sale	(174,931)	(126,514)
Sale of equity securities, available-for-sale	1,184	
Purchase of equity securities, available-for-sale	(476)	(23,984)
Principal payments on mortgage loans	24	27
Mortgage loans funded	(170)	(115)
Increase in policy loans	(2,905)	(1,944)
Sale of other long-term investments and property and equipment	406	178
Purchase of other long-term investments and property and equipment	(2,172)	(868)
Maturity of short-term investments	2,250	18,000
Purchase of short-term investments	(2,604)	(7,923)
Cash acquired in acquisition	9,770	
Net cash used in investing activities	(23,704)	(12,106)

See accompanying notes to consolidated financial statements.

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

	2009	2008
<b>Cash flows from financing activities:</b>		
Warrants exercised	\$ 69	55
Series A-1 Preferred Stock capital contribution		1,125
Annuity deposits	3,990	1,862
Annuity withdrawals	(2,515)	(1,084)
Net cash provided by financing activities	1,544	1,958
Net increase in cash and cash equivalents	14,124	24,547
Cash and cash equivalents at beginning of period	63,792	21,123
Cash and cash equivalents at end of period	\$ 77,916	45,670
<b>Supplemental disclosures of operating activities:</b>		
Cash paid during the period for income taxes	\$ 1,125	3,298

**Supplemental Disclosure of Non-Cash Investing Activities:**

On February 27, 2009, the Company acquired Integrity Capital Corporation ( ICC ) for 1,294,000 shares of Class A common stock with a fair value of \$8.4 million. CICA Life Insurance Company of America held a 13% interest in ICC prior to the acquisition with a carrying value of \$551,000, making the total non-cash acquisition price approximately \$9.0 million.

In the third quarter of 2009, the Company sold two parcels of real estate and made mortgage loans totaling \$977,000.

**Supplemental Disclosures of Non-Cash Financing Activities:**

Dividends on the Company's Series A-1 Convertible Preferred Stock, issued in 2004, and Series A-2 Convertible Preferred Stock, issued in 2005, were paid by the Company through the issuance of Class A common stock to the preferred shareholders in the amounts of \$216,000 and \$514,000 for the first nine months of 2009 and 2008, respectively. Accretion of deferred issuance costs and discounts on the Convertible Preferred Stock recorded as a deduction to Class A common stock during the first nine months of 2009 and 2008 was \$2.3 million and \$1.3 million, respectively.

See accompanying notes to consolidated financial statements.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**  
**September 30, 2009**  
**(Unaudited)**

**(1) Financial Statements**

The interim consolidated financial statements include the accounts and operations of Citizens, Inc. ( Citizens ), incorporated in the state of Colorado on November 8, 1977, and its wholly-owned subsidiaries, CICA Life Insurance Company of America ( CICA ), Computing Technology, Inc. ( CTI ), Funeral Homes of America, Inc. ( FHA ), Insurance Investors, Inc. ( III ), Citizens National Life Insurance Company ( CNLIC ), Integrity Capital Corporation ( ICC ), Integrity Capital Insurance Company ( ICIC ), Ozark National Life Insurance Company ( ONLIC ), Security Plan Life Insurance Company ( SPLIC ), and Security Plan Fire Insurance Company ( SPFIC ). Citizens and its consolidated subsidiaries are collectively referred to as the Company, we, us, or our.

The consolidated statements of financial position for September 30, 2009, the consolidated statements of operations for the three and nine-month periods ended September 30, 2009 and 2008, and the consolidated statements of cash flows for the nine-month period then ended have been prepared by the Company without audit. In the opinion of management, all adjustments to present fairly the financial position, results of operations, and changes in cash flows at September 30, 2009, and for comparative periods, have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States of America ( U.S. ) generally accepted accounting principles ( U.S. GAAP ) have been omitted. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission. The results of operations for the three and nine months ended September 30, 2009 are not necessarily indicative of the operating results for the full year.

The Company completed its acquisition of ICC in exchange for 1,294,000 shares of its Class A common stock in the first quarter of 2009. ICC is the parent of ICIC, an Indiana life insurance company. The transaction was valued at \$9.0 million on the closing date of February 27, 2009.

During the third quarter of 2009, the Company discovered an overstatement of ICIC s policyholder dividend liability that existed at the February 27, 2009 acquisition date in the amount of \$328,000. The correction of this error, net of tax of \$115,000, was recognized as a reduction of goodwill of \$213,000.

A purchase price accounting adjustment was recorded as of June 30, 2009 to increase policy reserves by \$307,000 and increase cost of insurance acquired ( COIA ) by \$326,000, due to the discovery of additional policy reserve items during the conversion of ONLIC, which were missing at acquisition. The difference of \$19,000 was recorded as a reduction of goodwill. ONLIC was acquired during the fourth quarter of 2008 and was fully converted to the Company s internal system in the third quarter of 2009.

Certain amounts presented in prior years have been reclassified to conform to the current presentation.

**(2) Accounting Pronouncements**

***Accounting Standards Recently Adopted***

Effective July 1, 2009, the Financial Accounting Standards Board s ( FASB ) Accounting Standards Codification ( ASC ) became the single official source of authoritative, nongovernmental generally accepted accounting principles. The historical U.S. GAAP hierarchy was eliminated and the ASC became the only level of authoritative U.S. GAAP, other than guidance issued by the Securities and Exchange Commission. Our accounting policies were not affected by the conversion to ASC. However, references to specific accounting standards in the footnotes to our consolidated financial statements have been changed to refer to the appropriate section of ASC.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**Notes to Consolidated Financial Statements, Continued**  
**September 30, 2009**  
**(Unaudited)**

On June 30, 2009, in our consolidated financial statements, we adopted the provisions of a new accounting standard relating to subsequent events, which establishes general standards of accounting for and disclosures of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The standard defines two types of subsequent events: recognized subsequent events, which provide additional evidence about conditions that existed at the balance sheet date, and nonrecognized subsequent events, which provide evidence about conditions that did not exist as of the balance sheet date, but arose after that date. Recognized subsequent events are required to be recognized in the financial statements, and certain nonrecognized subsequent events are required to be disclosed. The Standard also requires the disclosure of the date through which an entity has evaluated subsequent events. (See Note 12 for disclosure of subsequent events.)

On June 30, 2009, we adopted an update to accounting standards for disclosures about the fair value of financial instruments, which requires publicly-traded companies to provide disclosures on the fair value of financial instruments in interim financial statements.

On January 1, 2009, we adopted an update to existing accounting standards for business combinations. The update, which retains the underlying concepts of the original standard in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting, changes the method of applying the acquisition method in a number of ways. Acquisition costs are no longer considered part of the fair value of an acquisition and will generally be expensed as incurred, noncontrolling interests are valued at fair value at the acquisition date, in-process research and development is recorded at fair value as an indefinite-lived intangible asset at the acquisition date, restructuring costs associated with a business combination are generally expensed subsequent to the acquisition date, and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense. In April 2009, the FASB issued a further update in relation to accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies, which amends the previous guidance to require contingent assets acquired and liabilities assumed in a business combination to be recognized at fair value on the acquisition date if fair value can be reasonably estimated during the measurement period. If fair value cannot be reasonably estimated during the measurement period, the contingent asset or liability would be recognized in accordance with standards and guidance on accounting for contingencies and reasonable estimation of the amount of a loss. Further, this update eliminated the specific subsequent accounting guidance for contingent assets and liabilities, without significantly revising the original guidance. However, contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination would still be initially and subsequently measured at fair value. These updates are effective for all business acquisitions occurring on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We adopted the provisions of these updates for business combinations with an acquisition date on or after January 1, 2009 and these adoptions did not have a material effect on the Company's consolidated financial statements. There were no noncontrolling interests in the ICC acquisition.

On January 1, 2009, we adopted without material impact on our consolidated financial statements the provisions of the fair value measurement accounting standard related to nonfinancial assets and nonfinancial liabilities that are not required or permitted to be measured at fair value on a recurring basis, which include those measured at fair value in goodwill impairment testing, indefinite-lived intangible assets measured at fair value for impairment assessment, nonfinancial long-lived assets measured at fair value for impairment assessment, asset retirement obligations initially measured at fair value, and those initially measured at fair value in a business combination.

In April 2009, the FASB further updated the fair value measurement standard to provide additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. This update re-emphasizes that, regardless of market conditions, the fair value measurement is an exit price concept as defined in the original standard. It clarifies and includes additional factors to consider in determining whether there has been a significant decrease in market activity for an asset or liability and provides additional clarification on



estimating fair value when the market activity for an asset or liability has declined significantly. The scope of this update does not include assets and liabilities measured under Level 1 inputs. We adopted this update on June 30, 2009 prospectively to all fair value measurements as appropriate without material impact on our consolidated financial statements.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**Notes to Consolidated Financial Statements, Continued**  
**September 30, 2009**  
**(Unaudited)**

***Accounting Standards Not Yet Adopted***

In August 2009, the FASB further updated the fair value measurement guidance to clarify how an entity should measure liabilities at fair value. The update reaffirms fair value is based on an orderly transaction between market participants, even though liabilities are infrequently transferred due to contractual or other legal restrictions. However, identical liabilities traded in the active market should be used when available. When quoted prices are not available, the quoted price of the identical liability traded as an asset, quoted prices for similar liabilities or similar liabilities traded as an asset, or another valuation approach should be used. This update also clarifies that restrictions preventing the transfer of a liability should not be considered as a separate input or adjustment in the measurement of fair value. We adopted the provisions of this update for fair value measurements of liabilities effective October 1, 2009, and its adoption did not have a material impact on our consolidated financial statements.

**(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, and has no reportable differences between segments and consolidated operations.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**Notes to Consolidated Financial Statements, Continued**  
**September 30, 2009**  
**(Unaudited)**

Below is a summary of the segment information for the three and nine month periods ended September 30, 2009 and 2008.

**Three Months Ended September 30, 2009**

	<b>Life Insurance</b>	<b>Home Service Insurance</b>	<b>Other Non-Insurance Enterprises</b>	<b>Consolidated</b>
	<b>(In thousands)</b>			
<b>Revenues:</b>				
Premiums	\$ 25,795	10,357		36,152
Net investment income	4,232	3,126	55	7,413
Realized gains, net	650	356		1,006
Other income	108	20	145	273
<b>Total revenue</b>	<b>30,785</b>	<b>13,859</b>	<b>200</b>	<b>44,844</b>
<b>Benefits and expenses:</b>				
Insurance benefits paid or provided:				
Claims and surrenders	10,035	4,459		14,494
Increase in future policy benefit reserves	8,850	1,455		10,305
Policyholders dividends	1,809	18		1,827
<b>Total insurance benefits paid or provided</b>	<b>20,694</b>	<b>5,932</b>		<b>26,626</b>
Commissions	4,827	3,608		8,435
Other underwriting, acquisition and insurance expenses	2,563	3,588	621	6,772
Capitalization of deferred policy acquisition costs	(3,975)	(1,331)		(5,306)
Amortization of deferred policy acquisition costs	3,757	546		4,303
Amortization of cost of customer relationships acquired and other intangibles	397	549		946
<b>Total benefits and expenses</b>	<b>28,263</b>	<b>12,892</b>	<b>621</b>	<b>41,776</b>
<b>Income (loss) before Federal income tax</b>	<b>\$ 2,522</b>	<b>967</b>	<b>(421)</b>	<b>3,068</b>

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**Notes to Consolidated Financial Statements, Continued**  
**September 30, 2009**  
**(Unaudited)**

**Nine Months Ended September 30, 2009**

	<b>Life Insurance</b>	<b>Home Service Insurance</b>	<b>Other Non-Insurance Enterprises</b>	<b>Consolidated</b>
	<b>(In thousands)</b>			
<b>Revenues:</b>				
Premiums	\$ 75,570	30,924		106,494
Net investment income	12,196	9,396	141	21,733
Realized gains, net	1,068	1,682	77	2,827
Decrease in fair value of warrants			3,081	3,081
Other income	267	84	445	796
<b>Total revenue</b>	<b>89,101</b>	<b>42,086</b>	<b>3,744</b>	<b>134,931</b>
<b>Benefits and expenses:</b>				
Insurance benefits paid or provided:				
Claims and surrenders	30,259	13,995		44,254
Increase in future policy benefit reserves	24,258	3,763		28,021
Policyholders dividends	4,687	55		4,742
<b>Total insurance benefits paid or provided</b>	<b>59,204</b>	<b>17,813</b>		<b>77,017</b>
Commissions	14,531	10,931		25,462
Other underwriting, acquisition and insurance expenses	7,873	11,577	2,439	21,889
Capitalization of deferred policy acquisition costs	(12,227)	(4,030)		(16,257)
Amortization of deferred policy acquisition costs	10,677	1,038		11,715
Amortization of cost of customer relationships acquired and other intangibles	1,105	1,525		2,630
<b>Total benefits and expenses</b>	<b>81,163</b>	<b>38,854</b>	<b>2,439</b>	<b>122,456</b>
<b>Income before Federal income tax</b>	<b>\$ 7,938</b>	<b>3,232</b>	<b>1,305</b>	<b>12,475</b>

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
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**Three Months Ended September 30, 2008**

	<b>Life Insurance</b>	<b>Home Service Insurance</b>	<b>Other Non-Insurance Enterprises</b>	<b>Consolidated</b>
	<b>(In thousands)</b>			
<b>Revenues:</b>				
Premiums	\$ 24,634	9,407		34,041
Net investment income	4,309	3,072	162	7,543
Realized losses, net	(223)	(3)		(226)
Increase in fair value of warrants			(1,483)	(1,483)
Other income	89	1	198	288
Total revenue	28,809	12,477	(1,123)	40,163
<b>Benefits and expenses:</b>				
Insurance benefits paid or provided:				
Claims and surrenders	8,644	5,211		13,855
Increase in future policy benefit reserves	8,335	1,879		10,214
Policyholders dividends	1,618	18		1,636
Total insurance benefits paid or provided	18,597	7,108		25,705
Commissions	5,206	3,613		8,819
Other underwriting, acquisition and insurance expenses	2,813	3,947	552	7,312
Capitalization of deferred policy acquisition costs	(4,526)	(1,186)		(5,712)
Amortization of deferred policy acquisition costs	3,500	361		3,861
Amortization of cost of customer relationships acquired and other intangibles	209	467		676
Total benefits and expenses	25,799	14,310	552	40,661
Income (loss) before Federal income tax	\$ 3,010	(1,833)	(1,675)	(498)

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**Nine Months Ended September 30, 2008**

	<b>Life Insurance</b>	<b>Home Service Insurance</b>	<b>Other Non-Insurance Enterprises</b>	<b>Consolidated</b>
	<b>(In thousands)</b>			
<b>Revenues:</b>				
Premiums	\$ 72,584	29,331		101,915
Net investment income	12,519	9,255	713	22,487
Realized gains (losses), net	(220)	(8)	18	(210)
Increase in fair value of warrants			(1,674)	(1,674)
Other income	245	12	595	852
<b>Total revenue</b>	<b>85,128</b>	<b>38,590</b>	<b>(348)</b>	<b>123,370</b>
<b>Benefits and expenses:</b>				
Insurance benefits paid or provided:				
Claims and surrenders	26,462	15,201		41,663
Increase in future policy benefit reserves	23,430	1,514		24,944
Policyholders dividends	4,533	57		4,590
<b>Total insurance benefits paid or provided</b>	<b>54,425</b>	<b>16,772</b>		<b>71,197</b>
Commissions	15,136	10,770		25,906
Other underwriting, acquisition and insurance expenses	8,020	10,791	2,432	21,243
Capitalization of deferred policy acquisition costs	(13,017)	(3,859)		(16,876)
Amortization of deferred policy acquisition costs	10,038	1,491		11,529
Amortization of cost of customer relationships acquired and other intangibles	730	1,425		2,155
<b>Total benefits and expenses</b>	<b>75,332</b>	<b>37,390</b>	<b>2,432</b>	<b>115,154</b>
<b>Income (loss) before Federal income tax</b>	<b>\$ 9,796</b>	<b>1,200</b>	<b>(2,780)</b>	<b>8,216</b>

**(4) Total Comprehensive Income (Loss)**

<b>Three Months Ended September 30, 2009</b>	<b>Three Months Ended September 30, 2008</b>	<b>Nine Months Ended September 30, 2009</b>	<b>Nine Months Ended September 30, 2008</b>
<b>(In thousands)</b>			

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Net income (loss)	\$	2,248	(814)	9,341	4,913
Other comprehensive income (loss) net of effects of deferred acquisition costs and taxes:					
Unrealized gains (losses) on available-for-sale securities		16,963	(19,870)	22,614	(29,514)
Tax benefit (expense)		(3,678)	6,954	(4,233)	10,330
Other comprehensive income (loss)		13,285	(12,916)	18,381	(19,184)
Total comprehensive income (loss)	\$	15,533	(13,730)	27,722	(14,271)

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**(5) Earnings Per Share**

The following tables sets forth the computation of basic and diluted earnings (loss) per share:

	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
	<b>(In thousands, except per share amounts)</b>	
Basic and diluted earnings (loss) per share:		
Numerator:		
Net income (loss)	\$ 2,248	(814)
Less: Preferred stock dividends	(13)	(171)
Accretion of deferred issuance costs and discounts on preferred stock	(144)	(619)
Net income (loss) available to common stockholders	\$ 2,091	(1,604)
Net income (loss) allocated to Class A common stock	\$ 2,070	(1,585)
Net income (loss) allocated to Class B common stock	21	(19)
Net income (loss) available to common stockholders	\$ 2,091	(1,604)
Denominator:		
Weighted average shares of Class A outstanding basic and diluted	48,441	43,198
Weighted average shares of Class B outstanding basic and diluted	1,002	1,002
Total weighted average shares outstanding basic and diluted	49,443	44,200
Basic and diluted earnings (loss) per share of Class A common stock	\$ 0.04	(0.04)
Basic and diluted earnings (loss) per share of Class B common stock	\$ 0.02	(0.02)



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	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
	<b>(In thousands, except per share amounts)</b>	
Basic and diluted earnings per share:		
Numerator:		
Net income	\$ 9,341	4,913
Less: Preferred stock dividends	(216)	(514)
Accretion of deferred issuance costs and discounts on preferred stock	(2,289)	(1,287)
Net income available to common stockholders	\$ 6,836	3,112
Net income allocated to Class A common stock	\$ 6,764	3,076
Net income allocated to Class B common stock	72	36
Net income available to common stockholders	\$ 6,836	3,112
Denominator:		
Weighted average shares of Class A outstanding basic and diluted	47,177	43,121
Weighted average shares of Class B outstanding basic and diluted	1,002	1,002
Total weighted average shares outstanding basic and diluted	\$ 48,179	44,123
Basic earnings per share of Class A common stock	\$ 0.14	0.07
Basic earnings per share of Class B common stock	\$ 0.07	0.04
Diluted earnings per share of Class A common stock	\$ 0.09	0.07
Diluted earnings per share of Class B common stock	\$ 0.04	0.04

As discussed in Note 9, on July 13, 2009, the Series A-1 and A-2 Convertible Preferred Stock was converted to Class A common stock. For the three and nine month periods ended September 30, 2008, the effects of Series A-1 and A-2 Convertible Preferred Stock were anti-dilutive; therefore, diluted income per share is reported the same as basic income per share. The Series A-1 and A-2 Convertible Preferred Stock was anti-dilutive because the amount of the dividend and accretion of deferred issuance costs and discounts for the three and nine months ended September 30, 2009 and 2008 per Class A common stock share obtainable on conversion exceeds basic income per share available to common stockholders. For the three and nine months ended September 30, 2009, certain warrants on the Convertible Preferred Stock became dilutive. As such, the diluted weighted average shares of Class A common stock outstanding for the period was 47,204,000. Total diluted weighted average shares was 48,206,000. The warrants were anti-dilutive for the three and nine months ended September 30, 2008.

**(6) Investments**

Investments are an integral part of the Company's overall insurance operations. We maintain a conservative investment philosophy with investment purchases primarily in high quality investment grade securities that provide a secure return to meet cash flow requirements related to our insurance business. Approximately 93% of our investment holdings are in fixed maturity and equity securities as of September 30, 2009. The equity securities were purchased to diversify our overall investment holdings.

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The following tables represent gross unrealized gains and losses for fixed maturity securities for the periods indicated.

	Amortized Cost	September 30, 2009		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
(In thousands)				
Available-for-sale securities:				
U.S. Treasury securities	\$ 11,134	1,913		13,047
U.S. Government-sponsored enterprises	151,134	549	(739)	150,944
Securities issued by states and political subdivisions	50,349	1,004	(2,564)	48,789
Securities issued by foreign governments	105	21		126
Public utilities	24,529	619	(324)	24,824
Corporate	78,778	3,640	(1,377)	81,041
Securities not due at a single maturity date	19,788	776	(45)	20,519
Total available-for-sale securities	335,817	8,522	(5,049)	339,290
Held-to-maturity securities:				
U.S. Government-sponsored enterprises	202,197	505	(2,206)	200,496
Total fixed maturities	\$ 538,014	9,027	(7,255)	539,786
Total equity securities	\$ 42,414	10,424	(56)	52,894

	Amortized Cost	December 31, 2008		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
(In thousands)				
Available-for-sale securities:				
U.S. Treasury securities	\$ 11,306	3,113		14,419
U.S. Government-sponsored enterprises	280,434	1,128	(500)	281,062
Securities issued by states and political subdivisions	64,152	156	(6,203)	58,105
Securities issued by foreign governments	105	29		134
Public utilities	4,231	22	(100)	4,153
Corporate	83,089	1,112	(8,826)	75,375
Securities not due at a single maturity date	50,717	1,564	(374)	51,907
Total fixed maturities	\$ 494,034	7,124	(16,003)	485,155

Total equity securities	\$ 42,908	92	43,000
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The tables below present the fair values and gross unrealized losses of fixed maturities that have remained in a continuous unrealized loss position for the periods indicated.

	<b>September 30, 2009</b>								
	<b>Less than 12 months</b>			<b>Greater than 12 months</b>			<b>Total</b>		
	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b># of Securities</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b># of Securities</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b># of Securities</b>
	<b>(In thousands, except for # of securities)</b>								
Available-for-sale securities:									
U.S. Government sponsored enterprises	\$ 68,786	(711)	110	4,192	(28)	3	72,978	(739)	113
Security issued by states and political subdivisions				15,291	(2,564)	15	15,291	(2,564)	15
Public utilities				4,815	(324)	2	4,815	(324)	2
Corporate	2,587	(160)	8	14,466	(1,217)	9	17,053	(1,377)	17
Securities not due at a single maturity date				1,413	(45)	10	1,413	(45)	10
Total available-for-sale	71,373	(871)	118	40,177	(4,178)	39	111,550	(5,049)	157
Held-to-maturity securities:									
U.S. Government sponsored enterprises	134,692	(2,206)	53				134,692	(2,206)	53
Total fixed maturities	\$ 206,065	(3,077)	171	40,177	(4,178)	39	246,242	(7,255)	210

	<b>December 31, 2008</b>								
	<b>Less than 12 months</b>			<b>Greater than 12 months</b>			<b>Total</b>		
	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b># of Securities</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b># of Securities</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b># of Securities</b>
	<b>(In thousands, except for # of securities)</b>								
Available-for-sale securities:									
U.S. Government sponsored enterprises	\$ 18,680	(265)	14	11,256	(235)	11	29,936	(500)	25
Security issued by states and political subdivisions	32,389	(2,827)	39	21,492	(3,376)	23	53,881	(6,203)	62
Public utilities				1,915	(100)	1	1,915	(100)	1
Corporate	20,509	(2,170)	51	32,965	(6,656)	19	53,474	(8,826)	70
Securities not due at a single maturity date	118	(8)	3	11,629	(366)	24	11,747	(374)	27
Total fixed maturities	\$ 71,696	(5,270)	107	79,257	(10,733)	78	150,953	(16,003)	185

As of September 30, 2009, the Company had 39 securities in an unrealized loss position for greater than 12 months, which were primarily municipal, corporate and mortgage-backed securities. The Company has reviewed these securities and determined that no other-than-temporary impairment exists. The Company also asserts its intent and ability to hold these securities until the price recovers or they mature.

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The amortized cost and fair value of fixed maturity securities at September 30, 2009 by contractual maturity are shown 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.

	<b>September 30, 2009</b>	
	<b>Amortized Cost</b>	<b>Fair Value</b>
	<b>(In thousands)</b>	
Available-for-sale securities:		
Due in one year or less	\$ 7,199	7,398
Due after one year through five years	42,272	42,673
Due after five years through ten years	25,724	26,370
Due after ten years	240,834	242,330
Total available-for-sale securities	316,029	318,771
Held-to-maturity securities:		
Due after ten years	202,197	200,496
Securities not due at a single maturity date	19,788	20,519
Total fixed maturities	\$ 538,014	539,786

The securities not due at a single maturity date are primarily mortgage-backed obligations of U.S. Government corporations and agencies.

The Company uses the specific identification method related to security sales. There were no securities sold from the held-to-maturity portfolio during the nine months ended September 30, 2009 or 2008. Proceeds and gross realized gains (losses) from sales of fixed maturities available-for-sale for the nine months ended September 30, 2009 and 2008 are summarized as follows:

	<b>Nine Months Ended September 30, 2009                  2008</b>	
	<b>(In thousands)</b>	
Proceeds	\$ 72,148	
Gross realized gains	\$ 2,720	
Gross realized losses	\$	

Proceeds and gross realized gains (losses) from sales of equity securities for the nine months ended September 30, 2009 and 2008 are summarized as follows:

<b>Nine Months Ended September 30, 2009                  2008</b>	
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**(In thousands)**

Proceeds	\$	1,184
Gross realized gains	\$	219
Gross realized losses	\$	



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**(7) Fair Value Measurements**

As defined in the current accounting guidance, 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 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. Current accounting guidance requires all assets and liabilities carried at fair value 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 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 fixed maturity securities, U.S. Government-sponsored enterprise securities, municipal securities, certain mortgage and asset-backed securities, and warrants.

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 where we cannot corroborate the significant valuation inputs with market observable data.

The following table sets forth the Company's assets and liabilities that are measured at fair value on a recurring basis as of the date indicated:

	<b>Total</b>	<b>September 30, 2009</b>		<b>Level 3</b>
		<b>Level 1</b>	<b>Level 2</b>	
		<b>(In thousands)</b>		
<b>Financial Assets:</b>				
Fixed maturities available-for-sale and short-term investments	\$ 341,846	13,047	328,200	599
Equity securities available-for-sale	52,894	52,894		
<b>Total financial assets at fair value</b>	<b>\$ 394,740</b>	<b>65,941</b>	<b>328,200</b>	<b>599</b>

**Financial Liabilities:**

Warrants outstanding	\$ 1,892	1,892
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The following table presents additional information about fixed maturity securities measured at fair value on a recurring basis and for which we have utilized significant unobservable (Level 3) inputs to determine fair value:

		<b>September 30, 2009 (In thousands)</b>
Beginning balance at December 31, 2008	\$	654
Total realized and unrealized losses:		
Included in net income		
Included in other comprehensive income		(16)
Principal paydowns		(39)
Transfer in and (out) of Level 3		
Ending balance at September 30, 2009	\$	599

The Company reviews 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.

The Company has real estate held for sale that is valued at fair value on a non-recurring basis, using Level 2 independent appraisals, in the amount of \$3.0 million, at September 30, 2009.

*Valuation Related to Fair Value*

*Fixed maturity securities, available-for-sale.* At September 30, 2009, the fixed maturities valued using an independent pricing source totaled \$328.2 million for Level 2 assets and comprised 83.1% of total reported fair value. Fair values for Level 3 assets are based upon unadjusted broker quotes that are non-binding. The valuations are reviewed and validated quarterly through random testing by comparisons to independent pricing models, other third party pricing services, and back tested to recent trades.

For the nine months ended September 30, 2009, 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.* Fair values of these securities are based upon quoted market price and are classified as Level 1 assets.

*Cash and cash equivalents and Short-term investment.* The carrying amounts for cash and cash equivalents reflect the assets' fair values. The fair values for short-term investments are determined based on quoted market prices. These assets are classified as Level 1.

*Warrants outstanding.* Fair value of our warrants are based upon industry standard models that consider various observable inputs and are classified as Level 2.

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*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. The carrying amount and fair value for the financial assets and liabilities on the consolidated balance sheets for the periods indicated are as follows:

	<b>September 30, 2009</b>		<b>December 31, 2008</b>	
	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Carrying Value</b>	<b>Fair Value</b>
	<b>(In thousands)</b>			
Financial assets:				
Fixed maturities, held-to-maturity	\$ 202,197	200,496		
Mortgage loans	1,462	1,400	339	370
Policy loans	31,860	31,860	28,955	28,955
Cash and cash equivalents	77,916	77,916	63,792	63,792
Financial liabilities:				
Annuities	36,585	32,877	34,025	29,107

Fair values for fixed income securities are based on quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other assumptions, including the 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 6.8% and 8.2% per year as of September 30, 2009 and December 31, 2008, respectively, with maturities ranging from one to thirty years. Management estimated the fair value using an annual interest rate of 6.25% at September 30, 2009 and December 31, 2008.

Policy loans have a weighted average annual interest rate of 7.6% as of September 30, 2009 and December 31, 2008, and have no specified maturity dates. The aggregate fair value of policy loans approximates the carrying value reflected on the consolidated balance sheet. 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 that we have in force and cannot be valued separately and are not marketable; therefore, a fair value is not calculated.

For cash and cash equivalents, accrued investment income, reinsurance recoverable, other assets, Federal income tax payable and receivable, dividend accumulations, commissions payable, amounts held on deposit, and other liabilities, the carrying amounts approximate fair value because of the short maturity of such financial instruments.

The fair value of the Company's liabilities under annuity contract policies were estimated at September 30, 2009 using December 31, 2008 discounted cash flows using a risk free rate plus a component for non-performance risk and interest rate risk. 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.

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**(8) Legal Proceedings**

We are a defendant in a lawsuit originally filed on August 6, 1999 in the Texas District Court, Austin, Texas, now styled *Citizens Insurance Company of America, Citizens, Inc., and Harold E. Riley v. Fernando Hakim Daccach*, in which a class was originally certified by the trial court and affirmed by the Court of Appeals for the Third District of Texas. We appealed the grant of class status to the Texas Supreme Court, which on March 2, 2007, reversed the Court of Appeals' affirmation of the trial court's class certification order, decertified the class and remanded the case to the trial court for further proceedings consistent with the Texas Supreme Court's opinion. As a result, no class action is presently certified, and plaintiffs' counsel is seeking to recertify the class. In order to recertify the class, the lead plaintiff must establish that he is qualified to represent the purported class and that the res judicata effect of a class action will not have a deleterious effect on the putative class members. The underlying lawsuit alleges that certain life insurance policies we made available to non-U.S. residents, when combined with a policy feature that allowed certain cash benefits to be assigned to two non-U.S. trusts for the purpose of accumulating ownership of our Class A common stock, along with allowing the policyholders to make additional contributions to the trusts, were actually offers and sales of securities that occurred in Texas by unregistered dealers in violation of the Texas securities laws. The remedy sought was rescission and return of the insurance premium payments. We believe the lawsuit is without merit and intend to continue a vigorous defense in any remaining proceedings, including any class recertification. If the class is recertified, we would likely be further exposed to costly and time-consuming litigation, and an adverse judgment could have a material adverse effect on our results of operations and financial condition. The case is now before the Texas District Court judge for an analysis of evidence presented to determine if it warrants recertification of a class.

Security Plan Fire Insurance Company (SPFIC) is a defendant in a suit styled *The State of Louisiana v. AAA Insurance, or Road Home Litigation*, which was filed in the Civil District Court for the Parish of Orleans on August 23, 2007 by the state of Louisiana as subrogee/assignee of the insureds of more than 200 different insurance companies. The suit was filed to recover money that the state of Louisiana paid to certain insureds under the Louisiana Road Home Program for damages resulting from Hurricanes Katrina and Rita. The suit was removed to the United States District Court for the Eastern District of Louisiana on September 11, 2007 and appeals of the removal have been denied. In March 2009, the trial court judge dismissed all bad faith claims asserted against the defendants, including SPFIC. He also dismissed all claims for flood damage and all claims asserted under Louisiana's Valued Policy Law. Despite the District Court's recent rulings, the *Road Home Litigation* is still in the early stages of litigation, and no discovery has yet occurred. Therefore, it is not possible to evaluate how many claims relate to SPFIC, or the potential exposure to SPFIC. However, in the event of an adverse outcome, the potential exposure to SPFIC could be significant.

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

disputes over insurance coverage or claims adjudication;

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

disputes with our marketing firms, consultants and employee agents over compensation and termination of contracts and related claims;

disputes regarding our tax liabilities;

disputes relative to reinsurance and coinsurance agreements; and

disputes relating to businesses acquired and operated by us.

In the absence of countervailing considerations, we would expect to defend any such claims vigorously. However, in doing so, we could incur significant defense costs, including not only attorneys' fees and other direct litigation costs, but also the expenditure of substantial amounts of management time that otherwise would be devoted to our business. If we suffer an adverse judgment as a result of any claim, it could have a material adverse effect on our business, results of operations and financial condition.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**Notes to Consolidated Financial Statements, Continued**  
**September 30, 2009**  
**(Unaudited)**

**(9) Convertible Preferred Stock**

In July 2004, the Company completed a private placement of Series A-1 Convertible Preferred Stock ( Series A-1 Preferred ) to four unaffiliated institutional investors. We also issued to the investors warrants to purchase shares of our Class A common stock, at an exercise price of \$6.95 per share, and unit warrants to purchase Series A-2 Convertible Preferred Stock ( Series A-2 Preferred ). The conversion, exercise and redemption prices, along with the number of shares and warrants, have been adjusted for stock dividends paid on December 31, 2004 and on December 30, 2005.

On July 13, 2009, the Company converted all of its outstanding Series A-1 and Series A-2 Convertible Preferred Stock into Class A common shares in accordance with the mandatory redemption provision of the preferred shareholder agreement dated July 12, 2004. The total amount of Class A common shares issued as part of the conversion was 1,706,686, inclusive of pro rata dividends due through the conversion date.

**(10) Reinsurance**

In the normal course of business, the Company reinsures portions of certain policies that we underwrite to limit disproportionate risks. We retain varying amounts of individual insurance up to a maximum retention of \$100,000 on any life. The Company also reinsures 100% of our accidental death benefit rider coverage. Catastrophe reinsurance is in place for our property policies and provides \$10,000,000 of coverage above a \$500,000 deductible. Our health insurance policies are substantially all reinsured on a 100% coinsurance basis. We remain contingently liable to the extent that the reinsuring companies cannot meet their obligations under these reinsurance treaties.

During the current quarter, the Company added a new reinsurer to assume a percentage of the reinsurance risk over \$100,000 to diversify risk over several reinsurers. The Company now has three reinsurance companies to share risks exceeding our retention on any life.

**(11) Income Taxes**

The Company recognized an additional valuation allowance of \$1,799,000 in the first quarter of 2009 due to deferred tax assets generated by other-than-temporary impairments on investment securities recorded in the quarter and additional unrealized losses that occurred on the equity portfolio. Of this amount, \$135,000 was recorded as tax expense, \$1,410,000 was recorded in other comprehensive loss, and \$254,000 was recorded as additional goodwill from the 2008 acquisition of ONLIC. During the second quarter of 2009, \$2,833,000 of the valuation allowance was released due primarily to unrealized gains arising during the quarter in the stock portfolio. Additionally, \$585,000 of the valuation allowance, related to ONLIC's stock portfolio, was released and reduced goodwill. During the third quarter of 2009, \$2,258,000 of the valuation allowance was released, primarily from unrealized gains arising during the quarter in the stock portfolio. Additionally, another \$213,000 of the valuation allowance was set up in the third quarter and increased goodwill of ONLIC. The net reduction of goodwill related to tax adjustments for the year to date was \$118,000.

**(12) Subsequent Events**

Management has evaluated subsequent events through November 6, 2009, which is the date that the Company's financial statements were filed with the Securities and Exchange Commission. No material subsequent events have occurred since September 30, 2009 that required recognition or disclosure in these financial statements other than as noted below.

The Company has obtained appropriate state insurance regulatory approval to merge ONLIC into SPLIC effective October 1, 2009. This merger will consolidate the final expense and home service operations into one company.

In September of 2009, the Company entered into an asset purchase agreement to sell Funeral Homes of America for \$600,000 in cash. The sale was completed on October 30, 2009.





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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**

**September 30, 2009**

**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, could, expects, intends, targeted, may, will and similar expressions are intended to forward-looking statements but are not the exclusive means of identifying such statements.*

*Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those contemplated by the forward-looking statements. Factors that could cause the Company's future results to differ materially from expected results include, but are not limited to:*

*Changes in foreign and U.S. general economic conditions, including the performance of financial markets and interest rates;*

*Changes in consumer behavior, which may affect the Company's ability to sell its products and retain business;*

*The timely development of and acceptance of new products of the Company and perceived overall value of these products and services by existing potential customers;*

*Fluctuations in experience regarding current mortality, morbidity, persistency and interest rates relative to expected amounts used in pricing the Company's products;*

*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;*

*Our success at managing risks involved in the foregoing; and*

*The risk factors disclosed herein, as well as other risk factors disclosed previously and from time to time in our filings with the Securities and Exchange Commission.*

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

*on which such statement is made to reflect the occurrence of unanticipated events.*

*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.*

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**September 30, 2009**

**Overview**

Citizens, Inc. is an insurance holding company serving the life insurance needs of individuals in the United States and in more than 34 countries around the world. We pursue a strategy of offering ordinary whole life insurance with a focus on cash accumulation and final expense insurance products in niche markets where we believe we are able to achieve competitive advantages. Our core operations include issuing and servicing:

U.S. Dollar-denominated ordinary whole life insurance policies predominantly to high net worth, high income foreign residents, principally in Latin America and the Pacific Rim, through independent marketing consultants;

ordinary whole life insurance policies to middle income households in the midwest and the southern United States through independent marketing consultants; and

final expense and limited liability property policies to middle and lower income households in Louisiana and Arkansas through employee and independent agents in our home service distribution channel.

The Company reported earnings, net of tax, of \$2.2 million and \$9.3 million for the three and nine months ended September 30, 2009. Total revenues of \$44.8 million and \$134.9 million were recorded for the three and nine months ended September 30, 2009. Assets totaled \$919.6 million as of September 30, 2009.

*Life Insurance.* For more than 30 years, CICA and its predecessors have participated in the foreign marketplace through the issuance of U.S. Dollar-denominated ordinary whole life insurance to foreign nationals. Traditionally, this market has focused on the top 3-5% of the population of a country in terms of income and net worth. Over the years, however, there has been a shift to encompass a broader spectrum of the population, as upper middle classes develop in Latin America and the Pacific Rim. We make our insurance products available using third-party marketing organizations and independent marketing consultants. We received applications from 28 countries outside of the U.S. in the first nine months of 2009. Historically, the majority of our international business has come from Latin America; however, the Pacific Rim now represents a meaningful source of new business.

Through the domestic market of our Life Insurance segment, we provide ordinary whole life, credit life insurance, and final expense policies to middle income families and individuals in certain markets in the midwest and southern U.S. The majority of our revenues domestically are the result of U.S. domiciled life insurance company acquisitions since 1987.

*Home Service Insurance.* We provide final expense ordinary life insurance to middle and lower income individuals, primarily in Louisiana and Arkansas. Policies in this segment are sold and serviced through funeral homes or the home service marketing distribution system utilizing employee-agents who work on a route system to collect premiums and service policyholders.

The Company entered the Home Service business in 2004 with the acquisition of SPLIC and SPFIC. The acquisition of ONLIC in 2008 broadened the Home Service business into Arkansas. ONLIC was merged into SPLIC in October of 2009. The Company intends to continue to expand this segment through sales promotion and potential future acquisitions.

*Marketplace Conditions and Trends*

Described below are some of the significant trends affecting the life insurance industry and the possible effects they may have on our future operations.

The global recession has had an adverse impact on our insurance policy sales. We anticipate new insurance policy sales will be at lower levels until such time as the global economy recovers.

As an increasing percentage of the world population reaches retirement age, we believe we will benefit from increased demand for living products rather than death products, as aging baby boomers will require cash accumulation to provide expenses to meet their lifetime needs. Our ordinary life products are designed to accumulate cash values to provide for living expenses in a policy owner's later years, while continuously

providing a death benefit.

Table of Contents**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES****September 30, 2009**

We are exposed to a variety of risks, including the current market conditions as well as the credit crisis, the current recession and corresponding potential changes in the fair value of our investments. In the normal course of business, we employ established policies and procedures to manage our exposure to fluctuations in the current market and changes in the fair value of our investments.

Because of the trends described above, coupled with increasing costs of regulatory compliance such as the Sarbanes-Oxley Act of 2002, we believe there is a trend toward consolidation of domestic life insurance companies. We believe these trends should be a benefit to our acquisition strategy as more complementary acquisition candidates may become available for us to consider.

Many of the events and trends affecting the life insurance industry have had an impact on the life reinsurance industry. These events led to a decline in the availability of reinsurance. While we currently cede a limited amount of our primary insurance business to reinsurers, we may find it difficult to obtain reinsurance in the future, forcing us to seek reinsurers who are more expensive to us. If we cannot obtain affordable reinsurance coverage, either our net exposures will increase or we will have to reduce our underwriting commitments.

*Recent Acquisition*

The Company completed its acquisition ICC in exchange for 1,294,000 shares of Class A common stock in the first quarter of 2009. ICC is the parent of ICIC, an Indiana life insurance company. The transaction was valued at \$9.0 million on February 27, 2009, the closing date.

**Consolidated Results of Operations**

The following tables sets forth our consolidated net income and loss for the periods indicated:

<b>Three Months Ended</b>	<b>Net Income (Loss)</b>	<b>Basic Earnings (Loss) per Class A Share</b>	<b>Net Income (Loss) Increase (Decrease) from Previous Year</b>
<b>September 30, 2009</b>	\$ 2,248	\$ 0.04	376.2%
<b>2008</b>	(814)	(0.04)	(117.5)
<b>Nine Months Ended</b>	<b>Net Income (in thousands)</b>	<b>Basic Earnings per Class A Share</b>	<b>Net Income Increase (Decrease) from Previous Year</b>
<b>September 30, 2009</b>	\$ 9,341	\$ 0.14	90.1%
<b>2008</b>	4,913	0.07	(53.8)

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**September 30, 2009**

**Revenues:** Total revenues for the three and nine months ended September 30, 2009 increased 11.7% and 9.4% over the same periods in 2008 due primarily to increases in life insurance premiums, realized gains on investments and the adjustment in fair value of the Company's warrants. Total revenues excluding fair value adjustments of warrants outstanding increased 7.7% and 5.4% for the three and nine months ended September 30, 2009 compared to the same periods in 2008.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(In thousands)</b>			
Revenues:				
Premiums:				
Life insurance	\$ 34,589	32,837	101,858	97,178
Accident and health insurance	371	384	1,135	1,178
Property insurance	1,192	820	3,501	3,559
Net investment income	7,413	7,543	21,733	22,487
Realized gains (losses), net	1,006	(226)	2,827	(210)
Decrease (increase) in fair value of warrants		(1,483)	3,081	(1,674)
Other income	273	288	796	852
Total revenues	44,844	40,163	134,931	123,370
Exclude increase (decrease) in fair value of warrants		1,483	(3,081)	1,674
Total revenues excluding fair value adjustments of warrants outstanding	\$ 44,844	41,646	131,850	125,044

**Premium Income.** Premium income increased for the three and nine months ended September 30, 2009 to \$36.2 million and \$106.5 million from \$34.0 million and \$101.9 million for the same period in 2008. The increase in 2009 was due primarily to an increase in renewal premiums totaling \$31.3 million and \$93.1 million for the three and nine months ended September 30, 2009 compared to \$29.9 million and \$86.4 million for the same periods in 2008. In addition, approximately \$0.9 million and \$2.7 million of premium income for the three and nine months ended September 30, 2009 related to the acquisitions ICIC and ONLIC, which were not included in the first nine months of 2008.

**Net Investment Income.** Net investment income decreased to \$7.4 million and \$21.7 million for the three and nine months ended September 30, 2009 compared to \$7.5 million and \$22.5 million during the same period in 2008. The decrease in 2009 resulted from increased call activity on the fixed maturity securities portfolio due to the low interest rate environment, as well as the lower reinvestment rates available, which depressed the net investment income in 2009 compared to 2008. Investment income from fixed maturity securities accounted for approximately 81% of total investment income for the nine months ended September 30, 2009. We continue to invest primarily in bonds of U.S. Government-sponsored enterprises, such as FNMA and FHLMC.

**Table of Contents****CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
September 30, 2009**

Investment income related to equity securities increased from \$187,000 and \$485,000 for the three and nine months ended September 30, 2008 to \$254,000 and \$803,000 for the same periods in 2009. This increase resulted primarily from the equity securities of ONLIC acquired in the fourth quarter of 2008, which are included in the three and nine months ended September 30, 2009 and are not included in the comparable periods of 2008.

	<b>Three Months Ended September 30, 2009</b>		<b>Nine Months Ended September 30, 2009</b>	
	<b>2008</b>		<b>2008</b>	
	<b>(In thousands)</b>			
Gross investment income:				
Fixed maturity securities	\$ 6,461	6,706	18,591	19,733
Equity securities	254	187	803	485
Mortgage loans	5	8	18	20
Policy loans	628	526	1,813	1,520
Real estate investments	357	213	1,071	643
Other investment income	120	220	641	949
Total investment income	7,825	7,860	22,937	23,350
Less investment expenses	412	317	1,204	863
Net investment income	\$ 7,413	7,543	21,733	22,487

**Realized Gains, Net.** The Company realized net gains of \$1.0 million and \$2.8 million for the three and nine months ended September 30, 2009 compared to realized net losses of \$226,000 and \$210,000 for the same periods in 2008. The increase in realized amounts in 2009 was primarily due to gains related to sales of fixed maturity securities offset by realized losses of \$111,000 relating to other-than-temporary impairments recorded in the first quarter of 2009.

**Change in Fair Value of Warrants.** The Company recognized revenues from adjusting the fair value of our Class A common stock warrants of \$3.1 million in the nine months ended September 30, 2009 compared to losses of \$1.7 million for the same period in 2008. For the three months ended September 30, 2009, there was minimal change in the fair value adjustment due to the Company's stock price remaining fairly constant over the period. The Company adjusts the warrant liability at each reporting date to reflect the current fair value of warrants computed based upon the stock value and current market conditions, calculated using the Black-Scholes option pricing model. As the stock value increases and decreases, the warrant liability also increases and decreases in a like manner. The adjustment to fair value is recorded as an increase or decrease in fair value of warrants on the consolidated statement of operations.

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September 30, 2009**

**Benefits and Expenses:** The table below summarizes the benefits and expenses for the periods indicated.

	<b>Three Months Ended September 30, 2009</b>		<b>Nine Months Ended September 30, 2009</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(In thousands)</b>			
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	\$ 14,494	13,855	44,254	41,663
Increase in future policy benefit reserves	10,305	10,214	28,021	24,944
Policyholders dividends	1,827	1,636	4,742	4,590
Total insurance benefits paid or provided	26,626	25,705	77,017	71,197
Commissions	8,435	8,819	25,462	25,906
Other underwriting, acquisition and insurance expense	6,772	7,312	21,889	21,243
Capitalization of deferred policy acquisition costs	(5,306)	(5,712)	(16,257)	(16,876)
Amortization of deferred policy acquisition costs	4,303	3,861	11,715	11,529
Amortization of cost of customer relationships acquired and other intangibles	946	676	2,630	2,155
Total benefits and expenses	\$ 41,776	40,661	122,456	115,154

**Claims and Surrenders.** As noted in the table below, claims and surrenders increased from \$13.9 million and \$41.7 million in the three and nine months ended September 30, 2008 to \$14.5 million and \$44.3 million during the same periods in 2009.

	<b>Three Months Ended September 30, 2009</b>		<b>Nine Months Ended September 30, 2009</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(In thousands)</b>			
Death claims	\$ 5,454	5,156	17,236	17,058
Surrender benefits	4,530	3,591	14,158	10,768
Endowments	3,455	3,415	10,049	10,209
Property claims	514	1,178	1,264	2,226
Accident and health benefits	113	96	323	256
Other policy benefits	428	419	1,224	1,146
Total claims and surrenders	\$ 14,494	13,855	44,254	41,663

Death Claims increased to \$5.5 million and \$17.2 million for the three and nine months ended September 30, 2009 compared to \$5.2 million and \$17.1 million for the same periods in 2008. These amounts vary from period to period and were within Company expectations.

Surrender benefits increased to \$4.5 million and \$14.2 million for the three and nine months ended September 30, 2009 compared to \$3.6 million and \$10.8 million for the same periods in 2008. These amounts represent payments to contract holders upon termination of a contract. The Company monitors surrenders on an ongoing basis. Surrenders as



a percent of ordinary whole life insurance in force were 0.7% in the first nine months of 2009 and 0.5% in the first nine months of 2008. Management believes this increase in surrenders may be the result of the global recession affecting our policyholders.

The decrease in property claims was a result of no hurricanes in Louisiana in 2009. In 2008, hurricanes Gustav and Ike hit Louisiana, causing losses of \$741,000 in the three and nine month periods ended September 30.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**September 30, 2009**

**Increase in Reserves.** Included in the 2009 increase in reserves, compared to 2008, were ONLIC reserve corrections of \$0.4 million reported as of September 30, 2009. These adjustments to increase reserves were related to data issues that were discovered in the second quarter. In addition, 2008 reserves were depressed due to a correction of \$796,000 related to a reserve factor error that was corrected in the first quarter of 2008. Likewise, the three months ended September 30, 2008 reflected a manual correction that decreased reserves by \$1.0 million related to a policy lapse correction.

**Policyholders Dividends.** The Company sells participating ordinary whole life products. These policyholder dividends are factored into the premiums and, therefore, have no impact on profitability.

**Commissions.** Commissions during the three and nine months ended September 30, 2009 decreased to \$8.4 million and \$25.5 million from \$8.8 million and \$25.9 million in 2008. The decrease was primarily due to lower first year commissions, as first year premiums were down in 2009 compared to 2008 due to the global recession.

**Other Underwriting, Acquisition and Insurance Expense.** These expenses decreased to \$6.8 million for the three months ended September 30, 2009, and increased to \$21.9 million for the nine months ended September 30, 2009, compared to \$7.3 million and \$21.2 million for the same periods in 2008. The decrease for the quarter was due primarily to a one-time equipment tax of \$0.3 million. The increase in the nine months ended September 30, 2009 compared to the same period in 2008 was due primarily to \$1.3 million of expense from the acquisition of ONLIC and ICIC, which were not in 2008 expenses, offset by the previously mentioned state tax of \$0.3 million and lower audit fees in 2009.

**Federal Income Tax.** The effective tax rates for the three and nine months ended September 30, 2009 were 26.7% and 25.1% versus 63.5% and 40.2% for the same periods in 2008. The rate variance from the statutory rate of 35% was due to the fact that the changes in fair value of our Class A common stock warrants are not tax effected. These changes resulted in no gain for the three months and a \$3.1 million gain for the nine months ended September 30, 2009 compared to a loss of \$1.7 million for the nine months ended September 30, 2008. Also, the Company recorded an additional valuation allowance of \$135,000 in the first nine months of 2009 related to other-than-temporary impairments recognized in the second quarter.

**Segment Operations**

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

	<b>Life Insurance</b>	<b>Home Service Insurance</b>	<b>Other Non- Insurance Enterprises</b>	<b>Total</b>
	<b>(In thousands)</b>			
Income (loss) before Federal income tax:				
Three months ended:				
September 30, 2009	\$ 2,522	967	(421)	3,068
September 30, 2008	3,010	(1,833)	(1,675)	(498)
Nine months ended:				
September 30, 2009	7,938	3,232	1,305	12,475
September 30, 2008	9,796	1,200	(2,780)	8,216



**Table of Contents****CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
September 30, 2009***Life Insurance*

Our Life Insurance segment consists of issuing primarily ordinary whole life insurance in U.S. Dollar-denominated amounts to foreign residents, and domestically through independent marketing firms and consultants.

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(In thousands)</b>			
<b>Revenue:</b>				
Premiums	\$ 25,795	24,634	75,570	72,584
Net investment income	4,232	4,309	12,196	12,519
Realized gains (losses), net	650	(223)	1,068	(220)
Other income	108	89	267	245
<b>Total revenue</b>	<b>30,785</b>	<b>28,809</b>	<b>89,101</b>	<b>85,128</b>
<b>Benefits and expenses:</b>				
Insurance benefits paid or provided:				
Claims and surrenders	10,035	8,644	30,259	26,462
Increase in future policy benefit reserves	8,850	8,335	24,258	23,430
Policyholders dividends	1,809	1,618	4,687	4,533
<b>Total insurance benefits paid or provided</b>	<b>20,694</b>	<b>18,597</b>	<b>59,204</b>	<b>54,425</b>
Commissions	4,827	5,206	14,531	15,136
Other underwriting, acquisition and insurance expenses	2,563	2,813	7,873	8,020
Capitalization of deferred policy acquisition costs	(3,975)	(4,526)	(12,227)	(13,017)
Amortization of deferred policy acquisition costs	3,757	3,500	10,677	10,038
Amortization of cost of customer relationships acquired and other intangibles	397	209	1,105	730
<b>Total benefits and expenses</b>	<b>28,263</b>	<b>25,799</b>	<b>81,163</b>	<b>75,332</b>
<b>Income before Federal income tax</b>	<b>\$ 2,522</b>	<b>3,010</b>	<b>7,938</b>	<b>9,796</b>

**Premiums.** Premium revenues increased 4.7% and 4.1% to \$25.8 million and \$75.6 million for the three and nine months ended September 30, 2009 compared to \$24.6 million and \$72.6 million for the same three and nine months in 2008. The increase was primarily due to an increase in renewal business and increased premium revenue related to the acquisition of ICIC in the first quarter of 2009, which was not included in 2008.

**Net Investment Income.** Net investment income decreased 1.8% and 2.6% when comparing the three and nine months ended September 30, 2009 to the same periods of 2008. The decrease related to low investment rates available in 2009, as well as the significant call activity the Company experienced in the current year.

**Realized Gains (Losses), Net.** Net realized gains of \$0.7 million and \$1.1 million for the three and nine months ended September 30, 2009 were recognized and related to sales of bonds purchased in early 2009 and sold as credit spreads tightened.

Claims and Surrenders. Claims and surrenders increased to \$10.0 million and \$30.3 million for the three and nine months ended September 30, 2009 compared to \$8.6 million and \$26.5 million for the same three and nine months of 2008. These amounts fluctuated from period to period but were within anticipated ranges based upon management's expectations.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**September 30, 2009**

**Commissions.** Commission expense decreased to \$4.8 million and \$14.5 million for the three and nine months ended September 30, 2009 compared to \$5.2 million and \$15.1 million for the same periods in 2008, as a result of increased premium revenue related to renewal business, which pays a lower commission rate, versus the 2008 premium, which had a higher percentage of first year premiums with higher commission rates, as noted above.

**Home Service Insurance**

Our Home Service Insurance segment provides final expense ordinary life insurance to middle and lower income individuals in Louisiana and Arkansas. Our policies in this segment are sold and serviced through a home service marketing distribution system utilizing employee and independent agents.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(In thousands)</b>			
<b>Revenue:</b>				
Premiums	\$ 10,357	9,407	30,924	29,331
Net investment income	3,126	3,072	9,396	9,255
Realized gains (losses), net	356	(3)	1,682	(8)
Other income	20	1	84	12
<b>Total revenue</b>	<b>13,859</b>	<b>12,477</b>	<b>42,086</b>	<b>38,590</b>
<b>Benefits and expenses:</b>				
Insurance benefits paid or provided:				
Claims and surrenders	4,459	5,211	13,995	15,201
Increase in future policy benefit reserves	1,455	1,879	3,763	1,514
Policyholders dividends	18	18	55	57
<b>Total insurance benefits paid or provided</b>	<b>5,932</b>	<b>7,108</b>	<b>17,813</b>	<b>16,772</b>
Commissions	3,608	3,613	10,931	10,770
Other underwriting, acquisition and insurance expenses	3,588	3,947	11,577	10,791
Capitalization of deferred policy acquisition costs	(1,331)	(1,186)	(4,030)	(3,859)
Amortization of deferred policy acquisition costs	546	361	1,038	1,491
Amortization of cost of customer relationships acquired and other intangibles	549	467	1,525	1,425
<b>Total benefits and expenses</b>	<b>12,892</b>	<b>14,310</b>	<b>38,854</b>	<b>37,390</b>
<b>Income (loss) before Federal income tax</b>	<b>\$ 967</b>	<b>(1,833)</b>	<b>3,232</b>	<b>1,200</b>

**Premiums.** The ONLIC acquisition represented the majority of the increase in premium revenue, with \$0.5 million and \$1.5 million reported in the three and nine months ended September 30, 2009 compared to the same periods in 2008. It is the Company's objective to continue to expand the Home Service Insurance segment operations.

**Net Investment Income.** Net investment income increased 1.8% and 1.5% to \$3.1 million and \$9.4 million for the three and nine months ended September 30, 2009 compared to \$3.1 million and \$9.3 million for the same periods in

2008. The increase in 2009 is due to the overall increase in the investment portfolio holdings with the addition of ONLIC. In addition, SPLIC received \$240,000 from a lawsuit settlement related to a bond in default.

Realized Gains (Losses), Net. Net realized gains of \$0.4 million and \$1.7 million for the three and nine months ended September 30, 2009 were recognized primarily related to bond sales, which resulted in gross gains of \$1.6 million for the nine months ended September 30, 2009, and sales of stocks in ONLIC's portfolio resulting in gains of approximately \$218,000. The gains were offset by realized losses of \$103,000 resulting from other-than-temporary impairments recorded on ONLIC's bond portfolio during the first quarter of 2009.

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**Claims and Surrenders.** Claims and surrenders decreased with \$4.5 million and \$14.0 million recorded for the three and nine month periods ended September 30, 2009 compared to \$5.2 million and \$15.2 million for the same periods in 2008. This decrease was due primarily to a decrease in death benefits for SPLIC and a decrease in casualty claims for SPFIC in 2009 compared to the same period in 2008. SPFIC results in 2008 included claims from Hurricanes Ike and Gustav totaling \$0.7 million.

**Increase in Future Policy Benefit Reserves.** Policy reserves decreased for the three months ended September 30, 2009 to \$1.5 million from \$1.9 million in the same period in 2008 and increased to \$3.8 million compared to \$1.5 million for the nine months ended September 30, 2009 and 2008, respectively. The year-to-date increase in 2009 included \$0.4 million resulting from a correction related to ONLIC reserves caused by data issues discovered in the second quarter. There was \$0.5 million reserve increase for the quarter and \$1.7 million year to date relating to the acquisition of ONLIC, which was not included in operations in 2008.

**Commissions.** Commissions expense remained flat for the three months ended September 30, 2009 at \$3.6 million compared to the same period in 2008, and for the nine months ended September 30, 2009 commissions increased to \$10.9 million from \$10.8 million in the same period of 2008. Commissions expense in 2009 includes ONLIC commissions that were not included in 2008, offset by the higher commissions recorded in 2008 for Security Plan due to the use of a manual computation used, which resulted in a higher commission expense. This process has been partially automated in 2009 and is resulting in a more refined computation in the current year.

**Other Underwriting, Acquisition and Insurance Expenses.** Other underwriting, acquisition and insurance expenses decreased to \$3.6 million for the quarter ended September 30, 2009 compared to \$3.9 million for the same period in 2008. This decrease related to economies of scale achieved on acquisitions through the elimination of duplicate staff positions. For the nine months ended September 30, 2009, other underwriting, acquisition and insurance expense increased to \$11.6 million compared to \$10.8 million in the same period in 2008, due primarily to expenses associated with the acquisition of ONLIC.

***Other Non-Insurance Enterprises***

Loss before Federal income tax expense for other non-insurance enterprises was \$1.7 million and \$2.8 million for the three and nine months ended September 30, 2008 compared to a loss of \$0.4 million and income of \$1.3 million for the same periods in 2009. Overall, other non-insurance operations are relatively immaterial to the consolidated results, except for the fair value adjustment related to the Company's warrants. The fair value adjustment for the nine months ended September 30, 2009 was \$3.1 million, which was recorded as revenue, compared to a loss of \$1.7 million recorded for the same period in 2008. These amounts fluctuate due to the movement in our Class A common stock price and fair value calculation using the Black-Scholes valuation model.

**Investments**

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



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

	<b>September 30, 2009</b>		<b>December 31, 2008</b>	
	<b>Carrying Value (In thousands)</b>	<b>Percent of Total</b>	<b>Carrying Value (In thousands)</b>	<b>Percent of Total</b>
Fixed maturity securities:				
U.S. Government-sponsored corporations and U.S. Government agencies (1)	\$ 366,188	51.0%	\$ 295,481	46.6%
Corporate	81,041	11.3	75,375	11.8
Municipal bonds	48,789	6.8	58,105	9.2
Mortgage-backed (2)	20,519	2.9	51,907	8.2
Public utilities	24,824	3.5	4,153	0.7
Foreign governments	126		134	
 Total fixed maturity securities	 541,487	 75.5	 485,155	 76.5
Cash and cash equivalents	77,916	10.9	63,792	10.1
Short-term investments	2,556	0.3	2,250	0.4
Other investments:				
Policy loans	31,860	4.4	28,955	4.6
Equity securities	52,894	7.4	43,000	6.8
Mortgage loans	1,462	0.2	339	0.1
Real estate and other long-term investments	9,259	1.3	9,553	1.5
 Total cash, cash equivalents and investments	 \$ 717,434	 100.0%	 \$ 633,044	 100.0%

(1) Includes U.S. Treasury securities of \$13,047,000 and \$14,419,000 and U.S. Government agencies and U.S. Government-sponsored corporations of \$353,141,000 and \$281,062,000 at September 30, 2009 and December 31, 2008, respectively.

(2) Includes \$17,057,000 and \$46,371,000 of U.S. Government

agencies and U.S.  
Government-sponsored  
corporations at  
September 30, 2009 and  
December 31, 2008,  
respectively.

The Company established a held-to-maturity portfolio during the second quarter of 2009 in accordance with accounting guidance and management's intent at the time of purchase of the security. The held-to-maturity portfolio as of September 30, 2009 represents 37.3% of the total fixed maturity securities owned based upon carrying values, with the remaining 62.7% classified as available-for-sale. Held-to-maturity securities are reported in the financial statements at amortized cost and available-for-sale securities are reported at fair value.

The Company experienced significant call volume during the current year as market interest rates declined. Approximately 65% of the fixed maturity portfolio at September 30, 2009 is exposed to call risk. The Company has reinvested a portion of the proceeds in shorter duration corporate securities in anticipation that interest rates will rise and these future funds can be reinvested in longer term bonds yielding higher rates. As of September 30, 2009, balances held in cash and cash equivalents were higher compared to December 31, 2008 due to a time lag of reinvesting the fixed maturity securities that were called and a payable of \$13.8 million related to securities in the process of settlement. This balance is expected to decline and be more in line with the year-end 2008 balances as these funds are reinvested in longer term fixed maturities.

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The following table shows the distribution of the credit ratings of our portfolio of fixed maturity securities by carrying value.

	<b>September 30, 2009</b>		<b>December 31, 2008</b>	
	<b>Carrying Value (In thousands)</b>	<b>%</b>	<b>Carrying Value (In thousands)</b>	<b>%</b>
AAA and U.S. Government	\$ 404,875	74.8%	\$ 379,547	78.2%
AA	22,470	4.1	37,263	7.7
A	70,060	13.0	56,043	11.6
BBB	38,657	7.1	7,217	1.5
BB and other	5,425	1.0	5,085	1.0
Totals	\$ 541,487	100.0%	\$ 485,155	100.0%

The Company's holding of BBB bonds increased during the first nine months of 2009, as the Company purchased additional public utility and industrial corporate bonds in order to shorten its portfolio duration in light of the historically low interest rates.

**Other-Than-Temporary Impairment ( OTTI ) Review**

Unrealized losses for all investment securities are reviewed to determine whether the losses are other-than-temporary. Investment securities are evaluated for OTTI at least quarterly and more frequently when economic or market conditions warrant such an evaluation. In conducting this assessment, the Company evaluates a number of factors including, but not limited to:

- how much fair value has declined below amortized cost;
- how long the decline in fair value has existed;
- the financial condition of the issuer;
- contractual or estimated cash flows of the security;
- underlying supporting collateral;
- past events, current conditions and forecasts;
- significant rating agency changes on the issuer; and
- the Company's intent and ability to hold the fixed maturity security until maturity or for a period of time sufficient to allow for full recovery in fair value.

The term other-than-temporary is not intended to indicate that the decline in security value is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings or other comprehensive income is recognized. In the first quarter of 2009, the Company recorded other-than-temporary impairment charges relating to our bond and stock portfolios totaling \$111,000 recognized in earnings. There were no OTTI charges recorded relating to the second or third quarter of 2009.

**Liquidity and Capital Resources**

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

Liquidity requirements of Citizens are met primarily by funds provided from operations. Premium deposits and revenues, investment income and investment maturities are the primary sources of funds, while investment purchases, policy benefits, and operating expenses are the primary uses of funds. We historically have not had to liquidate investments to provide cash flow and did not do so during the first nine months of 2009. For the first nine months of 2009, the Company experienced high call volume related to fixed maturity securities totaling \$276.1 million compared to \$130.8 million for the first nine months of 2008.

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A potential liquidity concern is the risk of an extraordinary level of early policyholder withdrawals. We include provisions within our insurance policies, such as surrender charges, that help limit and discourage early withdrawals. Since these contractual withdrawals, as well as the level of surrenders experienced, were largely consistent with our assumptions in asset liability management, our associated cash outflows, to date, have not had an adverse impact on our overall liquidity. Individual life insurance policies are less susceptible to withdrawal than annuity reserves and deposit liabilities because policyholders may incur surrender charges and undergo a new underwriting process in order to obtain a new insurance policy. Cash flow projections and cash flow tests under various market interest rate scenarios are also performed annually to assist in evaluating liquidity needs and adequacy. We currently anticipate that available liquidity sources and future cash flows will be adequate to meet our needs for funds.

Cash flows from our insurance operations have been sufficient to meet current needs. Cash flows from operating activities were \$36.3 million and \$34.7 million for the nine months ended September 30, 2009 and 2008, respectively. We have traditionally also had significant cash flows from both scheduled and unscheduled investment security maturities, redemptions, and prepayments. These cash flows, for the most part, are reinvested into fixed income securities. During the second and third quarters of 2009, with purchases of \$202.3 million, the Company established a held-to-maturity portfolio. Net cash outflows from investment activity totaled \$23.7 million for the nine months ended September 30, 2009, and \$12.1 million for the nine months ended September 30, 2008. The outflows from investing activities for the nine months ended September 30, 2009 were a result of the investment of excess cash from operations reduced by \$9.8 million in cash acquired in the Integrity Capital Corporation acquisition. The outflows from investing activities for the nine months ended September 30, 2008 primarily related to the investment of excess cash and cash equivalents generated from operations.

Stockholders' equity at September 30, 2009 increased to \$215.5 million compared to \$171.5 million at December 31, 2008. The increase in 2009 was due to an increase in income earned during the period, as well as an increase in unrealized gains generated from the investment portfolio. Stockholders' equity also increased as a result of the issuance of \$8.4 million of Class A common stock for the acquisition of ICC and the redemption value of \$10.0 million resulting from the conversion of Series A-1 and A-2 Convertible Preferred Stock to Class A common stock during the period.

Investments increased to \$639.5 million at September 30, 2009 from \$569.3 million at December 31, 2008. Fixed maturities are categorized into fixed maturities available-for-sale, which are carried in our consolidated financial statements at fair value, and fixed maturities held-to-maturity, which are carried in our consolidated financial statements at amortized cost. Fixed maturities available-for-sale were 53.1% of investments at September 30, 2009 and 85.2% at December 31, 2008. Likewise, fixed maturities held-to-maturity were 31.6% of investments at September 30, 2009. There were no securities classified as held-to-maturity at December 31, 2008.

Policy loans were \$31.9 million at September 30, 2009 and \$29.0 million at December 31, 2008. These loans, which are secured by the underlying policy values, have yields ranging from 5% to 12% and maturities that are related to the maturity or termination of the applicable policies. Management believes that we maintain adequate liquidity despite the uncertain maturities of these loans.

Our cash balances at our primary depositories were significantly in excess of Federal Deposit Insurance Corporation coverage at September 30, 2009 and December 31, 2008. Management monitors the solvency of all financial institutions in which we have funds to minimize the exposure for loss. Management does not believe we have significant risk for such a loss.

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

Two of our subsidiaries fell below the minimum threshold at December 31, 2008. A capital contribution of \$1.0 million was made to SPFIC during the first quarter of 2009 because the ratio fell below 200% at December 31, 2008. An additional \$1.0 million contribution was made to SPFIC in the third quarter of 2009. Adjustments have also been made relative to SPFIC product profitability that we expect will have a positive impact on operations through the remainder of 2009 and into 2010. A capital contribution of \$1.0 million was also made to ONLIC during the first quarter of 2009 when its ratio fell below 200% at December 31, 2008. The decline in SPFIC's capital balance mainly resulted from hurricane losses in 2008 and an increase in operating expenses. The reduction in ONLIC's capital balance resulted from declines in asset values of preferred and common stock holdings. The capital contributions made in 2009 increased the ratios as anticipated in action plans submitted to the appropriate state insurance departments. The Company has received approval from the respective state insurance departments to merge ONLIC into SPLIC as of October 1, 2009. The capital contributions did not impact the overall consolidated financial position or results of operations of the Company.

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**Contractual obligations and off-balance sheet arrangements**

There have been no material changes in contractual obligations from those reported at December 31, 2008 in the Company's Form 10-K for the year ended December 31, 2008. The Company does not have off-balance sheet arrangements at September 30, 2009 and does not expect any future effects on the Company's financials related to any such arrangements. We do not utilize special purpose entities as investment vehicles, nor are there any such entities in which we have an investment that engages in speculative activities of any nature, and we do not use such investments to hedge our investment positions.

**Parent Company Liquidity and Capital Resources**

We are a holding company and have had minimal operations of our own. Our assets consist primarily of the capital stock of our subsidiaries. Accordingly, our cash flows depend upon the availability of statutorily permissible payments, primarily payments under management agreements from our two primary life insurance subsidiaries, CICA and SPLIC. The ability to make payments is limited by applicable laws and regulations of Colorado, CICA's state of domicile, and Louisiana, SPLIC's state of domicile, which subject insurance operations to significant regulatory restrictions. These laws and regulations require, among other things, that these insurance subsidiaries maintain minimum solvency requirements and limit the amount of dividends these subsidiaries can pay to the holding company. We historically have not relied upon dividends from subsidiaries for our cash flow needs.

**Critical Accounting Policies**

Our critical accounting policies are as follows:

*Policy Liabilities*

Future policy benefit reserves have been computed by the net level premium method with assumptions as to investment yields, dividends on participating business, mortality and withdrawals based upon our experience. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of policy liabilities and the increase in future policy benefit reserves. Management's judgments and estimates for future policy benefit reserves provide for possible unfavorable deviation.

We continue to use the original assumptions (including a provision for the risk of adverse deviation) in subsequent periods to determine the changes in the liability for future policy benefits (the "lock-in concept") unless a premium deficiency exists. Management monitors these assumptions and has determined that a premium deficiency does not exist at September 30, 2009. Management believes that our policy liabilities and increase in future policy benefit reserves as of and for the nine months ended September 30, 2009 and 2008 are based upon assumptions, including a provision for the risk of adverse deviation, that do not warrant revision. The relative stability of these assumptions and management's analysis is discussed below.

*Deferred Policy Acquisition Costs*

Acquisition costs, consisting of commissions and policy issuance, underwriting and agency expenses that relate to and vary with the production of new business, are deferred. These deferred policy acquisition costs are amortized primarily over the estimated premium paying period of the related policies in proportion to the ratio of the annual premium recognized to the total premium revenue anticipated, using the same assumptions as were used in computing liabilities for future policy benefits.

We utilize the factor method to determine the amount of costs to be capitalized and the ending asset balance. The factor method is based on the ratio of premium revenue recognized for the policies in force at the end of each reporting period compared to the premium revenue recognized for policies in force at the beginning of the reporting period. The factor method ensures that policies that lapsed or surrendered during the reporting period are no longer included in the deferred policy acquisition costs calculation. The factor method limits the amount of deferred costs to its estimated realizable value, provided actual experience is comparable to that contemplated in the factors.

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Inherent in the capitalization and amortization of deferred policy acquisition costs are certain management judgments about what acquisition costs are deferred, the ending asset balance and the annual amortization. Approximately 80% of our capitalized deferred acquisition costs are attributed to first year excess commissions. The remaining 20% are attributed to costs that vary with and are directly related to the acquisition of new insurance business. Those costs generally include costs related to the production, underwriting and issuance of new business.

A recoverability test that considers, among other things, actual experience and projected future experience is performed at least annually. These annual recoverability tests initially calculate the available premium (gross premium less benefit and expense portion of premium) for the next 30 years. The available premium per policy and the deferred policy acquisition costs per policy are then calculated. The deferred policy acquisition costs are then evaluated over two methods utilizing reasonable assumptions and two other methods using pessimistic assumptions. The two methods using reasonable assumptions illustrate an early-deferred policy acquisition recoverability period. The two methods utilizing pessimistic assumptions still support early recoverability of our aggregate deferred policy acquisition costs. Management believes that our deferred policy acquisition costs and related amortization as of and for the nine months ended September 30, 2009 and 2008 limits the amount of deferred costs to its estimated realizable value. This belief is based upon the analysis performed on capitalized expenses that vary with and are primarily related to the acquisition of new and renewal insurance business, utilization of the factor method and annual recoverability testing.

*Cost of Customer Relationships Acquired*

Cost of Customer Relationships Acquired ( CCRA ) is established when we purchase a block of insurance. CCRA is amortized primarily over the emerging profit of the related policies using the same assumptions as were used in computing liabilities for future policy benefits. We utilize various methods to determine the amount of the ending asset balance, including a static model and a dynamic model. Inherent in the amortization of CCRA are certain management judgments about the ending asset balance and the annual amortization. The assumptions used are based upon interest, mortality and lapses at the time of purchase.

A recoverability test that considers, among other things, actual experience and projected future experience is performed at least annually. These annual recoverability tests initially calculate the available premium (gross premium less benefit and expense portion of premium) for the next thirty years. The CCRA is then evaluated utilizing reasonable assumptions. Management believes that our CCRA and related amortization is recoverable as of and for the nine months ended September 30, 2009 and 2008. This belief is based upon the analysis performed on estimated future results of the block and our annual recoverability testing.

*Goodwill*

Current accounting guidance requires that goodwill balances be reviewed for impairment at least annually or more frequently if events occur or circumstances change that would indicate that a triggering event has occurred. A reporting unit is defined as an operating segment or one level below an operating segment. Most of the Company's reporting units, for which goodwill has been allocated, are equivalent to the Company's operating segments as there is no discrete financial information available for the separate components of the segment or all of the components of the segment have similar economic characteristics. Additional goodwill in the amount of \$254,000 was included in the first quarter of 2009 related to the acquisition of ONLIC in the fourth quarter of 2008.

The goodwill impairment test follows a two step process as defined under current accounting guidance. In the first step, the fair value of a reporting unit is compared to its carrying value. If the carrying value of a reporting unit exceeds its fair value, the second step of the impairment test is performed for purposes of measuring the impairment. In the second step, the fair value of the reporting unit is allocated to all of the assets and liabilities of the reporting unit to determine an implied goodwill value. If the carrying amount of the reporting unit goodwill exceeds the implied goodwill value, an impairment loss is recognized in an amount equal to that excess.

Management's determination of the fair value of each reporting unit incorporates multiple inputs including discounted cash flow calculations, peer company price to earnings multiples, the level of the Company's Class A common stock price and assumptions that market participants would make in valuing the reporting unit. Other assumptions can



include levels of economic capital, future business growth, and earnings projections.

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As of December 31, 2008, the Company had goodwill allocated to both the Life Insurance segment as well as the Home Service Insurance segment. The Company completed its annual goodwill assessment for the individual reporting units within the Life Insurance segment and Home Service Insurance segment as of December 31, 2008 and no impairment of goodwill was identified.

Goodwill increased by \$1.1 million in the first quarter of 2009 due to the acquisition of ICC. Additional goodwill in the amount of \$254,000 was included in the first quarter of 2009 related to the acquisition of ONLIC in the fourth quarter of 2008. This arose from an additional tax valuation allowance related to impairments on investments recorded in 2009, which resulted in an assumption change from the original acquisition. During the second quarter of 2009, a tax valuation allowance in the amount of \$585,000 was released and reduced goodwill. In the third quarter, goodwill was increased by \$213,000 for additional tax valuation allowance. Thus, goodwill was reduced in 2009 by \$118,000 related to tax valuation allowances. In addition, goodwill was increased by \$19,000 in the second quarter of 2009 as a result of a policy reserve omission at purchase date, which was discovered and recorded in the quarter.

During the third quarter of 2009, the Company discovered an overstatement of ICIC's policyholder dividend liability that existed at the February 27, 2009 acquisition date in the amount of \$328,000. The correction of this error, net of tax of \$115,000, was recognized as a reduction of goodwill of \$213,000.

*Valuation of Investments in Fixed Maturity and Equity Securities*

The evaluation of securities for impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period.

Based upon current accounting guidance, investment securities must be classified as held-to-maturity, available-for-sale or trading. Management determines the appropriate classification at the time of purchase. The classification of securities is significant since it directly impacts the accounting for unrealized gains and losses on securities. Fixed maturity securities are classified as held-to-maturity and carried at amortized cost when management has the positive intent and the Company has the ability to hold the securities to maturity. Securities not classified as held-to-maturity are classified as available-for-sale and are carried at fair value, with the unrealized holding gains and losses, net of tax, reported in other comprehensive income and do not affect earnings until realized.

The Company evaluates all securities on a quarterly basis, and more frequently when economic conditions warrant additional evaluations, for determining if an OTTI exists pursuant to the accounting guidelines. In evaluating the possible impairment of securities, consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial conditions and near-term prospects of the issuer, and the ability and intent of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the Federal government or its agencies, by government-sponsored agencies, or whether downgrades by bond rating agencies have occurred, and reviews of the issuer's financial condition.

If management determines that an investment experienced an OTTI, management must then determine the amount of OTTI to be recognized in earnings. If management 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 less any current period loss, the OTTI will be separated into the amount representing the credit loss and the amount related to all other factors. The amount of OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of OTTI related to other factors will be recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings will become the new amortized cost basis of the investment. If management intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current period credit loss, the OTTI will be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. Any recoveries related to the value of these securities

are recorded as an unrealized gain (as other comprehensive income (loss) in shareholders' equity) and not recognized in income until the security is ultimately sold.

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The Company from time to time may dispose of an impaired security in response to asset/liability management decisions, future market movements, business plan changes, or if the net proceeds can be reinvested at a rate of return that is expected to recover the loss within a reasonable period of time.

*Premium Revenue and Related Expenses*

Premiums on life and accident and health policies are reported as earned when due or, for short duration contracts, over the contract period on a pro rata basis. Benefits and expenses are associated with earned premiums so as to result in recognition of profits over the estimated life of the contracts. This matching is accomplished by means of provisions for future benefits and the capitalization and amortization of deferred policy acquisition costs.

Annuities are accounted for in a manner consistent with accounting for interest bearing financial instruments. Our primary annuity products do not include fees or other such charges.

*Tax Accounting*

A deferred tax asset or deferred tax liability is recorded only if a determination is made that is more-likely-than-not that the tax treatment on which the deferred tax item depends will be sustained in the event of an audit. These determinations inherently involves management's judgment. In addition, the Company must record a tax valuation allowance with respect to deferred tax assets if it is more-likely-than-not that the tax benefit will not be realized. This valuation allowance is in essence a contra account to the deferred tax asset. Management must determine the portion of the deferred tax asset and resulting tax benefit that may not be realized based upon judgment of expected outcomes. Due to significant estimates utilized in establishing the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that we will be required to record adjustments to the valuation allowance in future reporting periods. Such a charge could have a material adverse effect on our results of operations, financial condition and capital position.

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

*General*

The nature of our business exposes our investments to market risk. Market risk is the risk of loss that may occur when changes in interest rates and public equity prices adversely affect the value of our invested assets. Interest rate risk is our primary market risk exposure. Substantial and sustained increases and decreases in market interest rates can affect the fair value of our investments. The fair value of our fixed maturity portfolio generally increases when interest rates decrease and decreases when interest rates increase.

*Market Risk Related to Interest Rates*

Our exposure to interest rate changes results from our significant holdings of fixed maturity investments, which comprised over 84.7% of our investment portfolio as of September 30, 2009. These investments are mainly exposed to changes in U.S. Treasury rates. Our fixed maturities investments include U.S. Government-sponsored enterprises, U.S. Government bonds, securities issued by government agencies, and corporate bonds. Approximately 70.8% of the fixed maturities we owned at September 30, 2009 are instruments of U.S. Government-sponsored enterprises, or are backed by U.S. Government agencies.

To manage interest rate risk, we perform periodic projections of asset and liability cash flows to evaluate the potential sensitivity of our investments and liabilities. We assess interest rate sensitivity with respect to our available-for-sale fixed maturities investments using hypothetical test scenarios that assume either upward or downward 100 basis point shifts in the prevailing interest rates.

We performed a sensitivity analysis, as of December 31, 2008, for our interest rate sensitive assets. The changes in fair values of our fixed maturity and equity securities as of September 30, 2009 were within the expected range of this analysis.

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**September 30, 2009**

Changes in interest rates typically have a sizable effect on the fair values of our fixed maturities and equity securities. The interest rate of the ten-year U.S. Treasury bond increased to 3.3% as of September 30, 2009 from 2.2% at December 31, 2008. We continue to manage our investment portfolio in a conservative manner. Despite the current financial crisis, our fixed maturity portfolio with a fair value of \$539.8 million generated unrealized gains of \$1.8 million as of September 30, 2009 compared to unrealized losses of \$8.9 million on the fixed maturity portfolio with a fair value of \$485.2 million at December 31, 2008. The equity security portfolio with a fair value of \$52.9 million generated unrealized gains of \$10.5 million as of September 30, 2009 as compared to unrealized gains of \$0.1 million on the equity security portfolio with a fair value of \$43.0 million at December 31, 2008.

The following table summarizes our investment portfolio and the net unrealized gains and losses as of the periods indicated.

	September 30, 2009			December 31, 2008		
	Amortized Cost	Fair Value	Net Unrealized Gains (Losses) (In thousands)	Amortized Cost	Fair Value	Net Unrealized Gains (Losses)
Fixed maturities, available-for-sale	\$ 335,817	339,290	3,473	494,034	485,155	(8,879)
Fixed maturities, held-to-maturity	202,197	200,496	(1,701)			
Total fixed maturities	\$ 538,014	539,786	1,772	494,034	485,155	(8,879)
Total equity securities	\$ 42,414	52,894	10,480	42,908	43,000	92

There are no fixed maturities or other investments that we classify as trading instruments. At September 30, 2009 and December 31, 2008, we had no investments in derivative instruments, nor did we have any subprime or collateralized debt obligation risk.

*Market Risk Related to Equity Prices*

Changes in the level or volatility of equity prices affect the value of equity securities we hold as investments. However, our equity investments portfolio was only 8.3% of our total investments at September 30, 2009. Thus, we believe that potential significant decreases in the equity markets would not have a material adverse impact on our total investment portfolio, although impairments of the portfolio would adversely affect our net income.

**Item 4. CONTROLS AND PROCEDURES**

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

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

During the nine months ended September 30, 2009, there have been no changes that materially affect, or are reasonably likely to affect, the Company's internal controls over financial reporting (as defined in rules 13a-15(f) and 15d-15(f) under the Exchange Act).



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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**September 30, 2009**  
**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are a defendant in a lawsuit originally filed on August 6, 1999 in the Texas District Court, Austin, Texas, now styled *Citizens Insurance Company of America, Citizens, Inc., and Harold E. Riley v. Fernando Hakim Daccach*, in which a class was originally certified by the trial court and affirmed by the Court of Appeals for the Third District of Texas. We appealed the grant of class status to the Texas Supreme Court, which on March 2, 2007, reversed the Court of Appeals' affirmation of the trial court's class certification order, decertified the class and remanded the case to the trial court for further proceedings consistent with the Texas Supreme Court's opinion. As a result, no class action is presently certified, and plaintiffs' counsel is seeking to recertify the class. In order to recertify the class, the lead plaintiff must establish that he is qualified to represent the purported class and that the res judicata effect of a class action will not have a deleterious effect on the putative class members. The underlying lawsuit alleges that certain life insurance policies we made available to non-U.S. residents, when combined with a policy feature that allowed certain cash benefits to be assigned to two non-U.S. trusts for the purpose of accumulating ownership of our Class A common stock, along with allowing the policyholders to make additional contributions to the trusts, were actually offers and sales of securities that occurred in Texas by unregistered dealers in violation of the Texas securities laws. The remedy sought was rescission and return of the insurance premium payments. We believe the lawsuit is without merit and intend to continue a vigorous defense in any remaining proceedings, including any class recertification. If the class is recertified, we would likely be further exposed to costly and time-consuming litigation, and an adverse judgment could have a material adverse effect on our results of operations and financial condition. The case is now before the Texas District Court judge for an analysis of evidence presented to determine if it warrants recertification of a class.

Security Plan Fire Insurance Company (SPFIC) is a defendant in a suit styled *The State of Louisiana v. AAA Insurance, or Road Home Litigation*, which was filed in the Civil District Court for the Parish of Orleans on August 23, 2007 by the state of Louisiana as subrogee/assignee of the insureds of more than 200 different insurance companies. The suit was filed to recover money that the state of Louisiana paid to certain insureds under the Louisiana Road Home Program for damages resulting from Hurricanes Katrina and Rita. The suit was removed to the United States District Court for the Eastern District of Louisiana on September 11, 2007 and appeals of the removal have been denied. In March 2009, the trial court judge dismissed all bad faith claims asserted against the defendants, including SPFIC. He also dismissed all claims for flood damage and all claims asserted under Louisiana's Valued Policy Law. Despite the District Court's recent rulings, the *Road Home Litigation* is still in the early stages of litigation, and no discovery has yet occurred. Therefore, it is not possible to evaluate how many claims relate to SPFIC, or the potential exposure to SPFIC. However, in the event of an adverse outcome, the potential exposure to SPFIC could be significant.

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

disputes over insurance coverage or claims adjudication;

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

disputes with our marketing firms, consultants and employee agents over compensation and termination of contracts and related claims;

disputes regarding our tax liabilities;

disputes relative to reinsurance and coinsurance agreements; and

disputes relating to businesses acquired and operated by us.

In the absence of countervailing considerations, we would expect to defend any such claims vigorously. However, in doing so, we could incur significant defense costs, including not only attorneys' fees and other direct litigation costs, but also the expenditure of substantial amounts of management time that otherwise would be devoted to our business. If we suffer an adverse judgment as a result of any claim, it could have a material adverse effect on our business, results of operations and financial condition.



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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES**  
**September 30, 2009**

**Item 1A. Risk Factors**

There are no updates to our risk factors as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008, except as noted below.

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

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

The capacity for an insurance company's growth in premiums is partially a function of its required statutory surplus. Maintaining appropriate levels of statutory surplus, as measured by statutory accounting practices prescribed or permitted by a company's state of domicile, is considered important by insurance regulatory authorities. Failure to maintain required levels of statutory surplus could result in increased regulatory scrutiny and enforcement action by regulatory authorities. See the Liquidity and Capital Resources section of this report for additional disclosure regarding risk-based capital levels for the Company's insurance subsidiaries.

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

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

Due to significant unrealized losses and realized OTTI losses in our investment portfolio as of December 31, 2008, we recorded a deferred tax asset ( DTA ) as of December 31, 2008, as well as established a valuation allowance of \$7.7 million relative to that asset. The valuation allowance was established based on facts, circumstances and information available at the reporting date, which indicated it was more likely than not that some or all of the DTA would not be realized.

Currently, we evaluate our DTA quarterly for recoverability based on available evidence. This process involves management's judgment about assumptions, which are subject to change from period to period due to tax rate changes or variances between our projected operating performance and our actual results. Ultimately, future adjustments to the DTA valuation allowance, if any, will be determined based upon changes in the expected realization of the net deferred tax assets. The realization of the deferred tax assets depends on the existence of sufficient taxable income in either the carry back or carry forward periods under applicable tax law. Due to significant estimates utilized in establishing the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that we will be required to record adjustments to the valuation allowance in future reporting periods. Such a charge could have a material adverse effect on our results of operation, financial condition and capital position.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.



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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
September 30, 2009**

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

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

Exhibit Number    The following exhibits are filed herewith:

- 3.1            Restated and Amended Articles of Incorporation (a)
- 3.2            Bylaws (b)
- 4.1            Amendment to State Series A-1 and A-2 Senior Convertible Preferred Stock (c)
- 10.1          Self-Administered Automatic Reinsurance Agreement    Citizens Insurance Company of America and Riunione Adriatica di Sicurta, S.p.A. (d)
- 10.2          Bulk Accidental Death Benefit Reinsurance Agreement between Connecticut General Life Insurance Company and Citizens Insurance Company of America, as amended (e)
- 10.3          Coinsurance Reinsurance Agreement, Assumption Reinsurance Agreement, Administrative Services Agreement dated March 9, 2004, between Citizens Insurance Company of America and Texas International Life Insurance Company, Reinsurance Trust Agreement dated March 9, 2004, by and among Citizens Insurance Company of America, Texas International Life Insurance Company and Wells Fargo Bank, N.A. (f)
- 10.4          Coinsurance Reinsurance Agreement, Assumption Reinsurance Agreement, Administrative Services Agreement dated March 9, 2004, between Combined Underwriters Life Insurance Company and Texas International Life Insurance Company, Reinsurance Trust Agreement dated March 9, 2004, by and among Combined Underwriters Life Insurance Company, Texas International Life Insurance Company and Wells Fargo Bank, N.A. (g)
- 10.5(a)        Securities Purchase Agreement dated July 12, 2004 among Citizens, Inc., Mainfield Enterprises, Inc., Steelhead Investments Ltd., Portside Growth and Opportunity Fund, and Smithfield Fiduciary LLC (h)
- 10.5(b)        Registration Rights Agreement dated July 12, 2004 among Citizens, Inc., Mainfield Enterprises, Inc., Steelhead Investments Ltd., Portside Growth and Opportunity Fund, and Smithfield Fiduciary LLC (h)
- 10.5(c)        Unit Warrant dated July 12, 2004, to Mainfield Enterprises, Inc. (h)
- 10.5(d)        Unit Warrant dated July 12, 2004, to Steelhead Investments Ltd. (h)
- 10.5(e)        Unit Warrant dated July 12, 2004, to Portside Growth and Opportunity Fund (h)
- 10.5(f)        Unit Warrant dated July 12, 2004, to Smithfield Fiduciary LLC (h)

- 10.5(g) Warrant to Purchase Class A Common Stock to Mainfield Enterprises, Inc. (h)
- 10.5(h) Warrant to Purchase Class A Common Stock to Steelhead Investments Ltd. (h)
- 10.5(i) Warrant to Purchase Class A Common Stock to Portside Growth and Opportunity Fund (h)

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
September 30, 2009**

Exhibit Number	The following exhibits are filed herewith:
10.5(j)	Warrant to Purchase Class A Common Stock to Smithfield Fiduciary LLC (h)
10.5(k)	Subordination Agreement among Regions Bank, the Purchasers and Citizens, Inc. dated July 12, 2004 (h)
10.5(l)	Non-Exclusive Finders Agreement dated September 29, 2003, between Citizens, Inc. and the Shemano Group, Inc. (h)
10.6	Self-Administered Automatic Reinsurance Agreement between Citizens Insurance Company of America and Converium Reinsurance (Germany) Ltd. (i)
10.7	Self-Administered Automatic Reinsurance Agreement between Citizens Insurance Company of America and Scottish Re Worldwide (England) (j)
10.8	Self-Administered Automatic Reinsurance Agreement CICA Life Insurance Company of America and Scor Global Life U.S. Re Insurance Company (k)*
10.9	Self-Administered Automatic Reinsurance Agreement CICA Life Insurance Company of America and Mapfre Re Compania de Reaseguros, S.A. (l)*
11	Statement re: Computation of per share earnings (see financial statements)
21	Subsidiaries of the Registrant (m)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act*
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act*
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act*
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act*

**\* Filed herewith.**

(a) Filed on  
March 15, 2004  
with the  
Registrant's  
Annual Report on  
Form 10-K for the  
Year Ended  
December 31,  
2003 as

Exhibit 3.1, and incorporated herein by reference.

- (b) Filed on March 31, 1999 with the Registrant's Annual Report on Form 10-K for the Year Ended December 31, 1998, as Exhibit 3.2, and incorporated herein by reference.
- (c) Filed on July 15, 2004, with the Registrant's Current Report on Form 8-K as Exhibit 4.1, and incorporated herein by reference.
- (d) Filed as Exhibit 10.8 with the Registration Statement on Form S-4, SEC File No. 333-16163, on November 14, 1996 and incorporated herein by reference.
- (e) Filed on April 9, 1997 as Exhibit 10.9 with the Registrant's Annual Report on Form 10-K for the Year Ended December 31, 1996, Amendment

No. 1, and  
incorporated  
herein by  
reference.

(f) Filed on  
March 22, 2004 as  
Exhibit 10.8 of  
the Registrant's  
Current Report on  
Form 8-K, and  
incorporated  
herein by  
reference.

(g) Filed on  
March 22, 2004 as  
Exhibit 10.9 of  
the Registrant's  
Current Report on  
Form 8-K, and  
incorporated  
herein by  
reference.

(h) Filed on July 15,  
2004 as part of  
Exhibit 10.12 with  
the Registrant's  
Current Report on  
Form 8-K, and  
incorporated  
herein by  
reference.

(i) Filed on  
March 31, 2005,  
with the  
Registrant's  
Annual Report on  
Form 10-K for the  
Year Ended  
December 31,  
2004, as  
Exhibit 10.10(m),  
and incorporated  
herein by  
reference.

(j) Filed on  
March 31, 2005,

with the  
Registrant's  
Annual Report on  
Form 10-K for the  
Year Ended  
December 31,  
2004, as  
Exhibit 10.10(n),  
and incorporated  
herein by  
reference.

(k) Filed on  
November 6,  
2009, with the  
Registrant's  
Quarterly Report  
on Form 10-Q for  
the Quarter Ended  
September 30,  
2009, as  
Exhibit 10.8(k),  
and incorporated  
herein by  
reference.

(l) Filed on  
November 6,  
2009, with the  
Registrant's  
Quarterly Report  
on Form 10-Q for  
the Quarter Ended  
September 30,  
2009, as  
Exhibit 10.9(l),  
and incorporated  
herein by  
reference.

(m) Filed on August 7,  
2009 with the  
Registrant's  
Quarterly Report  
on Form 10-Q for  
the Quarter Ended  
June 30, 2009, as  
Exhibit 21,  
incorporated  
herein by  
reference.





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**SIGNATURES**

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

**CITIZENS, INC.**

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

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

Date: November 6, 2009