

UNITRIN INC
Form 10-K
February 04, 2009
Table of Contents

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

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008

OR

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number: 001-18298

UNITRIN, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

95-4255452
(I.R.S. Employer
Identification No.)

Edgar Filing: UNITRIN INC - Form 10-K

One East Wacker Drive, Chicago, Illinois
(Address of principal executive offices)

60601
(Zip Code)

(312) 661-4600

(Registrant's telephone number, including area code)

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

| Title of each class | Name of each exchange on which registered |
|--|---|
| Common Stock, \$0.10 par value per share | New York Stock Exchange |
| Preferred Share Purchase Rights | New York Stock Exchange |

pursuant to Rights Agreement

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of June 30, 2008, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$1.6 billion based on the closing sale price as reported on the New York Stock Exchange. Solely for purposes of this calculation, all executive officers and directors of the registrant are considered affiliates.

Registrant had 62,314,503 shares of common stock outstanding as of January 30, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held on May 6, 2009 are incorporated by reference into Part III.

Table of Contents

Table of Contents

| | | |
|---|--|-----|
| <u>Caution Regarding Forward-Looking Statements</u> | | 1 |
| Part I | | |
| Item 1. <u>Business</u> | | 2 |
| Item 1A. <u>Risk Factors</u> | | 18 |
| Item 1B. <u>Unresolved Staff Comments</u> | | 23 |
| Item 2. <u>Properties</u> | | 24 |
| Item 3. <u>Legal Proceedings</u> | | 24 |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u> | | 25 |
| Part II | | |
| Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | | 25 |
| Item 6. <u>Selected Financial Data</u> | | 28 |
| Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | | 29 |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | | 76 |
| Item 8. <u>Financial Statements and Supplementary Data</u> | | 79 |
| Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u> | | 140 |
| Item 9A. <u>Controls and Procedures</u> | | 140 |
| Item 9B. <u>Other Information</u> | | 141 |
| Part III | | |
| Item 10. <u>Directors, Executive Officers and Corporate Governance</u> | | 141 |
| Item 11. <u>Executive Compensation</u> | | 141 |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | | 142 |
| Item 13. <u>Certain Relationships and Related Transactions and Director Independence</u> | | 142 |
| Item 14. <u>Principal Accounting Fees and Services</u> | | 142 |
| Part IV | | |
| Item 15. <u>Exhibits, Financial Statement Schedules</u> | | 143 |

Table of Contents

Caution Regarding Forward-Looking Statements

This 2008 Annual Report on Form 10-K, including the accompanying consolidated financial statements of Unitrin, Inc. (Unitrin) and its subsidiaries (individually and collectively referred to herein as the Company) and the notes thereto appearing in Item 8 herein (the Consolidated Financial Statements), the Management's Discussion and Analysis of Financial Condition and Results of Operations appearing in Item 7 herein (the MD&A) and the other Exhibits and Financial Statement Schedules filed as a part hereof or incorporated by reference herein may contain or incorporate by reference information that includes or is based on forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements give expectations or forecasts of future events. The reader can identify these statements by the fact that they do not relate strictly to historical or current facts. They use words such as believe(s), goal(s), target(s), estimate(s), anticipate(s), forecast(s), project(s), plan(s), intend(s), expect(s), might, and terms of similar meaning in connection with a discussion of future operating or financial performance. Forward-looking statements, in particular, include statements relating to future actions, prospective services or products, future performance or results of current and anticipated services or products, sales efforts, expenses, the outcome of contingencies such as legal proceedings, trends in operations and financial results.

Any or all forward-looking statements may turn out to be wrong, and, accordingly, readers are cautioned not to place undue reliance on such statements, which speak only as of the date of this 2008 Annual Report on Form 10-K. Forward-looking statements can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Many such factors will be important in determining the Company's actual future results. These statements are based on current expectations and the current economic environment. They involve a number of risks and uncertainties that are difficult to predict. These statements are not guarantees of future performance; actual results could differ materially from those expressed or implied in the forward-looking statements.

Among the general factors that could cause actual results to differ materially from estimated results are:

Changes in general economic conditions, including performance of financial markets, interest rates, unemployment rates and fluctuating values of particular investments held by the Company;

Heightened competition, including, with respect to pricing, entry of new competitors and the development of new products by new and existing competitors;

The number and severity of insurance claims (including those associated with catastrophe losses) and their impact on the adequacy of loss reserves;

The impact of inflation on insurance claims, including, but not limited to, the effects attributed to scarcity of resources available to rebuild damaged structures, including labor and materials and the amount of salvage value recovered for damaged property;

Orders, interpretations or other actions by regulators that impact the reporting, adjustment and payment of claims;

Changes in the pricing or availability of reinsurance;

Changes in the financial condition of reinsurers and amounts recoverable therefrom;

Changes in industry trends and significant industry developments;

Edgar Filing: UNITRIN INC - Form 10-K

Regulatory approval of insurance rates, policy forms, license applications and similar matters;

Developments related to insurance policy claims and coverage issues including, but not limited to, interpretations or decisions by courts or regulators that may govern or influence insurance policy coverage issues arising with respect to losses incurred in connection with hurricanes and other catastrophes;

Governmental actions, including new laws or regulations or court decisions interpreting existing laws and regulations or policy provisions;

Table of Contents

Adverse outcomes in litigation or other legal or regulatory proceedings involving Unitrin or its subsidiaries or affiliates;

Regulatory, accounting or tax changes that may affect the cost of, or demand for, the Company's products or services;

The impact of residual market assessments and assessments for insurance industry insolvencies;

Changes in distribution channels, methods or costs resulting from changes in laws or regulations, lawsuits or market forces;

Changes in ratings by credit rating agencies including A.M. Best Co., Inc. (A.M. Best);

Changes in laws or regulations governing or affecting the regulatory status of industrial banks, such as Fireside Bank, and their parent companies, including minimum capital requirements and restrictions on the non-financial activities and equity investments of companies that acquire control of industrial banks;

Changes in the estimated rates of automobile loan receivables net charge-off used to estimate Fireside Bank's reserve for loan losses, including, but not limited to, the impact of changes in the value of collateral held;

The failure to complete the acquisition of Direct Response Corporation and its subsidiaries (Direct Response);

The level of success and costs expended in realizing economies of scale and implementing significant business consolidations and technology initiatives;

Increased costs and risks related to data security;

Absolute and relative performance of the Company's products or services; and

Other risks and uncertainties described from time to time in the Company's filings with the Securities and Exchange Commission (SEC).

No assurances can be given that the results contemplated in any forward-looking statements will be achieved or will be achieved in any particular timetable. The Company assumes no obligation to publicly correct or update any forward-looking statements as a result of events or developments subsequent to the date of this 2008 Annual Report on Form 10-K. The reader is advised, however, to consult any further disclosures the Company makes on related subjects in filings made with the SEC.

PART I

Item 1. Business.

Unitrin was incorporated in Delaware in 1990. Unitrin's subsidiaries serve the basic financial needs of individuals, families and small businesses by providing property and casualty insurance, life and health insurance, and automobile finance services.

Edgar Filing: UNITRIN INC - Form 10-K

The Company files annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, amendments to those reports, and other information with the SEC. The public can obtain copies of these materials by visiting the SEC's Public Reference Room at 450 Fifth Street, NW, Washington DC 20549, or by calling the SEC at 1-800-SEC-0330, or by accessing the SEC's website at sec.gov, where the SEC maintains reports, proxy and information statements and other information regarding the Company and other issuers that file electronically with the SEC. In addition, as soon as reasonably practicable after such materials are filed with or furnished to the SEC, the Company makes copies available to the public free of charge through its website at unitrin.com.

Table of Contents

(a) GENERAL DEVELOPMENT OF BUSINESS

Purchase of Primesco, Inc.

On April 1, 2008, Unitrin completed its acquisition of Primesco, Inc. (Primesco) of Decatur, Alabama, in a cash merger transaction for a total purchase price of \$95.5 million, including transaction costs of \$0.2 million. Primesco's wholly-owned subsidiaries, Mutual Savings Life Insurance Company (Mutual Savings Life) and Mutual Savings Fire Insurance Company (Mutual Savings Fire), specialize in the sale of life, health and fire insurance products to persons of modest financial means in Alabama, Georgia, Mississippi and several other states in the Southeast. Similar to the Company's Career Agency Companies business unit, Mutual Savings Life and Mutual Savings Fire employ a network of employee agents who call on customers in their homes to sell and service products and collect premiums. Due to the similarity of the products, distribution network and back-office operations of the Company's Career Agency Companies and Mutual Savings Life and Mutual Savings Fire, the Company is in the process of combining the businesses into a single business unit.

Pending Purchase of Direct Response Corporation

On August 29, 2008, Unitrin's subsidiary, Trinity, entered into a definitive agreement to acquire Direct Response in a cash transaction initially valued at approximately \$220 million, subject to certain purchase price adjustments. Such purchase price adjustments are currently estimated to reduce the purchase price to approximately \$200 million. Except for approval yet to be received from a state insurance regulator, the Company has received all federal and state regulatory approvals necessary to close the transaction. The transaction is subject to timely approval by such insurance regulator and the satisfaction of other customary closing conditions. Direct Response specializes in the sale of personal automobile insurance through direct mail and the Internet through web insurance portals and its own websites, response.com and teachers.com. Due to the similarity of the products and back-office operations of the Company's Unitrin Direct business unit and Direct Response, the Company intends to combine the two businesses into a single business unit.

Sale of Unitrin Business Insurance

On June 3, 2008, the Company completed its previously disclosed sale of its Unitrin Business Insurance operations to AmTrust Financial Services, Inc. (AmTrust) for total consideration of \$101.8 million. AmTrust acquired the renewal rights to the Unitrin Business Insurance book of business, certain legal entities and selected other assets, and the workforce that the Company employed to underwrite and process its Unitrin Business Insurance products. The Company retained pre-closing loss and loss adjustment expense (LAE) reserves. Results of operations for Unitrin Business Insurance are reported as discontinued operations in the Consolidated Financial Statements.

Unitrin Business Insurance's products included commercial automobile, general liability, fire, multi-peril and workers compensation insurance and were marketed by independent insurance agents.

Unitrin Common Stock Repurchases

During 2008, Unitrin repurchased approximately 2 million shares of its common stock at an aggregate cost of \$69 million in open market transactions. Subject to market conditions and other factors, the Company may, from time to time, repurchase additional shares of Unitrin common stock, in the open market or in privately negotiated transactions, pursuant to the outstanding repurchase authorization of Unitrin's Board of Directors. At December 31, 2008, approximately 1.4 million shares of Unitrin common stock remained under such authorization.

Table of Contents

(b) BUSINESS SEGMENT FINANCIAL DATA

Financial information about Unitrin's business segments for the years ended December 31, 2008, 2007 and 2006 is contained in the following portions of this 2008 Annual Report on Form 10-K of Unitrin, Inc. and is incorporated herein by reference: (i) Note 19, "Business Segments," to the Consolidated Financial Statements; and (ii) MD&A.

(c) DESCRIPTION OF BUSINESS

The Company is engaged, through its subsidiaries, in the property and casualty insurance, life and health insurance and automobile finance businesses. The Company conducts its operations through five operating segments: Kemper, Unitrin Specialty, Unitrin Direct, Life and Health Insurance and Fireside Bank.

NOTE: The Company uses the registered trademark, "Kemper", under license, for personal lines insurance only, from Lumbermens Mutual Casualty Company ("Lumbermens"), which is not affiliated with the Company. Lumbermens continues to use the name, "Kemper Insurance Companies" ("KIC"), in connection with its operations, which are distinct from, and not to be confused with, Unitrin's Kemper business segment.

Unitrin's subsidiaries employ approximately 7,700 full-time associates supporting its operations of which approximately 1,220 are employed in the Kemper segment, 770 in the Unitrin Specialty segment, 610 in the Unitrin Direct segment, 4,100 in the Life and Health Insurance segment, 730 at Fireside Bank and the remainder in various corporate and other staff functions.

Property and Casualty Insurance Business

Unitrin's property and casualty insurance business operations are primarily conducted through the Kemper, Unitrin Specialty, and Unitrin Direct segments. In addition, the Life and Health Insurance segment's career agents also sell property insurance to its customers. Unitrin's insurance subsidiaries operating in the Kemper, Unitrin Specialty, Unitrin Direct and Life and Health Insurance segments provide automobile, homeowners, fire, and other types of property and casualty insurance to individuals and commercial automobile insurance to businesses. Automobile insurance in these segments accounted for 57%, 57% and 56% of Unitrin's consolidated insurance premiums earned from continuing operations for the years ended December 31, 2008, 2007 and 2006, respectively. Automobile insurance in these segments accounted for 50%, 45% and 45% of Unitrin's consolidated revenues from continuing operations for the years ended December 31, 2008, 2007 and 2006, respectively. Homeowners insurance, excluding dwellings and personal property insurance, in these segments accounted for 12%, 13% and 12% of Unitrin's consolidated insurance premiums earned from continuing operations for the years ended December 31, 2008, 2007 and 2006, respectively. Homeowners insurance, excluding dwellings and personal property insurance, in these segments accounted for 11%, 10% and 10% of Unitrin's consolidated revenues from continuing operations for the years ended December 31, 2008, 2007 and 2006, respectively.

Property insurance indemnifies an insured with an interest in physical property for loss of, or damage to, such property or the loss of its income-producing abilities. Casualty insurance primarily covers liability for damage to property of, or injury to, a person or entity other than the insured. In most cases casualty insurance also obligates the insurance company to provide a defense for the insured in litigation arising out of events covered by the policy.

The Kemper and Unitrin Specialty segments distribute their products through independent agents who are paid commissions for their services. The Unitrin Direct segment distributes its products directly to consumers and through employer-sponsored voluntary benefit programs.

Table of Contents

Kemper

Kemper, based in Jacksonville, Florida, conducts business in 39 states geographically dispersed throughout the United States. In 2008, the following states provided approximately three-fifths of the premium revenues included in this segment: New York (18%), North Carolina (13%), California (13%) and Texas (12%).

Kemper primarily sells preferred and standard risk automobile and homeowners insurance. Kemper's insurance products accounted for approximately 51% of the aggregate insurance premium revenues of Unitrin's continuing property and casualty insurance business in 2008. Kemper's products are marketed by over 2,500 independent insurance agents. These personal lines products are designed and priced for those individuals who have demonstrated favorable risk characteristics and loss history. Typical customers include middle to upper income individuals and families.

Unitrin Specialty

Unitrin Specialty, based in Dallas, Texas, conducts business in 24 states, principally in the midwest, southeast, southwest and western United States. In 2008, the following states provided more than two-thirds of the premium revenues in this segment: California (38%), Texas (20%), Washington (5%) and Louisiana (5%).

Unitrin Specialty provides nonstandard personal and commercial automobile insurance. Unitrin Specialty's insurance products accounted for approximately 27% of the aggregate insurance premium revenues of Unitrin's continuing property and casualty insurance business in 2008. Nonstandard automobile insurance is provided for individuals and businesses that have had difficulty obtaining standard or preferred risk insurance, usually because of their driving records or claims or premium payment history. Unitrin Specialty's products are marketed through approximately 8,000 independent agents and brokers.

Unitrin Direct

Unitrin Direct, based in Chicago, Illinois, markets automobile insurance primarily through direct mail, web insurance portals, click-thrus, and its own website. In addition, Merastar Insurance Company, based in Chattanooga, Tennessee, specializes in the sale of personal automobile and homeowners insurance through employer-sponsored voluntary benefit programs. The combined Unitrin Direct segment's automobile and homeowners insurance products are available in every state in the U.S. with the exception of Alaska, Hawaii and Massachusetts. In 2008, the following states provided approximately two-thirds of the premium revenues in this segment: California (14%), Florida (14%), Michigan (7%), Pennsylvania (7%), New York (6%), Virginia (6%), Georgia (5%) and New Jersey (5%). Unitrin Direct's insurance products accounted for approximately 16% of the aggregate insurance premium revenues of Unitrin's continuing property and casualty insurance business in 2008.

Unitrin Direct writes a broad spectrum of personal automobile insurance risks ranging from preferred to non-standard private passenger automobile insurance risks, and competes with companies that sell insurance directly to the consumer and employer-sponsored voluntary benefit programs, as well as companies that sell through agents. Unitrin Direct also offers homeowners and renters insurance across 48 states, and in 2008 began offering homeowners and renters insurance directly to consumers across 10 states, complementing its direct automobile insurance business.

Table of Contents**Property and Casualty Loss and Loss Adjustment Expense Reserves**

The Company's reserves for losses and LAE for property and casualty insurance (Property and Casualty Insurance Reserves) are reported using the Company's estimate of its ultimate liability for losses and LAE for claims that occurred prior to the end of any given accounting period but have not yet been paid. The Company had \$1,268.7 million and \$1,322.9 million of gross loss and LAE reserves at December 31, 2008 and 2007, respectively. Property and Casualty Insurance Reserves by business segment at December 31, 2008 and 2007 were:

| Dollars in Millions | 2008 | 2007 |
|---|-------------------|-------------------|
| Business Segments: | | |
| Kemper | \$ 476.1 | \$ 502.4 |
| Unitrin Specialty | 293.1 | 278.6 |
| Unitrin Direct | 163.1 | 142.6 |
| Life and Health Insurance | 23.0 | 11.4 |
| Total Business Segments | 955.3 | 935.0 |
| Discontinued Operations | 280.0 | 342.2 |
| Unallocated Ceded Reserves | 33.4 | 45.7 |
| Total Property and Casualty Insurance Reserves | \$ 1,268.7 | \$ 1,322.9 |

Certain reserves acquired in connection with a business acquisition from SCOR Reinsurance Company (SCOR) in 2002 (the Unallocated Ceded Reserves) are reinsured by an insurance subsidiary of SCOR (see Note 8, Property and Casualty Insurance Reserves, to the Consolidated Financial Statements). The Company does not allocate these reserves to its business segments.

In estimating the Company's Property and Casualty Insurance Reserves, the Company's actuaries exercise professional judgment and must consider, and are influenced by, many variables that are difficult to quantify. Accordingly, the process of estimating and establishing the Company's Property and Casualty Insurance Reserves is inherently uncertain and the actual ultimate net cost of claims may vary materially from the estimated amounts reserved. The reserving process is particularly imprecise for claims involving asbestos, environmental matters, construction defect and other emerging and/or long-tailed exposures which may not be discovered or reported until years after the insurance policy period has ended. See MD&A, Critical Accounting Estimates, under the caption Property and Casualty Insurance Reserves for Losses and Loss Adjustment Expense beginning on page 32 for a discussion of the Company's reserving process and the factors considered by the Company's actuaries in estimating the Company's Property and Casualty Insurance Reserves.

Table of Contents

The Company's goal is to ensure its total reserves for property and casualty insurance losses and LAE are adequate to cover all costs, while sustaining minimal variation from the time reserves for losses and LAE are initially estimated until losses and LAE are fully developed. Changes in the Company's estimates of these losses and LAE over time, also referred to as development, will occur and may be material. Favorable development is recognized when the Company decreases its estimate of previously reported losses and LAE and results in an increase in net income in the period recognized, whereas adverse development is recognized when the Company increases its estimate of previously reported losses and LAE and results in a decrease in net income. The Company recognized total favorable development of \$79.3 million, \$101.1 million and \$91.6 million before tax for the years ended December 31, 2008, 2007 and 2006, respectively. Development for each of the Company's continuing business segments and Unitrin Business Insurance for the years ended December 31, 2008, 2007 and 2006, was:

| Dollars in Millions | Favorable (Adverse) Development | | |
|--|---------------------------------|-----------------|----------------|
| | 2008 | 2007 | 2006 |
| Continuing Operations: | | | |
| Kemper | \$ 61.0 | \$ 54.2 | \$ 68.2 |
| Unitrin Specialty | 5.5 | 15.3 | 8.9 |
| Unitrin Direct | (3.2) | (5.5) | (4.5) |
| Life and Health Insurance | (13.7) | (8.6) | (6.8) |
| Total Favorable Development from Continuing Operations, Net | 49.6 | 55.4 | 65.8 |
| Discontinued Operations: | | | |
| Unitrin Business Insurance, Net | 29.7 | 45.7 | 25.8 |
| Total Favorable Development, Net | \$ 79.3 | \$ 101.1 | \$ 91.6 |

Development in the Company's Kemper segment comprised a substantial portion of the Company's development reported in continuing operations in 2008, 2007 and 2006. See MD&A, Critical Accounting Estimates, under the caption Property and Casualty Insurance Reserves for Losses and Loss Adjustment Expense Kemper Development for additional information regarding this development. See MD&A, Catastrophes, Kemper, Unitrin Specialty, Unitrin Direct, and Life and Health Insurance for the impact of development on the results reported by the Company's business segments. See MD&A, Catastrophes, for additional information on the impact of catastrophes on the development reported for the Company's Life and Health Insurance segment. See Note 8, Property and Casualty Insurance Reserves to the Consolidated Financial Statements for a tabular reconciliation for the latest three one-year periods setting forth the Company's Property and Casualty Insurance Reserves as of the beginning of each year, incurred losses and LAE for insured events of the current year, changes in incurred losses and LAE for insured events of prior years, payments of losses and LAE for insured events of the current year, payments of losses and LAE for insured events of prior years and the Company's Property and Casualty Insurance Reserves at the end of the year and additional information regarding the nature of adjustments to incurred losses and LAE for insured events of prior years.

Ten Year Loss Development History

The following table illustrates the change over time in the Company's estimate of reserves for losses and LAE. The first section shows the amount of reserves reported in the Company's consolidated financial statements as originally reported at the end of each calendar year. The second section, reading down, shows the cumulative amount of payments made through the end of each successive year with respect to that reserve liability. The third section, reading down, shows a reestimation of the original reserve shown in the first section. In the third section, the original reserve is reestimated using information that has become known in subsequent years and as trends become more apparent. The last section compares the latest reestimate with the original estimate. Conditions and trends that affected development in the past may not necessarily repeat in the future. Accordingly, it may not be appropriate to extrapolate reserve deficiencies or redundancies based on this table.

Table of Contents**Loss and Loss Adjustment Expense Reserve Development**

| Dollars in Millions | December 31, | | | | | | | | | | |
|---|--------------|--------|--------|--------|--------|----------|----------|----------|----------|----------|----------|
| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
| Gross Reserve for Unpaid Losses and LAE | \$ 448 | \$ 521 | \$ 541 | \$ 700 | \$ 975 | \$ 1,426 | \$ 1,511 | \$ 1,531 | \$ 1,433 | \$ 1,323 | \$ 1,269 |
| Deduct: | | | | | | | | | | | |
| Reinsurance Recoverables | 16 | 35 | 36 | 62 | 92 | 325 | 229 | 209 | 138 | 85 | 85 |
| Net Reserve for Unpaid Losses and LAE | \$ 432 | \$ 486 | \$ 505 | \$ 638 | \$ 883 | \$ 1,101 | \$ 1,282 | \$ 1,322 | \$ 1,295 | \$ 1,238 | \$ 1,184 |
| Cumulative Amount Paid, Net of Reinsurance as of: | | | | | | | | | | | |
| One Year Later | \$ 191 | \$ 229 | \$ 274 | \$ 341 | \$ 402 | \$ 405 | \$ 487 | \$ 508 | \$ 511 | \$ 518 | |
| Two Years Later | 288 | 336 | 393 | 483 | 578 | 621 | 707 | 742 | 724 | | |
| Three Years Later | 339 | 404 | 477 | 568 | 682 | 788 | 830 | 854 | | | |
| Four Years Later | 368 | 456 | 523 | 617 | 731 | 850 | 891 | | | | |
| Five Years Later | 386 | 486 | 556 | 647 | 762 | 882 | | | | | |
| Six Years Later | 400 | 508 | 576 | 666 | 781 | | | | | | |
| Seven Years Later | 409 | 523 | 590 | 679 | | | | | | | |
| Eight Years Later | 421 | 531 | 600 | | | | | | | | |
| Nine Years Later | 427 | 539 | | | | | | | | | |
| Ten Years Later | 434 | | | | | | | | | | |
| Reestimate of Net Reserve for Unpaid Losses and LAE as of: | | | | | | | | | | | |
| End of Year | \$ 432 | \$ 486 | \$ 505 | \$ 638 | \$ 883 | \$ 1,101 | \$ 1,282 | \$ 1,322 | \$ 1,295 | \$ 1,238 | \$ 1,184 |
| One Year Later | 419 | 485 | 564 | 720 | 886 | 1,062 | 1,190 | 1,230 | 1,195 | 1,159 | |
| Two Years Later | 408 | 495 | 612 | 722 | 879 | 1,026 | 1,131 | 1,158 | 1,106 | | |
| Three Years Later | 427 | 533 | 619 | 724 | 872 | 1,006 | 1,088 | 1,106 | | | |
| Four Years Later | 441 | 544 | 623 | 725 | 857 | 980 | 1,049 | | | | |
| Five Years Later | 448 | 548 | 624 | 719 | 840 | 951 | | | | | |
| Six Years Later | 453 | 549 | 623 | 709 | 819 | | | | | | |
| Seven Years Later | 453 | 548 | 618 | 693 | | | | | | | |
| Eight Years Later | 452 | 543 | 608 | | | | | | | | |
| Nine Years Later | 449 | 535 | | | | | | | | | |
| Ten Years Later | 442 | | | | | | | | | | |

Table of Contents**Loss and Loss Adjustment Expense Reserve Development**

| Dollars in Millions | 1998 | 1999 | 2000 | 2001 | 2002 | December 31, 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|--|---------|----------|----------|---------|--------|----------------------|----------|----------|----------|----------|------|
| Initial Net Reserve for Unpaid Losses and LAE in Excess Of (Less Than) Reestimated Net Reserve for Unpaid Losses and LAE: | | | | | | | | | | | |
| Amount of Reestimate | \$ (10) | \$ (49) | \$ (103) | \$ (55) | \$ 64 | \$ 150 | \$ 233 | \$ 216 | \$ 189 | \$ 79 | |
| Reestimate as a Percentage of Initial Net Reserve for Unpaid Losses and LAE | (2.3)% | (10.1)% | (20.4)% | (8.6)% | 7.2% | 13.6% | 18.2% | 16.3% | 14.6% | 6.4% | |
| Latest Reestimate of: | | | | | | | | | | | |
| Gross Reserve for Unpaid Losses and LAE | \$ 468 | \$ 629 | \$ 712 | \$ 796 | \$ 921 | \$ 1,283 | \$ 1,275 | \$ 1,328 | \$ 1,246 | \$ 1,216 | |
| Recoverable for Reinsurance | 26 | 94 | 104 | 103 | 102 | 332 | 226 | 222 | 140 | 57 | |
| Net Reserve for Unpaid Losses and LAE | \$ 442 | \$ 535 | \$ 608 | \$ 693 | \$ 819 | \$ 951 | \$ 1,049 | \$ 1,106 | \$ 1,106 | \$ 1,159 | |
| Cumulative (Increase) Decrease to Reestimation of Gross Reserve for Unpaid Losses and LAE: | \$ (20) | \$ (108) | \$ (171) | \$ (96) | \$ 54 | \$ 143 | \$ 236 | \$ 203 | \$ 187 | \$ 107 | |

Table of Contents

The Company acquired Valley Group Inc. and its subsidiaries (VGI) in 1999. Accordingly, reserves for VGI are included in the table for 1999 and forward. Under the agreement governing the acquisition of VGI, the Company was entitled to recover from the seller 90% of the unfavorable development of VGI's pre-acquisition loss and LAE reserves, subject to a maximum recovery of \$50 million. Reserve development shown in the preceding table for the years 1999 to 2004 is net of changes in the Company's estimated recovery, which was received in 2004. Reserves increased in 2002 and 2003 partly due to the Company's acquisition of the personal lines business of KIC. At the end of 2002, the Company also acquired two insurance companies from SCOR. Reinsurance recoverable in 2003 and forward includes a recoverable from a subsidiary of SCOR under an indemnity reinsurance agreement whereby the subsidiary assumed the pre-acquisition liabilities of the two insurance companies acquired by the Company. In 2005, three major hurricanes that significantly impacted the Company (Katrina, Rita and Wilma) made landfall in the United States. Accordingly, reserves at December 31, 2005 increased as claims from these hurricanes were established for adjudication, and declined in subsequent years as claims were paid. The Company acquired Merastar in 2007. Accordingly, reserves for this business are included in the table for 2007 and forward. In 2008, three major hurricanes that significantly impacted the Company (Dolly, Gustav and Ike) made landfall in the United States. Accordingly, reserves at December 31, 2008 increased as claims from these hurricanes were established for adjudication.

Reserve estimates increase or decrease as more information becomes known about individual claims and as changes in conditions and claims trends become more apparent. In 2008, the Company reduced its property and casualty insurance reserves by \$79.3 million to recognize favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE reserves developed favorably by \$45.8 million and commercial lines insurance losses and LAE reserves developed favorably by \$33.5 million in 2008. Personal lines insurance losses and LAE reserves developed favorably in 2008 due primarily to the emergence of more favorable loss trends than expected for the 2006 and 2005 accident years due to the improvements in the Company's claims handling procedures, partially offset by adverse development of \$8.9 million related to certain re-opened claims from Hurricane Rita, which occurred in the 2005 accident year. Commercial lines insurance losses and LAE reserves developed favorably in 2008 primarily in the Company's discontinued operations. During the fourth quarter of 2008, the Company's actuaries conducted their regular reserve review of the Unitrin Business Insurance run-off business for all traditional reserving groups. In addition, the Company's actuaries updated certain analyses using the Company's experience as well as more recent industry studies to re-estimate asbestos, environmental liabilities and construction defect liabilities. These updated analyses, along with the actuaries' regular reserve reviews during 2008, resulted in favorable reserve development of \$29.7 million in 2008. In 2007, the Company reduced its property and casualty insurance reserves by \$101.1 million to record favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE and commercial lines insurance losses and LAE developed favorably by \$44.4 million and \$56.7 million, respectively, in 2007. The reserve reductions were primarily due to the emergence of more favorable loss trends than expected for the 2006, 2005 and 2004 accident years, partially due to the improvements in the Company's claims handling procedures. In 2006, the Company reduced its property and casualty insurance reserves by \$91.6 million to record favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE and commercial lines insurance losses and LAE developed favorably by \$63.6 million and \$28.0 million, respectively, in 2006. The reserve reductions were primarily due to the emergence of more favorable loss trends than expected for the 2005 and 2004 accident years, partially due to the improvements in the Company's claims handling procedures. In 2005, the Company reduced its property and casualty insurance reserves by \$92.1 million to record favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE and commercial lines insurance losses and LAE developed favorably by \$73.1 million and \$19.0 million, respectively, in 2005. The reserve reductions were primarily due to the emergence of more favorable loss trends than expected for the 2004 and 2003 accident years, partially due to improvements in the Company's claims handling procedures. In 2004, the Company reduced its property and casualty insurance reserves by \$39.0 million to record favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE and commercial lines insurance losses and LAE developed favorably by \$29.7 million and \$9.3 million, respectively, in 2004. The reserve reductions were primarily due to favorable development of the 2003 accident year. During 2001 and 2002, the Company increased its property and casualty

Table of Contents

insurance reserves to reflect adverse development due to developing loss trends primarily related to construction defect, mold, automobile liability and product liability loss exposures in its commercial lines of business as well as personal automobile liability.

The Company does not discount reserves. There are no significant differences between the Company's property and casualty reserves carried on a statutory basis and those computed in accordance with accounting principles generally accepted in the United States of America, except that such reserves for statutory reporting purposes are recorded net of reinsurance in the statutory financial statements.

Catastrophe Losses

Catastrophes and storms are inherent risks of the property and casualty insurance business. These catastrophic events and natural disasters include hurricanes, tornadoes, earthquakes, hailstorms, wildfires, high winds and winter storms. Such events result in insured losses that are, and will continue to be, a material factor in the results of operations and financial position of Unitrin's property and casualty insurance companies. Further, because the level of insured losses that could occur in any one year cannot be accurately predicted, these losses contribute to material year-to-year fluctuations in the results of the operations and financial position of these companies. Specific types of catastrophic events are more likely to occur at certain times within the year than others. This factor adds an element of seasonality to property and casualty insurance claims. The occurrence and severity of catastrophic events are difficult to accurately predict in any year. However, some geographic locations are more susceptible to these events than others. Management has endeavored to control its direct insurance exposures in certain regions that are prone to naturally occurring catastrophic events through a combination of geographic diversification, restrictions on the amount and location of new business production in such regions, and reinsurance. The Company has adopted the industry-wide catastrophe classifications of storms and other events promulgated by Insurance Services Office, Inc. (ISO) to track and report losses related to catastrophes. ISO classifies a disaster as a catastrophe when the event causes \$25.0 million or more in direct losses to property and affects a significant number of policyholders and insurers. ISO-classified catastrophes are assigned a unique serial number recognized throughout the insurance industry. The discussions that follow utilize ISO's definition of catastrophes.

The process of estimating and establishing reserves for catastrophe losses is inherently uncertain and the actual ultimate cost of a claim, net of actual reinsurance recoveries, may vary materially from the estimated amount reserved. The Company's estimates of direct catastrophe losses are generally based on inspections by claims adjusters and historical loss development experience for areas that have not been inspected or for claims that have not yet been reported. The Company's estimates of direct catastrophe losses are based on the coverages provided by its insurance policies. The Company's homeowners insurance policies do not provide coverage for losses caused by floods, but generally provide coverage for physical damage caused by wind or wind driven rain. Accordingly, the Company's estimates of direct losses for homeowners insurance do not include losses caused by flood. Depending on the policy, automobile insurance may provide coverage for losses caused by flood. Estimates of the number of and severity of claims ultimately reported are influenced by many variables including, but not limited to, repair or reconstruction costs and determination of cause of loss, that are difficult to quantify and will influence the final amount of claim settlements. All these factors, coupled with the impact of the availability of labor and material on costs, require significant judgment in the reserve setting process. A change in any one or more of these factors is likely to result in an ultimate net claim cost different from the estimated reserve. The Company's estimates of indirect losses from residual market assessments are based on a variety of factors including, but not limited to, actual or estimated assessments provided by or received from the assessing entity, insurance industry estimates of losses, and estimates of the Company's market share in the assessable states. Actual assessments may differ materially from these estimated amounts.

Table of Contents**Reinsurance**

The Company manages its exposure to catastrophes and other natural disasters through a combination of geographical diversification, restrictions on the amount and location of new business production in such regions, and reinsurance. To limit its exposures to catastrophic events, the Company maintains various primary catastrophe reinsurance programs for its property and casualty insurance businesses. Coverage for each primary catastrophe reinsurance program is provided in various layers. In addition to these programs, the Company purchases reinsurance from the Florida Hurricane Catastrophe Fund (the FHCF) for hurricane losses in Florida at retentions lower than those described below for the Company's primary catastrophe reinsurance programs. See Note 20, Catastrophe Reinsurance, to the Consolidated Financial Statements for information pertaining to the Company's primary catastrophe reinsurance programs for 2008, 2007 and 2006. The Company's catastrophe reinsurance programs for 2009 are described below.

Coverage for each catastrophe reinsurance program effective January 1, 2009 is provided in various layers as presented below:

| (Dollars in Millions) | Catastrophe Losses and LAE | | Percentage of Coverage |
|--|-------------------------------|---------|---------------------------|
| | In Excess of | Up to | |
| Kemper Segment | | | |
| Retained | \$ | \$ 50.0 | 0.0% |
| 1st Layer of Coverage | 50.0 | 100.0 | 55.4% |
| 2nd Layer of Coverage | 100.0 | 200.0 | 95.0% |
| 3rd Layer of Coverage | 200.0 | 350.0 | 86.6% |
| Unitrin Direct and Unitrin Specialty Segments | | | |
| Retained | \$ | \$ 2.0 | 0.0% |
| 1st Layer of Coverage | 2.0 | 15.0 | 95.7% |
| Life and Health Insurance Segment Property Insurance Operations | | | |
| Retained | \$ | \$ 8.0 | 0.0% |
| 1st Layer of Coverage | 8.0 | 15.0 | 97.0% |
| 2nd Layer of Coverage | 15.0 | 25.0 | 100.0% |

The Company substantially reduced the level of catastrophe reinsurance coverage purchased for its Life and Health Insurance segment in 2009 in anticipation of reducing its exposure to catastrophe risks prior to the beginning of the hurricane season. If the Company does not substantially reduce the Life and Health Insurance segment's exposure to catastrophe risks prior to the beginning of the hurricane season, the Company expects to purchase additional catastrophe reinsurance coverage, subject to availability of coverage on terms acceptable to the Company.

The estimated aggregate annual premiums, excluding reinstatement premium in 2009 are \$22.8 million for the Kemper segment program, \$1.2 million for the Unitrin Direct and Unitrin Specialty segments program and \$3.8 million for the Life and Health Insurance segment program.

In the event that the Company's incurred catastrophe losses and LAE covered by any of its catastrophe reinsurance programs exceed the retention for that particular layer, each of the programs above requires one reinstatement of such coverage. In such an instance, the Company is required to pay a reinstatement premium to the reinsurers to reinstate the full amount of reinsurance available under such layer. The reinstatement premium is a percentage of the original premium based on the ratio of the losses exceeding the Company's retention to the reinsurers' coverage limit. The catastrophe reinsurance program for the Life and Health Insurance segment also includes reinsurance coverage from the FHCF for hurricane losses in Florida at retentions lower than those described above.

In addition to the catastrophe loss exposures caused by natural events described above, Unitrin's property and casualty insurance companies are exposed to losses from catastrophic events that are not the result of acts of nature, such as acts of terrorism, the nature and level of which in any period are very difficult to predict. While

Table of Contents

there were no reported losses experienced by Unitrin's property and casualty insurance companies in relation to the terrorist attacks on September 11, 2001, the companies have reinsurance coverage to address certain exposures to potential future terrorist attacks. The reinsurance coverage for certified events, as designated by the federal government, is from the Terrorist Risk Insurance Act and the coverage for non-certified events is available in the catastrophe reinsurance program for Unitrin's property and casualty insurance companies. However, certain perils, such as biological, chemical, nuclear pollution or contamination, are excluded from the Company's reinsurance coverage for non-certified events.

In addition to the catastrophe reinsurance programs described above, Unitrin's property and casualty insurance companies utilize other reinsurance arrangements to limit their maximum loss, provide greater diversification of risk and minimize exposures on larger risks.

Under the various reinsurance arrangements, Unitrin's property and casualty insurance companies are indemnified by reinsurers for certain losses incurred under insurance policies issued by the companies. As indemnity reinsurance does not discharge an insurer from its direct obligations to policyholders on risks insured, Unitrin's property and casualty insurance companies remain directly liable. However, so long as the reinsurers meet their obligations, the net liability for Unitrin's property and casualty insurance companies is limited to the amount of risk that they retain. Unitrin's property and casualty insurance companies purchase their reinsurance only from reinsurers rated A- or better by A. M. Best at the time of purchase.

For further discussion of the reinsurance programs, see Note 8, Property and Casualty Insurance Reserves, Note 20, Catastrophe Reinsurance, and Note 21, Other Reinsurance, to the Consolidated Financial Statements.

Pricing

Pricing levels for property and casualty insurance are influenced by many factors, including the frequency and severity of claims, state regulation and legislation, competition, general business and economic conditions including market rates of interest, inflation, expense levels, and judicial decisions. In addition, many state regulators require consideration of investment income when approving or setting rates, which reduces underwriting margins. See MD&A under the captions Kemper, Unitrin Specialty and Unitrin Direct.

Competition

Based on the most recent annual data published by A.M. Best as of the end of 2007, there were approximately 965 property and casualty insurance groups in the United States, made up of approximately 2,350 companies. Unitrin's property and casualty insurance companies ranked among the 70 largest property and casualty insurance groups in the United States, measured by net premiums written (42nd), policyholders surplus (68th) and admitted assets (64th).

In 2007, the industry's estimated net premiums written were more than \$450 billion, of which 77% were accounted for by the top 50 groups of companies. Unitrin's property and casualty insurance companies wrote less than 1% of the industry's estimated 2007 premium volume.

Property and casualty insurance is a highly competitive business, particularly with respect to personal automobile insurance. Unitrin's property and casualty insurance companies compete on the basis of, among other measures, (i) using appropriate pricing, (ii) maintaining underwriting discipline, (iii) selling to selected markets, (iv) utilizing technological innovations for the marketing and sale of insurance, (v) controlling expenses, (vi) maintaining adequate ratings from A.M. Best and other ratings agencies, (vii) providing quality services to agents and policyholders, and (viii) making strategic acquisitions of suitable property and casualty insurers.

Life and Health Insurance Business

The Company's Life and Health Insurance segment consists of Unitrin's wholly-owned subsidiaries, United Insurance Company of America (United Insurance), The Reliable Life Insurance Company (Reliable), Union

Table of Contents

National Life Insurance Company (Union National Life), Mutual Savings Life, United Casualty Insurance Company of America (United Casualty), Union National Fire Insurance Company (Union National Fire), Mutual Savings Fire and Reserve National Insurance Company (Reserve National). As discussed below, United Insurance, Reliable, Union National Life, Mutual Savings Life, United Casualty, Union National Fire and Mutual Savings Fire (the Career Agency Companies) distribute their products through a network of employee, or career, agents. Reserve National distributes its products through a network of exclusive independent agents. Both these career agents and independent agents are paid commissions for their services. In 2008, the following states provided more than two-thirds of the Life and Health Insurance segment's premium revenues: Texas (24%), Louisiana (11%), Mississippi (6%), Alabama (5%), Illinois (4%), Florida (4%), North Carolina (4%), Missouri (4%), Georgia (4%) and South Carolina (4%). Life insurance accounted for 17% of the Company's consolidated insurance premiums earned from continuing operations for each of the years ended December 31, 2008, 2007 and 2006. Life insurance accounted for 15%, 13%, and 14% of Unitrin's consolidated revenues from continuing operations for the years ended December 31, 2008, 2007 and 2006, respectively.

Career Agency Companies

The Career Agency Companies, based in St. Louis, Missouri, focus on providing individual life and health insurance products to customers of modest incomes who desire basic protection for themselves and their families. Their leading product is ordinary life insurance, including permanent and term insurance. Face amounts of these policies are lower than those of policies typically sold to higher income customers by other companies in the industry. Premiums average \$15 per policy per month. Permanent policies are offered primarily on a non-participating, guaranteed-cost basis. Approximately 80% of the Life and Health Insurance segment's premium revenues are generated by the Career Agency Companies.

The Career Agency Companies employ nearly 2,700 career agents to distribute their products in 25 states. These career agents are full-time employees who call on customers in their homes to sell insurance products, provide services related to policies in force and collect premiums, typically monthly. The Life and Health Insurance segment's career agents also distribute certain property insurance products.

Customers of the Career Agency Companies generally are families with annual incomes of less than \$25,000. According to the U.S. Bureau of the Census, in 2007, there were approximately 27 million households in the United States with less than \$25,000 of annual income, representing approximately 24% of all U.S. households.

Reserve National

Reserve National, based in Oklahoma City, Oklahoma, is licensed in 31 states throughout the south, southwest and midwest, and specializes in the sale of accident and health insurance products and Medicare Supplement insurance, primarily to individuals living in rural areas where health maintenance organizations and preferred provider organizations are less prevalent.

Reserve National has approximately 240 independent agents appointed to market and distribute its products. These agents typically represent only Reserve National.

Reinsurance

Consistent with insurance industry practice, Unitrin's life and health insurance companies utilize reinsurance arrangements to limit their maximum loss, provide greater diversification of risk and minimize exposures on larger risks. Included among the segment's reinsurance arrangements is excess of loss reinsurance coverage specifically designed to protect against losses arising from catastrophic events under the property insurance policies distributed by the Career Agency Companies' agents and written by United Casualty, Union National Fire and Mutual Savings Fire or written by Capitol County Mutual Fire Insurance Company (Capitol), a mutual insurance company owned by its policyholders, and its subsidiary, Old Reliable Casualty Company (ORCC), and reinsured by Unitrin's subsidiary, Trinity. The annual catastrophe reinsurance program for the Career Agency Companies, Capitol and ORCC is described above in the discussion of Reinsurance under Property

Table of Contents

and Casualty Insurance Business of this Item 1 beginning on page 12. Also see MD&A Catastrophes and Note 20, Catastrophe Reinsurance to the Consolidated Financial Statements for additional information pertaining to the Life and Health Insurance segment's catastrophe reinsurance program.

Lapse Ratio

The lapse ratio is a measure of a life insurer's loss of existing business. For a given year, this ratio is commonly computed as the total face amount of individual life insurance policies lapsed, surrendered, expired and decreased during such year, less policies increased and revived during such year, divided by the total face amount of policies at the beginning of the year plus the face amount of policies issued and reinsurance assumed in the prior year. The Life and Health Insurance segment's lapse ratio for individual life insurance was 9%, 10%, and 10% in 2008, 2007 and 2006, respectively.

The customer base served by the Career Agency Companies and competing life insurance companies tends to have a higher incidence of lapse than other demographic segments of the population. Thus, to maintain or increase the level of its business, the Career Agency Companies must continue to write a high volume of new policies.

Pricing

Premiums for life and health insurance products are based on assumptions with respect to mortality, morbidity, investment yields, expenses, and lapses and are also affected by state laws and regulations, as well as competition. Pricing assumptions are based on the experience of Unitrin's life and health insurance subsidiaries, as well as the industry in general, depending upon the factor being considered. The actual profit or loss produced by a product will vary from the anticipated profit if the actual experience differs from the assumptions used in pricing the product.

Premiums for policies sold by the Career Agency Companies are set at levels designed to cover the relatively high cost of in-home servicing of such policies. As a result of such higher expenses, incurred claims as a percentage of earned premiums tend to be lower for companies utilizing this method of distribution than the life insurance industry average.

Premiums for medicare supplement and other accident and health policies must take into account the rising costs of medical care. The annual rate of medical cost inflation has historically been higher than the general rate of inflation, necessitating frequent rate increases, most of which are subject to approval by state regulatory agencies.

Competition

Based on the most recent data published by A.M. Best as of the end of 2007, there were approximately 400 life and health insurance company groups in the United States, made up of approximately 2,000 companies. The Unitrin Life and Health Insurance segment ranked in the top quartile of life and health insurance company groups, as measured by admitted assets (91st), net premiums written (88th) and capital and surplus (96th).

Unitrin's life and health insurance subsidiaries generally compete by using appropriate pricing, selling to selected markets, controlling expenses, maintaining adequate ratings from A.M. Best, and providing competitive services to agents and policyholders.

Automobile Finance Business

Fireside Bank, based in Pleasanton, California, is engaged in the automobile finance business. Fireside Bank is organized under California law as an industrial bank and its deposits are insured by the Federal Deposit Insurance Corporation (the FDIC). Fireside Bank's principal business is the financing of used automobiles through the purchase of retail installment contracts from automobile dealers. The borrowers under these contracts typically have marginal credit histories and are considered to be sub-prime.

Table of Contents

Fireside Bank purchases loan contracts from automobile dealers in 19 states. At December 31, 2008, the following states comprised over four-fifths of Fireside Bank's outstanding loans and contracts: California (65%), Oregon (6%), Washington (5%), Colorado (5%) and Arizona (4%). Fireside Bank is one of the largest sub-prime automobile finance sources in California. Fireside Bank does business with over 5,000 automobile dealers. Fireside Bank has over 135,000 contracts and loans outstanding, totaling in excess of \$1 billion.

Strong underwriting and collection practices are key elements to successful operating performance in the sub-prime automobile finance business. Over two-thirds of Fireside Bank's general and administrative expenses are devoted to loan production and servicing activities. Fireside Bank individually underwrites each credit application and historically has declined to extend credit to more than three-quarters of its credit applicants. See the discussion of loan loss reserves under the headings "Fireside Bank" and "Critical Accounting Estimates" in the MD&A and Note 1, "Basis of Presentation and Significant Estimates," Note 2, "Summary of Accounting Policies and Accounting Changes," and Note 6, "Automobile Loan Receivables and Certificates of Deposits," to the Consolidated Financial Statements. Fireside Bank competes for automobile loan contracts primarily on the basis of timely service to its automobile dealer customers and by offering competitive terms. Principal competitors include banks, finance companies, credit unions and "captive" credit subsidiaries of automobile manufacturers.

Fireside Bank's financing activities are funded primarily by FDIC-insured certificates of deposits. Fireside Bank originates deposits through its California branch network, through brokers and over the Internet and competes for funds primarily with other banks, credit unions and savings and loan associations.

The Company is in the process of exploring strategic alternatives associated with its investment in Fireside Bank.

Investments

The quality, nature, and amount of the various types of investments which can be made by insurance companies are regulated by state laws. Depending on the state, these laws permit investments in qualified assets including, but not limited to, municipal, state and federal government obligations, corporate bonds, real estate, preferred and common stocks, investment partnerships, limited liability investment companies and limited partnerships and mortgages, where the value of the underlying real estate exceeds the amount of the loan.

The Company employs a total return investment strategy while maintaining liquidity to meet both its short and long-term insurance obligations primarily through the combination of investment-grade fixed maturity investments and, to a lesser extent, equity securities with the potential for long-term price appreciation. See the discussions of the Company's investments under the headings "Critical Accounting Estimates," "Investment Results," "Investment Quality and Concentrations," "Securities Lending, Credit Default Swaps and Hedging Activities," "Distressed and Mezzanine Debt and Secondary Transactions Investments" and "Liquidity and Capital Resources" in the MD&A, "Quantitative and Qualitative Disclosures about Market Risk," in Item 7A and Note 5, "Investments," and Note 15, "Income from Investments," to the Consolidated Financial Statements.

Regulation

Insurance Regulation

Unitrin is subject to the insurance holding company laws of a number of states. Certain dividends and distributions by an insurance subsidiary are subject to approval by the insurance regulators of the state of incorporation of such subsidiary. Other significant transactions between an insurance subsidiary and its holding company or other subsidiaries of the holding company may require approval by insurance regulators in the state of incorporation of each of the insurance subsidiaries participating in such transactions.

Unitrin's insurance subsidiaries are subject to extensive regulation in the states in which they do business. Such regulation pertains to a variety of matters, including policy forms, premium rate plans, licensing of agents, licenses to transact business, trade practices, investments and solvency. The majority of Unitrin's insurance

Table of Contents

operations are in states requiring prior approval by regulators before proposed rates for property, casualty, or health insurance policies may be implemented. However, rates proposed for life insurance generally become effective immediately upon filing with a state, even though the same state may require prior rate approval for other types of insurance. Insurance regulatory authorities perform periodic examinations of an insurer's market conduct and other affairs.

Insurance companies are required to report their financial condition and results of operation in accordance with statutory accounting principles prescribed or permitted by state insurance regulators in conjunction with the National Association of Insurance Commissioners (the NAIC). State insurance regulators also prescribe the form and content of statutory financial statements, perform periodic financial examinations of insurers, set minimum reserve and loss ratio requirements, establish standards for the types and amounts of investments and require minimum capital and surplus levels. Such statutory capital and surplus requirements include risk-based capital (RBC) rules promulgated by the NAIC. These RBC standards are intended to assess the level of risk inherent in an insurance company's business and consider items such as asset risk, credit risk, underwriting risk and other business risks relevant to its operations. In accordance with RBC formulas, a company's RBC requirements are calculated and compared to its total adjusted capital to determine whether regulatory intervention is warranted. At December 31, 2008, the total adjusted capital of each of Unitrin's insurance subsidiaries exceeded the minimum levels required under RBC rules.

Unitrin's insurance subsidiaries are required under the guaranty fund laws of most states in which they transact business to pay assessments up to prescribed limits to fund policyholder losses or liabilities of insolvent insurance companies. Unitrin's insurance subsidiaries also are required to participate in various involuntary pools or assigned risk pools, principally involving windstorms and high risk drivers. In most states, the involuntary pool participation of Unitrin's insurance subsidiaries is in proportion to their voluntary writings of related lines of business in such states.

In addition to the regulatory requirements described above, a number of legislative and regulatory measures pending or enacted in recent years may significantly affect the insurance business in a variety of ways. These measures include, among other things, tort reform, consumer privacy requirements, credit score regulation, producer compensation regulations, corporate governance requirements and financial services deregulation initiatives.

State insurance laws intended primarily for the protection of policyholders contain certain requirements that must be met prior to any change of control of an insurance company or insurance holding company that is domiciled or, in some cases, an insurance company having such substantial business that it is deemed commercially domiciled, in that state. These requirements may include the advance filing of specific information with the state insurance regulators, a public hearing on the matter, and the review and approval of the change of control by such regulators. The Company has insurance subsidiaries domiciled in a number of states, including Alabama, California, Illinois, Indiana, Louisiana, Missouri, New York, Oklahoma, Oregon, Texas and Wisconsin. In these states, control generally is presumed to exist through the direct or indirect ownership of 10% or more of the voting securities of an insurance company. Any purchase of Unitrin's shares that would result in the purchaser owning 10% or more of Unitrin's voting securities would be presumed to result in the acquisition of control of Unitrin's insurance subsidiaries. Such an acquisition generally would require the prior approval of the insurance regulatory authorities in each state in which Unitrin's insurance subsidiaries are domiciled or deemed to be commercially domiciled. In addition, many states require pre-acquisition notification to the state insurance regulators of a change of control of an insurance company licensed in that state if specific market concentration thresholds would be triggered by the acquisition. While those pre-acquisition notification statutes generally do not authorize the state insurance regulators to disapprove the change of control, they do authorize the issuance of a cease and desist order with respect to the insurance company if certain conditions, such as undue market concentration, would result from the acquisition. These insurance regulatory requirements may deter, delay or prevent transactions effecting control of the Company or the ownership of Unitrin's voting securities, including transactions that could be advantageous to Unitrin's shareholders.

Table of Contents

Fireside Bank Regulation

Fireside Bank is an industrial bank regulated by the California Department of Financial Institutions (the "CDFI"). Under California banking law, Fireside Bank is permitted to engage in the activities of a commercial bank, except the activity of accepting demand deposits, and is generally subject to the same laws and regulations to which commercial banks are subject under the California banking law. In addition, since Fireside Bank's deposits are insured by the FDIC, it is subject to a broad system of regulation under the Federal Deposit Insurance Act, FDIC regulations and other federal regulations. The regulations of these state and federal agencies govern most aspects of Fireside Bank's business, and are generally intended to protect a bank's depositors, creditors, borrowers and the deposit insurance fund. They impose reporting obligations, minimum capitalization requirements, limitations on dividends, investments, loans, borrowings, branching, mergers and acquisitions, reserves against deposits, and other requirements, including those relating to privacy, fairness in consumer credit, and prevention and detection of fraud and financial crime. Federal law also imposes certain restrictions on Fireside Bank's transactions with the Company and other affiliates, and certain fair lending and reporting requirements involving consumer lending operations and Community Reinvestment Act activities.

Item 1A. Risk Factors.

Most issuers, including Unitrin, are exposed to numerous risks associated with the extremely volatile and disruptive nature of the current capital and credit markets. The following discussion details the significant factors affecting the other risks that are more specific to Unitrin.

Realized losses from investments may occur in the event that policyholders surrender life insurance policies or request policy loans at rates materially greater than assumed.

The Company's Life and Health Insurance segment's principal market for life insurance consists of customers of modest incomes who desire basic protection for themselves and their families. These customers generally are families with annual incomes of less than \$25,000. In a severe downturn in the economy with high unemployment rates, these customers may forgo basic insurance protection for themselves and their families in favor of basic daily necessities such as food and shelter. In such cases, customers might surrender their life insurance policies to receive the policies' cash value or may request policy loans. While the Company's Life and Health Insurance segment maintains short-term liquidity to meet normal policy surrender and loan activity, a material, elevated level of policy surrender and loan activity could result in the Company's Life and Health Insurance segment selling impaired investments before unrealized losses have been fully recovered. The Company's premium revenues could also decline due to policy surrender activity which may adversely affect the Company's results of operations.

Catastrophe losses and reinsurance risks may adversely affect the Company's results of operations, liquidity and financial condition.

Property and casualty insurance companies are subject to claims arising out of catastrophes that may have a significant effect on their results of operations, liquidity and financial condition. Catastrophes can be caused by various events, including hurricanes, tornadoes, windstorms, earthquakes, hail storms, explosions, severe winter weather and wildfires and may include man-made events, such as the September 11, 2001 terrorist attacks. The incidence, frequency, and severity of catastrophes are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event.

Unitrin's insurance subsidiaries seek to reduce their exposure to catastrophe losses through underwriting strategies and the purchase of catastrophe reinsurance. Reinsurance does not relieve Unitrin's insurance subsidiaries of their direct liability to their policyholders. As long as the reinsurers meet their obligations, the net liability for Unitrin's insurance subsidiaries is limited to the amount of risk that they retain. However, the

Table of Contents

Company cannot be certain that reinsurers will pay the amounts due from them either now, in the future, or on a timely basis, which could impact the Company's liquidity. A reinsurer's insolvency, inability or unwillingness to make payments under the terms of its reinsurance agreement with Unitrin's insurance subsidiaries could have a material adverse effect on the Company's financial position and results of operations.

In addition, market conditions beyond the Company's control determine the availability and cost of the reinsurance protection Unitrin's insurance subsidiaries may purchase. A decrease in the amount of reinsurance that Unitrin's insurance subsidiaries purchase generally should decrease their cost of reinsurance, but increase their risk of loss. An increase in the amount of reinsurance that Unitrin's insurance subsidiaries purchase generally should increase their cost of reinsurance, but decrease their risk of loss. However, if the amount of reinsurance available is reduced, Unitrin's insurance subsidiaries could pay more for the same level, or a lower level, of reinsurance coverage. Accordingly, the Company may be forced to incur additional expenses for reinsurance or may not be able to obtain sufficient reinsurance on acceptable terms, which could adversely affect Unitrin's insurance subsidiaries' ability to write future business or result in their retaining more risk with respect to their insurance policies.

Estimating property and casualty insurance reserves is inherently uncertain, and if the Company's loss reserves are insufficient, it will have an unfavorable impact on the Company's results.

The Company establishes loss and LAE reserves to cover estimated liabilities, which remain unpaid as of the end of each accounting period, and to investigate and settle all claims incurred under the property and casualty insurance policies that it has issued. Loss and LAE reserves are established for claims that have been reported to the Company as of the end of the accounting period, as well as for claims that have occurred but have not yet been reported to the Company. The estimates of loss and LAE reserves are based on the Company's assessment of the facts and circumstances known to it at the time, as well as estimates of the impact of future trends in the severity of claims, the frequency of claims and other factors.

As described more thoroughly above, the process of estimating loss reserves is complex and imprecise. The estimate of the ultimate cost of claims must take into consideration many factors that are dependent on the outcome of future events. The impact on the Company's loss reserves from these factors is difficult to estimate accurately. Such factors consist of, but are not limited to, the following:

Changes in the length of time between the actual occurrence of the event that gives rise to a claim, and the date on which the claim is reported;

Changes in underwriting practices;

Changes in claim handling procedures;

Changes in medical care, including the impact of inflation, the extent of injuries and the utilization of medical services;

Changes in the cost of home repair, including the impact of inflation and the availability of labor and materials;

Changes in the judicial environment, including, but not limited to, the interpretation of policy provisions, the impact of jury awards and changes in case law; and

Changes in state regulatory requirements;

A change in any one or more of the foregoing factors is likely to result in a projected ultimate loss that is different from the previously estimated cost. Such changes may be material.

Edgar Filing: UNITRIN INC - Form 10-K

The Company uses informed, subjective professional judgment in estimating the ultimate cost of claims. The estimate of the ultimate cost at any particular valuation point may vary materially from the actual cost when claims are ultimately settled.

Table of Contents

The Company continually reviews the adequacy of its reserve estimates in a regular and ongoing process as experience develops and further claims are reported and settled. The Company reflects any adjustments to reserves in the results of the periods in which such estimates are changed.

The Company estimates the reserves for each product line and coverage that it writes. The Company uses a variety of generally accepted actuarial loss reserving estimation methodologies that analyze experience trends and other relevant factors. These methodologies generally utilize analyses of historical patterns of the development of paid and reported losses by accident year, product lines and coverage. An accident year is the year in which the insured event that gave rise to the claim occurred. This process relies on the basic assumption that past experience, adjusted for the effects of current developments and likely trends, is an appropriate basis for predicting future outcomes. The expected ultimate losses are adjusted as claims mature and are eventually settled.

Using the various complex actuarial methods and different underlying assumptions, the Company's actuaries produce a number of point estimates for each class of business. After reviewing the appropriateness of the underlying assumptions, management selects the carried reserve for each product line and coverage.

The Company does have some exposure to construction defect and asbestos claims. The estimation of loss reserves relating to construction defect and asbestos are subject to greater uncertainty than other types of claims due to differing court decisions as well as judicial interpretations and legislative actions that in some cases have tended to broaden coverage beyond the original intent of the insurance policies.

Fireside Bank's automobile loan receivable portfolio is subject to default risk.

The results of operations and financial condition of Fireside Bank depend, to a large extent, on the performance of its automobile loan receivable portfolio. Automobile loan borrowers may default during the terms of their loans. Fireside Bank bears the full risk of losses resulting from defaults. In the event of a default, the collateral value of the financed vehicle usually does not cover the outstanding loan balance and costs of recovery. A substantial portion of Fireside Bank's automobile loan receivable portfolio is considered sub-prime. The risk of default for sub-prime loans is higher than for prime loans and has been accentuated by recent economic conditions. Approximately 65% of Fireside Bank's automobile loan portfolio is concentrated in loans to borrowers residing in California. Present economic conditions in California appear to be worse than in other states.

Fireside Bank maintains an allowance for loan losses that represents management's best estimate of the inherent losses in Fireside Bank's automobile loan receivable portfolio. If the allowance is inadequate, Fireside Bank would recognize the losses in excess of that allowance as an expense and the Company's results of operations would be adversely affected. A material increase to the allowance for loan losses could also result in Fireside Bank's ratio of Tier 1 capital to total assets falling below 15%, the ratio level at which Fireside Bank has agreed with its regulators to maintain. In such a case, the Company would likely contribute additional amounts of capital to Fireside Bank. Such contributions could impact Unitrin's liquidity and capital resources available for other corporate purposes.

The Unitrin Direct segment may not reach profitability

The Unitrin Direct segment reported significant operating losses in each of the last two years. While the Company has taken a number of actions intended to improve Unitrin Direct's profitability including, but not limited to, implementing premium rate increases in most states, improving insurance risk selection, reducing marketing spending, modifying its direct marketing program to target a better response rate and the anticipated acquisition of Direct Response, there is no assurance that Unitrin Direct will become profitable in future years.

Table of Contents

The insurance industry is highly competitive.

The Company's insurance businesses face significant competition. Competitive success is based on many factors, including:

Competitiveness of premiums charged;

Underwriting discipline;

Selectiveness of sales markets;

Technological innovation;

Ability to control expenses;

Adequacy of ratings from A.M. Best and other ratings agencies; and

Quality of services provided to agents and policyholders.

The inability to compete effectively in any of the Company's business segments could materially reduce its customer base and revenues, and could adversely affect the financial condition of the Company.

See "Competition" in Item 1 of Part I beginning on pages 13 and 15, for more information on the competitive rankings in the property and casualty insurance markets and the life and health insurance markets, respectively, in the United States.

A significant downgrade in the ratings of Unitrin's insurance subsidiaries could adversely affect their businesses.

Third party rating agencies assess and rate the claims-paying ability of insurance companies based upon criteria established by the rating agencies. Financial strength ratings are used by agents and clients as an important means of assessing the financial strength and quality of insurers. A significant downgrade by a recognized rating agency in the ratings of Unitrin's insurance subsidiaries, particularly those that market their products through independent agents, could result in a substantial loss of business for that subsidiary if agents or policyholders move to other companies with higher claims paying and financial strength ratings. Any substantial loss of business could have a material adverse effect on the financial condition and results of operations of that subsidiary.

Unitrin's subsidiaries are subject to significant regulation by state insurance departments and by the FDIC and state bank regulators.

Insurance. Unitrin's insurance subsidiaries are subject to extensive regulation in the states in which they do business. Current regulations encompass a wide variety of matters, including policy forms, premium rates, licensing, trade practices, investment standards, statutory capital and surplus requirements, reserve and loss ratio requirements, restrictions on transactions among affiliates and consumer privacy.

Banking. Fireside Bank is regulated by the FDIC and the CDFI. These agencies regulate most aspects of Fireside Bank's business and impose reporting obligations and a broad array of restrictions and requirements on such matters as capitalization, dividends, investments, loans and borrowings, and many requirements which relate to privacy and fairness in consumer credit or the detection and prevention of fraud and financial crime.

Effect on Operations. Insurance and banking regulatory agencies conduct periodic examinations of Unitrin's subsidiaries and require the filing of annual and other reports relating to financial condition, holding company issues and other matters. If an insurance company fails to obtain

Edgar Filing: UNITRIN INC - Form 10-K

required licenses or approvals, or if any of Unitrin's subsidiaries fail to comply with other regulatory requirements, including banking regulations applicable to Fireside Bank, the regulatory agencies can suspend or delay their operations or licenses, require corrective action, and impose penalties or other remedies available under the applicable regulations.

Table of Contents

These federal and state laws and regulations, and their interpretation by the various regulatory agencies and courts, are undergoing continual revision and expansion. The regulatory structures in the financial services industry have come under intense scrutiny as a result of the recent turmoil in the financial markets. It is not possible to predict how new legislation or regulations or new interpretations of existing laws and regulations may impact the operations of Unitrin's subsidiaries. Significant changes in, or new interpretations of, these laws and regulations could make it more expensive for Unitrin's subsidiaries to conduct their businesses and could materially affect the profitability of their operations and the Company's financial results.

For a more detailed discussion of the regulations applicable to Unitrin's subsidiaries, see Insurance Regulation and Fireside Bank Regulation under Regulation in Item 1, beginning on page 16.

The effects of emerging claim and coverage issues on the Company's insurance businesses are uncertain.

As industry practices and regulatory, judicial, political, social and other environmental conditions change, unexpected and unintended issues related to insurance claims and coverages may emerge. These emerging practices, conditions and issues could adversely affect the Company's insurance businesses by either extending coverages beyond the Company's underwriting intent or by increasing the number or size of claims. The effects of such emerging claim and coverage issues are extremely hard to predict, but could harm the business of Unitrin's insurance subsidiaries.

Legal and regulatory proceedings are unpredictable.

Unitrin and its subsidiaries are involved in lawsuits, regulatory inquiries, and other legal proceedings arising out of the ordinary course of its businesses. Many of these matters raise difficult and complicated factual and legal issues and are subject to uncertainties and complexities, and the outcomes of these matters are difficult to predict. For further information about the Company's pending litigation, see Item 3, Legal Proceedings, on page 24.

Unitrin is dependent on receiving dividends from its subsidiaries to service its debt and to pay dividends to its shareholders.

As a holding company with no business operations of its own, Unitrin depends upon the dividend income that it receives from its subsidiaries as the primary source of funds to pay interest and principal on its outstanding debt obligations and to pay dividends to its shareholders. Unitrin's subsidiaries are subject to significant regulatory restrictions from state insurance and banking laws and regulations which limit their ability to declare and pay dividends. These regulations impose minimum solvency and liquidity requirements on dividends between affiliated companies and require prior notice to, and may require approval from, state insurance or bank regulators before dividends can be paid. The inability of one or more of Unitrin's subsidiaries to pay sufficient dividends to Unitrin may materially affect Unitrin's ability to timely pay its debt obligations or to pay dividends to its shareholders.

The Company has a large equity concentration in Intermec, Inc.

The fair value of the Company's investment in the common stock of its investee, Intermec, Inc. (Intermec), at December 31, 2008 was \$168.1 million, or 43 percent of the fair value of the Company's total equity portfolio (reflecting its investee at fair value). The Company's investment in Intermec common stock is subject to a variety of risk factors under the umbrella of market risk. General economic swings influence Intermec's performance. A downturn in the economy could have a negative impact on Intermec. A downturn in the global supply chain solutions industry, in which Intermec competes, may have an adverse effect on the fair value of the Company's investment in Intermec common stock.

Table of Contents

The Company's investments in limited liability investment companies and limited partnerships are concentrated in companies and partnerships that invest in distressed and mezzanine debt and secondary transactions.

At December 31, 2008, the Company's insurance subsidiaries had \$242.3 million invested in limited liability investment companies and limited partnerships accounted for under the equity method of accounting, that invest in distressed and mezzanine debt of other companies and secondary transactions. In addition, the Company's insurance subsidiaries had unfunded commitments to invest an additional \$129.0 million in such limited liability investment companies and limited partnerships. Such unfunded commitments generally may be used to fund other investments of such limited liability investment companies and limited partnerships, as well as to fund losses of such limited liability investment companies and limited partnerships. The underlying investments of such limited liability investment companies and limited partnerships and companies generally provide opportunities for higher returns, but at a higher risk than investment-grade investments. General economic swings influence the performance of the underlying investments in distressed and mezzanine debt and secondary transactions. The Company has also made direct investments in the same or similar distressed and mezzanine debt securities of certain issuers in which such limited liability investment companies and limited partnerships have made investments. A severe and continued downturn in the economy may result in deterioration in the business prospects of the issuers of the underlying investments that could adversely affect the Company's operating results and financial position.

The Company is subject to interest rate risk in its investment portfolio.

One of the Company's primary market risk exposures is to changes in interest rates. A decline in market interest rates could have an adverse effect on the Company's investment income as it invests cash in new investments that may yield less than the portfolio's average rate. In a declining interest rate environment, borrowers may seek to refinance their borrowings at lower rates and, accordingly, prepay or redeem securities the Company holds more quickly than the Company initially expected. This action may cause the Company to reinvest the redeemed proceeds in lower yielding investments. An increase in market interest rates could also have an adverse effect on the value of the Company's investment portfolio, for example, by decreasing the fair values of the fixed income securities that comprise a substantial majority of its investment portfolio.

Fireside Bank receives interest on the loans it makes to its customers. Fireside Bank also pays interest on the certificates of deposits it accepts. Accordingly, it is exposed to interest rate changes.

Managing technology initiatives to address business developments and increasing data security regulations and risks present significant challenges to the Company.

While technological developments can streamline many business processes and ultimately reduce the cost of operations, technology initiatives can present short-term cost and implementation risks. In addition, projections of expenses, implementation schedules and utility of results may be inaccurate and can escalate over time. The Company faces rising costs and competing time constraints in meeting compliance requirements of new and proposed regulations. The expanding volume and sophistication of computer viruses, hackers and other external hazards may increase the vulnerability of the Company's data systems to security breaches. These increased risks and expanding regulatory requirements expose the Company to potential data loss and damages and significant increases in compliance and litigation costs.

Item 1B. Unresolved Staff Comments.

Not applicable.

Table of Contents

Item 2. Properties.

Owned Properties

The Company owns the 41-story office building at One East Wacker Drive, Chicago, Illinois, that houses the executive offices of Unitrin. Unitrin and two of its subsidiaries occupy approximately 42,100 square feet of the 527,000 rentable square feet in the building. In addition, Unitrin's subsidiaries together own and occupy 14 buildings located in 7 states consisting of approximately 50,700 square feet in the aggregate. Unitrin subsidiaries hold additional properties solely for investment purposes that are not utilized by Unitrin or its subsidiaries.

Leased Facilities

Kemper leases facilities with an aggregate square footage of approximately 285,000 at 9 locations in 7 states. The latest expiration date of the existing leases is in September of 2018.

Fireside Bank leases 16 facilities, of which 11 are occupied, with an aggregate square footage of approximately 152,000 in 5 states. The latest expiration date of the existing leases is in August of 2016.

Unitrin Specialty leases facilities with an aggregate square footage of approximately 148,000 at 3 locations in 3 states. The latest expiration date of the existing leases is in June of 2018.

Unitrin Direct leases facilities with an aggregate square footage of approximately 197,000 at 8 locations in 6 states. The latest expiration date of the existing leases is in February of 2018.

Unitrin's Life and Health Insurance segment leases facilities with aggregate square footage of approximately 506,000 at 149 locations in 27 states. The latest expiration date of the existing leases is in October of 2017.

Unitrin's corporate data processing operation occupies a facility with an aggregate square footage of approximately 30,000 square feet under a lease that expires in December 2014.

Kemper, Unitrin Specialty and Unitrin Direct share leased facilities with an aggregate square footage of approximately 58,000 at 4 locations in 3 states. The latest expiration date of the existing leases is in March of 2018.

The properties described above are in good condition. The properties utilized in the Company's operations consist of facilities suitable for general office space, call centers and data processing operations.

Item 3. Legal Proceedings.

Proceedings

In the ordinary course of their businesses, Unitrin and its subsidiaries are involved in a number of legal proceedings including lawsuits and regulatory examinations and inquiries. Some of these proceedings include matters particular to the Company or one or more of its subsidiaries, while others pertain to business practices in the industries in which Unitrin or its subsidiaries operate. Some lawsuits seek class action status that, if granted, could expose Unitrin or its subsidiaries to potentially significant liability by virtue of the size of the putative classes. These matters can raise complicated issues and may be subject to many uncertainties, including, but not limited to: (i) the underlying facts of the matter; (ii) unsettled questions of law; (iii) issues unique to the jurisdiction where the matter is pending; (iv) damage claims, including claims for punitive damages, that are disproportionate to the actual economic loss incurred; and (v) the legal, regulatory and political environment faced by large corporations generally and the insurance and banking sectors specifically. Accordingly, the outcomes of these matters are difficult to predict, and the amounts or ranges of potential loss at particular points in time are in most cases difficult or impossible to ascertain.

Table of Contents

During the course of 2008, Unitrin and certain of its subsidiaries, like many property and casualty insurers, were forced to defend numerous individual lawsuits, mass actions and statewide putative class actions in Louisiana and Texas arising out of Hurricanes Katrina and Rita. In these matters, the plaintiffs seek compensatory and punitive damages, and equitable relief. The Company and its relevant subsidiaries believe they have meritorious defenses to these proceedings and are defending them vigorously.

Fireside Bank is defending two class action lawsuits in California state courts alleging that its post-repossession notices to defaulting borrowers failed to comply with certain aspects of California law. The plaintiffs seek: (i) compensatory damages, including a refund of deficiency balances collected from customers who received the allegedly defective notices; (ii) punitive damages; and (iii) equitable relief. Statewide classes have been certified in these matters and Fireside Bank successfully moved to have the two cases treated on a coordinated basis. Fireside Bank is contesting the allegations that its post-repossession notices were deficient and believes it has meritorious defenses to these lawsuits.

Financial Impact

The Company believes that resolution of its pending legal proceedings will not have a material adverse effect on the Company's financial position. However, given the unpredictability of the legal environment, there can be no assurance that one or more of these matters will not produce a loss which could have a material adverse effect on the Company's financial results for any given period.

Legal Environment

The legal and regulatory environment within which Unitrin and its subsidiaries conduct their business is often unpredictable. Industry practices that were considered legally-compliant and reasonable for years may suddenly be deemed unacceptable by virtue of an unexpected court or regulatory ruling. Anticipating such shifts in the law and the impact they may have on the Company and its operations is a difficult task and there can be no assurances that the Company will not encounter such shifts in the future.

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

During the quarter ended December 31, 2008, no matters were submitted to a vote of shareholders.

PART II**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities. Market Information**

Unitrin's common stock is traded on the New York Stock Exchange (the "NYSE") under the symbol of "UTR".

| <i>DOLLARS PER SHARE</i> | THREE MONTHS ENDED | | | | YEAR ENDED |
|-----------------------------|--------------------|------------------|-------------------|------------------|------------------|
| | MARCH 31, 2008 | JUNE 30, 2008 | SEPT. 30, 2008 | DEC. 31, 2008 | DEC. 31, 2008 |
| Common Stock Market Prices: | | | | | |
| High | \$ 47.74 | \$ 40.00 | \$ 29.74 | \$ 28.00 | \$ 47.74 |
| Low | 32.60 | 27.54 | 20.73 | 13.05 | 13.05 |
| Close | 35.34 | 27.57 | 24.94 | 15.94 | 15.94 |

| <i>DOLLARS PER SHARE</i> | THREE MONTHS ENDED | | | | YEAR ENDED |
|-----------------------------|--------------------|------------------|-------------------|------------------|------------------|
| | MARCH 31, 2007 | JUNE 30, 2007 | SEPT. 30, 2007 | DEC. 31, 2007 | DEC. 31, 2007 |
| Common Stock Market Prices: | | | | | |
| High | \$ 52.92 | \$ 50.20 | \$ 51.70 | \$ 53.00 | \$ 53.00 |
| Low | 43.75 | 46.60 | 39.65 | 41.86 | 39.65 |
| Close | 47.07 | 49.18 | 49.59 | 47.99 | 47.99 |

Table of Contents**Holders**

As of January 29, 2009, the approximate number of record holders of Unitrin's common stock was 5,691.

Dividends

| <i>DOLLARS PER SHARE</i> | THREE MONTHS ENDED | | | | YEAR ENDED |
|---|--------------------|------------------|-------------------|------------------|------------------|
| | MARCH 31, 2008 | JUNE 30, 2008 | SEPT. 30, 2008 | DEC. 31, 2008 | DEC. 31, 2008 |
| Cash Dividends Paid to Shareholders (per share) | \$ 0.47 | \$ 0.47 | \$ 0.47 | \$ 0.47 | \$ 1.88 |

| <i>DOLLARS PER SHARE</i> | THREE MONTHS ENDED | | | | YEAR ENDED |
|---|--------------------|------------------|-------------------|------------------|------------------|
| | MARCH 31, 2007 | JUNE 30, 2007 | SEPT. 30, 2007 | DEC. 31, 2007 | DEC. 31, 2007 |
| Cash Dividends Paid to Shareholders (per share) | \$ 0.455 | \$ 0.455 | \$ 0.455 | \$ 0.455 | \$ 1.82 |

Unitrin's insurance subsidiaries are subject to various state insurance laws that restrict the ability of these insurance subsidiaries to pay dividends without prior regulatory approval. In addition, Unitrin's automobile finance subsidiary, Fireside Bank, is subject to certain risk-based capital regulations also having the effect of limiting the amount of dividends that may be paid by Fireside Bank and has agreed not to pay dividends without the prior approval of the FDIC and the CDFI. See MD&A, Letter to Shareholders and Liquidity and Capital Resources and Note 11, Shareholders' Equity, to the Consolidated Financial Statements for information on Unitrin's ability and intent to pay dividends.

Issuer Purchases of Equity Securities

The Company's stock repurchase program was first announced on August 8, 1990. The repurchase program was subsequently expanded several times, most recently in November 2006, when the Board of Directors expanded the Company's authority to repurchase the Company's common stock by an aggregate number of 6,000,000 shares (in addition to approximately 750,000 shares remaining under its prior authorization). A total of 1,378,454 shares remain available for repurchase under the repurchase program which does not have an expiration date.

The Company did not repurchase any shares in the fourth quarter of 2008.

During the quarter ended December 31, 2008, no shares were withheld or surrendered, either actually or constructively, to satisfy the exercise price and/or tax withholding obligations relating to the exercise of stock options or stock appreciation rights under the Company's four stock option plans or shares withheld to satisfy tax withholding obligations on the vesting of awards under the Company's restricted stock plan.

Table of Contents**Unitrin Common Stock Performance Graph**

The following graph assumes \$100 invested on December 31, 2003 in (i) the Unitrin Common Stock, (ii) the S&P MidCap 400 Index, and (iii) the S&P Composite 1500 Insurance Index, in each case with dividends reinvested. The Company is a constituent of each of these two indices.

The comparisons in the graph below are based on historical data and are not intended to forecast the possible future performance of the Unitrin Common Stock.

| Company / Index | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Unitrin, Inc. | \$ 100 | \$ 114.05 | \$ 117.14 | \$ 135.31 | \$ 134.73 | \$ 47.95 |
| S&P MidCap 400 Index | 100 | 116.48 | 131.11 | 144.64 | 156.18 | 99.59 |
| S&P Composite 1500 Insurance Index | 100 | 108.69 | 124.72 | 138.20 | 128.87 | 60.26 |

Table of Contents**Item 6. Selected Financial Data.**

| <i>DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS</i> | 2008 | 2007 (a)(b) | 2006 (a)(c) | 2005 (a) | 2004 (a) |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| FOR THE YEAR | | | | | |
| Earned Premiums | \$ 2,376.6 | \$ 2,286.9 | \$ 2,290.5 | \$ 2,287.7 | \$ 2,289.2 |
| Automobile Finance Revenues | 242.3 | 260.2 | 245.0 | 217.6 | 198.5 |
| Net Investment Income | 212.9 | 289.9 | 286.0 | 258.4 | 241.2 |
| Other Income | 4.1 | 3.5 | 14.4 | 9.5 | 13.1 |
| Net Realized Investment Gains (Losses) | (93.7) | 62.5 | 26.5 | 56.9 | 78.5 |
| Total Revenues | \$ 2,742.2 | \$ 2,903.0 | \$ 2,862.4 | \$ 2,830.1 | \$ 2,820.5 |
| Net Income (Loss): | | | | | |
| From Continuing Operations | \$ (38.0) | \$ 178.1 | \$ 267.6 | \$ 237.2 | \$ 219.9 |
| From Discontinued Operations | 8.4 | 27.3 | 19.4 | 18.9 | 21.4 |
| Net Income (Loss) | \$ (29.6) | \$ 205.4 | \$ 287.0 | \$ 256.1 | \$ 241.3 |
| Net Income (Loss) Per Share: | | | | | |
| From Continuing Operations | \$ (0.60) | \$ 2.71 | \$ 3.94 | \$ 3.44 | \$ 3.22 |
| From Discontinued Operations | 0.13 | 0.42 | 0.29 | 0.27 | 0.31 |
| Net Income (Loss) Per Share | \$ (0.47) | \$ 3.13 | \$ 4.23 | \$ 3.71 | \$ 3.53 |
| Net Income (Loss) Per Share Assuming Dilution: | | | | | |
| From Continuing Operations | \$ (0.60) | \$ 2.70 | \$ 3.92 | \$ 3.41 | \$ 3.19 |
| From Discontinued Operations | 0.13 | 0.42 | 0.28 | 0.27 | 0.31 |
| Net Income (Loss) Per Share Assuming Dilution | \$ (0.47) | \$ 3.12 | \$ 4.20 | \$ 3.68 | \$ 3.50 |
| Dividends Paid to Shareholders (per share) | \$ 1.88 | \$ 1.82 | \$ 1.76 | \$ 1.70 | \$ 1.66 |
| AT YEAR END | | | | | |
| Total Assets | \$ 8,818.8 | \$ 9,394.4 | \$ 9,329.9 | \$ 9,200.9 | \$ 8,798.4 |
| Insurance Reserves | \$ 4,241.3 | \$ 3,855.9 | \$ 3,918.7 | \$ 3,936.4 | \$ 3,844.0 |
| Unearned Premiums | 733.5 | 722.2 | 778.9 | 810.6 | 807.6 |
| Certificates of Deposits | 1,110.8 | 1,274.3 | 1,162.7 | 1,074.3 | 922.4 |
| Notes Payable | 560.8 | 560.1 | 504.5 | 503.6 | 502.8 |
| All Other Liabilities | 523.8 | 690.9 | 675.5 | 716.6 | 681.8 |
| Total Liabilities | 7,170.2 | 7,103.4 | 7,040.3 | 7,041.5 | 6,758.6 |
| Shareholders' Equity | 1,648.6 | 2,291.0 | 2,289.6 | 2,159.4 | 2,039.8 |
| Total Liabilities and Shareholders' Equity | \$ 8,818.8 | \$ 9,394.4 | \$ 9,329.9 | \$ 9,200.9 | \$ 8,798.4 |
| Book Value Per Share | \$ 26.46 | \$ 35.65 | \$ 34.18 | \$ 31.52 | \$ 29.64 |

(a) Adjusted for the retrospective application of a change in accounting principle for the elimination of a reporting lag for certain investments accounted for under the equity method of accounting. See Note 2, *Summary of Accounting Policies and Accounting Changes*, to the

Edgar Filing: UNITRIN INC - Form 10-K

Consolidated Financial Statements.

- (b) The Company's investee, Intermec, recognized the financial impact of Statement of Financial Accounting Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, in its financial statements at December 31, 2006. Intermec initially applied the provisions of Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. The Company accounts for its investment in Intermec under the equity method of accounting on a three-month-delay basis. Accordingly, the Company recognized a decrease of \$2.3 million to its Shareholders' Equity in 2007 for its pro rata share of the impact of Intermec's adoption of SFAS No. 158 and recognized a decrease of \$0.9 million to the Company's Shareholders' Equity in the second quarter of 2007 for its pro rata share of the impact of Intermec's adoption of FIN 48.
- (c) Shareholders' Equity decreased by \$ 7.3 million at December 31, 2006, as a result of the Company's initial application of the recognition provisions of SFAS No. 158 for the Company's postretirement benefit plans.

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Index to

**Management's Discussion and Analysis of
Financial Condition and Results of Operations**

| | |
|---|---|
| Letter to Shareholders | Incorporated by reference to Exhibit 13 |
| <u>Summary of Results</u> | 30 |
| <u>Critical Accounting Estimates</u> | 30 |
| <u>Catastrophes</u> | 40 |
| <u>Kemper</u> | 42 |
| <u>Unitrin Specialty</u> | 46 |
| <u>Unitrin Direct</u> | 49 |
| <u>Life and Health Insurance</u> | 52 |
| <u>Fireside Bank</u> | 56 |
| <u>Investment Results</u> | 59 |
| <u>Investment Quality and Concentrations</u> | 62 |
| <u>Securities Lending, Credit Default Swaps and Hedging Activities</u> | 67 |
| <u>Distressed and Mezzanine Debt and Secondary Transactions Investments</u> | 68 |
| <u>Interest and Other Expenses</u> | 68 |
| <u>Income Taxes</u> | 69 |
| <u>Liquidity and Capital Resources</u> | 69 |
| <u>Off-Balance Sheet Arrangements</u> | 73 |
| <u>Contractual Obligations</u> | 74 |
| <u>Accounting Changes</u> | 75 |

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations

SUMMARY OF RESULTS

Net Loss was \$29.6 million (\$0.47 per common share) for the year ended December 31, 2008, compared to Net Income of \$205.4 million (\$3.13 per common share) for the year ended December 31, 2007. Net Loss from Continuing Operations was \$38.0 million (\$0.60 per common share) in 2008, compared to Net Income from Continuing Operations of \$178.1 million (\$2.71 per common share) for same period in 2007. As discussed throughout this MD&A results from continuing operations decreased for the year ended December 31, 2008 due primarily to lower operating results in the aggregate, including higher catastrophe losses, lower Net Investment Income and higher losses arising from other than temporary declines in fair value of investments and realized investment losses from sales of stocks of financial institutions. Catastrophe losses from continuing operations were \$144.9 million before tax for the year ended December 31, 2008, compared to \$39.4 million for the same period in 2007. The Company reported Income from Discontinued Operations of \$8.4 million and \$27.3 million for the years ended December 31, 2008 and 2007, respectively.

Earned Premiums were \$2,376.6 million in 2008, compared to \$2,286.9 million in 2007. Earned premium increased primarily in the Unitrin Specialty and Unitrin Direct segments and to a lesser extent the Life and Health Insurance and Kemper segments.

Automobile Finance Revenues decreased by \$17.9 million in 2008, compared to 2007, due to both a lower level of loans outstanding and lower interest rates.

Net Investment Income decreased by \$77.0 million in 2008 due primarily to lower net investment income from certain investments in limited liability investment companies and limited partnerships, lower short-term investment income and lower dividend income from the Company's investment in Northrop, partially offset by higher net investment income from acquired businesses.

Net Realized Investment Gains (Losses), which are reported in the Statement of Operations, was a loss of \$93.7 million in 2008, compared to a gain of \$62.5 million in 2007. Net Realized Gains (Losses) for the years ended December 31, 2008 and 2007, include pretax losses of \$152.9 million and \$33.0 million, respectively, from other than temporary declines in the fair values of investments.

Other Comprehensive Investment Gains (Losses), which are not reported in the Statement of Operations, but rather are reported in the Statement of Comprehensive Income (Loss), was a loss of \$595.6 million in 2008, compared to a gain of \$69.2 million in 2007. The net comprehensive investment loss for the year ended December 31, 2008 was due primarily to a \$281.3 million decline in the value of the Company's investment in Northrop stock and the general decline in value of most of the Company's investments in fixed maturities and equity securities due to the overall decline in the economy and stock market in the fourth quarter of 2008. The Company's investments in the financial sector declined in value over \$125 million for the year ended December 31, 2008.

CRITICAL ACCOUNTING ESTIMATES

Unitrin's subsidiaries conduct their businesses in three industries: property and casualty insurance, life and health insurance and automobile finance. Accordingly, the Company is subject to several industry-specific accounting principles under accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in accordance with GAAP requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The process of estimation is inherently uncertain. Accordingly, actual results could ultimately differ materially from the estimated amounts reported in a company's financial statements. Different assumptions are likely to result in

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

CRITICAL ACCOUNTING ESTIMATES (Continued)

different estimates of reported amounts. The Company's critical accounting policies most sensitive to estimates include the valuation of investments, the valuation of property and casualty insurance reserves for losses and LAE, the valuation of the reserve for loan losses, the assessment of recoverability of goodwill and the valuation of pension benefit obligations.

Valuation of Investments

Except for the Company's investments accounted for under the equity method of accounting, and certain mutual funds classified as trading securities, the Company's investments in fixed maturities, preferred stocks and common stocks are classified as available for sale and are reported at fair value determined in accordance with SFAS No. 157, *Fair Value Measurements*. The Company has no investments for which it has elected to account for under the fair value option prescribed by SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities Including an amendment of FASB Statement No. 115*.

Except for investments accounted for under the equity method of accounting or under the fair value option of SFAS No. 159, under the provisions of GAAP a company is generally required to classify its investments in fixed maturities, preferred stocks and common stocks into one of the following three investment categories based on the its intent with respect to a particular investment at the time of acquisition:

- a) Trading;
- b) Held to maturity; or
- c) Available for sale.

The classification of the investment may affect a company's reported results. For investments classified as trading or for which a company elects the fair value option, a company is required to recognize changes in the fair values into income for the period reported. For investments in fixed maturities classified as held to maturity, a company is required to carry the investment at amortized cost, with only the amortization occurring during the period recognized into income. Changes in the fair value of investments classified as available for sale are not recognized to income during the period, but rather are recognized as a separate component of equity until realized. Investments accounted for under the equity method of accounting are valued at cost plus cumulative undistributed earnings and not at fair value. Had the Company reported all the changes in the fair values of its investments in fixed maturities, preferred stock and common stock, including its investment in Intermec, and other equity securities into income, the Company's reported net income for the year ended December 31, 2008, would have decreased by \$448.2 million.

The Company regularly reviews its investments for factors that may indicate that a decline in the fair value of an investment below its cost or amortized cost is other than temporary. Some factors considered in evaluating whether or not a decline in fair value is other than temporary include:

- a) The Company's ability and intent to retain the investment for a period of time sufficient to allow for a recovery in value;
- b) The duration and extent to which the fair value has been less than cost; and

Edgar Filing: UNITRIN INC - Form 10-K

c) The financial condition and prospects of the issuer.

Such reviews are inherently uncertain in that the value of the investment may not fully recover or may decline further in future periods resulting in realized losses.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****CRITICAL ACCOUNTING ESTIMATES (Continued)***Property and Casualty Insurance Reserves for Losses and Loss Adjustment Expenses*

The Company's Property and Casualty Insurance Reserves are reported using the Company's estimate of its ultimate liability for losses and LAE for claims that occurred prior to the end of any given accounting period but have not yet been paid. The Company had \$1,268.7 million and \$1,322.9 million of gross loss and LAE reserves at December 31, 2008 and 2007, respectively. Property and Casualty Insurance Reserves for the Company's business segments at December 31, 2008 and 2007 were:

| Dollars in Millions | 2008 | 2007 |
|---|-------------------|-------------------|
| Business Segments: | | |
| Kemper | \$ 476.1 | \$ 502.4 |
| Unitrin Specialty | 293.1 | 278.6 |
| Unitrin Direct | 163.1 | 142.6 |
| Life and Health Insurance | 23.0 | 11.4 |
| Total Business Segments | 955.3 | 935.0 |
| Discontinued Operations | 280.0 | 342.2 |
| Unallocated Ceded Reserves | 33.4 | 45.7 |
| Total Property and Casualty Insurance Reserves | \$ 1,268.7 | \$ 1,322.9 |

The Unallocated Ceded Reserves were acquired in connection with a business acquisition from SCOR in 2002 and are reinsured by an insurance subsidiary of SCOR (see Note 8, Property and Casualty Insurance Reserves, to the Consolidated Financial Statements). The Company does not allocate these reserves to its business segments or Unitrin Business Insurance.

In estimating the Company's Property and Casualty Insurance Reserves, the Company's actuaries exercise professional judgment and must consider, and are influenced by, many variables that are difficult to quantify. Accordingly, the process of estimating and establishing the Company's Property and Casualty Insurance Reserves is inherently uncertain and the actual ultimate net cost of claims may vary materially from the estimated amounts reserved. The reserving process is particularly imprecise for claims involving asbestos, environmental matters, construction defect and other emerging and/or long-tailed exposures which may not be discovered or reported until years after the insurance policy period has ended.

The Company's actuaries generally estimate reserves at least quarterly for most product lines and/or coverage levels using accident quarters or accident months spanning 10 or more years depending on the size of the product line and/or coverage level or emerging issues relating to them. The Company's actuaries use a variety of generally accepted actuarial loss reserving estimation methodologies including, but not limited to, the following:

Incurred Loss Development Methodology;

Paid Loss Development Methodology;

Edgar Filing: UNITRIN INC - Form 10-K

Bornhuetter-Ferguson Incurred Loss Methodology;

Bornhuetter-Ferguson Paid Loss Methodology; and

Frequency and Severity Methodology.

The Company's actuaries generally review the results of at least four of these estimation methodologies, two based on paid data and two based on incurred data, to initially estimate loss and LAE reserves and to determine if a change in prior estimates is required. In some cases, the methodologies produce a cluster of estimates with a tight band of indicated possible outcomes. In other cases, however, the methodologies produce conflicting results

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****CRITICAL ACCOUNTING ESTIMATES (Continued)**

and wider bands of indicated possible outcomes. However, such bands do not necessarily constitute a range of outcomes, nor does the Company's management or the Company's actuaries calculate a range of outcomes.

At a minimum, the Company's actuaries analyze 45 product and/or coverage levels for over 40 separate current and prior accident quarters for both losses and LAE using many of the loss reserving estimation methodologies identified above as well as other generally accepted actuarial estimation methodologies. In all, there are over 10,000 combinations of accident quarters, coverage levels, and generally accepted actuarial estimation methodologies used to estimate the Company's unpaid losses and LAE. In some cases, the Company's actuaries make adjustments to the loss reserving estimation methodologies identified above or use additional generally accepted actuarial estimation methodologies to estimate ultimate losses and LAE.

For each accident quarter, the point estimate selected by the Company's actuaries is not necessarily one of the points produced by any particular one of the methodologies utilized, but often is another point selected by the Company's actuaries, using their professional judgment, that takes into consideration each of the points produced by the several loss reserving estimation methodologies used. In some cases, for a particular product, the current accident quarter may not have enough paid claims data to rely upon, leading the Company's actuaries to conclude that the incurred loss development methodology provides a better estimate than the paid loss development methodology. Therefore, the Company's actuaries may give more weight to the incurred loss development methodology for that particular accident quarter. As an accident quarter ages for that same product, the actuary may gain more confidence in the paid loss development methodology and begin to give more weight to the paid loss development methodology. The Company's actuaries' quarterly selections are summed by product and/or coverage levels to create the actuarial indication of the ultimate losses. More often than not, the actuarial indication for a particular product line and accident quarter is most heavily weighted towards the incurred loss development methodology, particularly for short-tail lines such as personal automobile insurance. Historically, the incurred loss development methodology has been more reliable in predicting ultimate losses for these lines, especially in the more recent accident quarters, when compared with the paid loss development methodology. However, in some circumstances changes can occur which impact numerous variables including, but not limited to, those variables identified below that are difficult to quantify and/or impact the predictive value of prior development patterns relied upon in the incurred loss development methodology and paid loss development methodology. In those circumstances, the Company's actuaries must make adjustments to these loss reserving estimation methodologies or use additional generally accepted actuarial estimation methodologies. In those circumstances, the Company's actuaries, using their professional judgment, may place more weight on the adjusted loss reserving estimation methodologies or other generally accepted actuarial estimation methodologies until the newer development patterns fully emerge and the Company's actuaries can fully rely on the unadjusted loss reserving estimation methodologies. In the event of a wide variation among results generated by the different projection methodologies, the Company's actuaries further analyze the data using additional techniques.

In estimating reserves, the Company's actuaries exercise professional judgment and must consider, and are influenced by, many variables that are difficult to quantify, such as:

Changes in the level of minimum case reserves, and the automatic aging of those minimum case reserves;

Changes to claims practices including, but not limited to, changes in the reporting and impact of large losses, adequacy of case reserves, implementation of new systems for handling claims, turnover of claims department staffs, timing and depth of the audit review of claims handling procedures;

Changes in underwriting practices;

Edgar Filing: UNITRIN INC - Form 10-K

Changes in the mix of business by state, class and policy limit within product line;

Growth in new lines of business;

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

CRITICAL ACCOUNTING ESTIMATES (Continued)

Changes in the attachment points of the Company's reinsurance programs;

Medical costs including, but not limited to, the ability to assess the extent of injuries and the impact of inflation;

Repair costs including, but not limited to, the impact of inflation and the availability of labor and materials;

Changes in the judicial environment including, but not limited to, the interpretation of policy provisions, the impact of jury awards and changes in case law; and

Changes in state regulatory requirements.

A change in any one or more of the foregoing factors is likely to result in a projected ultimate net claim loss and LAE that is different from the previously estimated reserve and/or previous frequency and severity trends. Such changes in estimates may be material.

For example, the Company's actuaries review frequency (number of claims per policy or exposure), severity (dollars of loss per claim) and average premium (dollars of premium per exposure). Actual frequency and severity experienced will vary depending on changes in mix by class of insured risk. Similarly, the actual frequency and rate of recovery from reinsurance will vary depending on changes in the attachment point for reinsurance. In particular, in periods of high growth or expansion into new markets, there may be additional uncertainty in estimating the ultimate losses and LAE. The contributing factors of this potential risk are changes in the Company's mix by policy limit and mix of business by state or jurisdiction.

Actuaries use historical experience and trends as predictors of how losses and LAE will emerge over time. However, historical experience may not necessarily be indicative of how actual losses and LAE will emerge. Changes in reserve adequacy, changes in minimum case reserves and changes in internal claims handling procedures could impact the timing and recognition of incurred claims and produce an estimate that is either too high or too low if not adjusted for by the actuary. For example, if, due to changes in claims handling procedures, actual claims are settled more rapidly than they were settled historically, the estimate produced by the paid loss development methodology would tend to be overstated if the actuary did not identify and adjust for the impact of the changes in claims handling procedures. Similarly, if, due to changes in claims handling procedures, actual claim reserves are set at levels higher than past experience, the estimate produced by the incurred loss development methodology would tend to be overstated if the actuary did not identify and adjust for the impact of the changes in claims handling procedures.

The final step in the quarterly loss and LAE reserving process involves a comprehensive review of the actuarial indications by the Company's senior actuary and senior management who apply their collective judgment and determine the appropriate estimated level of reserves to record. Numerous factors are considered in this determination process, including, but not limited to, the assessed reliability of key loss trends and assumptions that may be significantly influencing the current actuarial indications, changes in claim handling practices or other changes that affect the timing of payment or development patterns, changes in the mix of business, the maturity of the accident year, pertinent trends observed over the recent past, the level of volatility within a particular line of business, the improvement or deterioration of actuarial indications in the current period as compared to prior periods, and the amount of reserves related to third party pools for which the Company does not have access to the underlying data and, accordingly, relies on calculations provided by such pools. Total recorded reserves for property and casualty insurance losses and LAE were 1.2%, 2.0% and 3.9% higher than the actuarial indication of reserves at December 31, 2008, 2007 and 2006, respectively. Total recorded reserves for property and casualty insurance losses and LAE as a percentage of the actuarial indication of reserves decreased in 2008 and 2007 due primarily to the Company's senior actuary and senior management placing greater reliance

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****CRITICAL ACCOUNTING ESTIMATES (Continued)**

on the actuarial indications in determining the appropriate estimated level of reserves, due in part to the continued improvement in the actuarial indications in some product lines.

The Company's goal is to ensure its total reserves for property and casualty insurance losses and LAE are adequate to cover all costs, while sustaining minimal variation from the time reserves for losses and LAE are initially estimated until losses and LAE are fully developed. Changes in the Company's estimates of these losses and LAE over time, also referred to as development, will occur and may be material. Favorable development is recognized when the Company decreases its estimate of previously reported losses and LAE and results in an increase in net income in the period recognized, whereas adverse development is recognized when the Company increases its estimate of previously reported losses and LAE and results in a decrease in net income. The Company recognized total favorable development of \$79.3 million, \$101.1 million and \$91.6 million before tax for the years ended December 31, 2008, 2007 and 2006, respectively. Development for each of the Company's continuing business segments and Unitrin Business Insurance for the years ended December 31, 2008, 2007 and 2006, was:

| Dollars in Millions | Favorable (Adverse) Development | | |
|---|---------------------------------|----------|---------|
| | 2008 | 2007 | 2006 |
| Continuing Operations: | | | |
| Kemper | \$ 61.0 | \$ 54.2 | \$ 68.2 |
| Unitrin Specialty | 5.5 | 15.3 | 8.9 |
| Unitrin Direct | (3.2) | (5.5) | (4.5) |
| Life and Health Insurance | (13.7) | (8.6) | (6.8) |
| Total Favorable Development, Net from Continuing Operations | \$ 49.6 | \$ 55.4 | \$ 65.8 |
| Discontinued Operations: | | | |
| Unitrin Business Insurance, Net | 29.7 | 45.7 | 25.8 |
| Total Favorable Development, Net | \$ 79.3 | \$ 101.1 | \$ 91.6 |

Development in the Company's Kemper segment comprised a substantial portion of the Company's development reported in continuing operations in 2008, 2007 and 2006. Development in Unitrin Business Insurance comprised all of the Company's development reported in discontinued operations. Together these two operations comprised a substantial portion of the Company's favorable development in 2008, 2007 and 2006. Additional information regarding this development follows.

Kemper Development

In June of 2002, the Company acquired the personal lines property and casualty insurance business of KIC in a renewal rights transaction. Pursuant to the agreements among the parties, KIC retained all liabilities for policies issued by KIC prior to the closing, while the Company is entitled to premiums written for substantially all personal lines property and casualty insurance policies issued or renewed after the closing and is liable for losses and LAE incurred thereon. The Kemper segment did not complete a full calendar year underwriting cycle after the acquisition date until 2004. Accordingly, the Company's results for 2002 and 2003 did not represent 100% of the acquired business. For example, for the 2002 calendar year, the Company's share of earned premiums for the KIC personal lines business was approximately 20% of the entire KIC personal lines business. For the 2003 calendar year, the Company's share of earned premiums was approximately 90% of the entire KIC personal lines business.

The Company's actuaries use various generally accepted actuarial incurred and paid loss development methodologies to estimate unpaid losses and LAE. The key assumption in these estimation methodologies is that

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****CRITICAL ACCOUNTING ESTIMATES (Continued)**

patterns observed in prior periods are indicative of how losses and LAE are expected to develop in the future and that such historical data can be used to predict and estimate ultimate losses and LAE. Initially, the Company's actuaries had to rely solely on the historical data of KIC (the KIC Data) to predict how losses for business written by the Company after the acquisition would develop. As the Company continued to renew policies, the paid loss and incurred loss data related to the Company's share of the entire KIC personal lines business gradually increased. Immediately after the acquisition, the Company began accumulating incurred and paid loss and LAE data for its share of the KIC personal lines business (the Unitrin Data). In 2003, and throughout 2004, the Company's actuaries began to review the Unitrin Data and began comparing development factors for it with the development factors for the KIC Data. These initial reviews indicated that the Unitrin Data was producing lower development factors than the factors produced by the KIC Data. However, the amount of Unitrin Data available for analysis was still limited, and the Company's actuaries could not be confident that the observed changes in development were anything but random fluctuations and, therefore, placed less weight on the most recent development patterns.

Since the acquisition, the Company's actuaries have gained increasing confidence that the development patterns from the Unitrin Data were not only different from the KIC Data, but that these patterns were also sustainable. As the Company's actuaries gave more weight, and continued to give more weight each quarter, to the improved development patterns from the Unitrin Data in the selection of their incremental development factors throughout 2005 and 2006 and into 2007, the Kemper segment has recognized favorable development each quarter as appropriate.

The lower development factors for the Unitrin Data primarily resulted from improvements in the claim handling procedures on this book of business. In 2002, Kemper began to place special emphasis on reporting claims directly to the Company. Prior to that time, a policyholder's agent usually was the primary contact to report a claim. In July of 2002, approximately one-third of all claims were reported directly to Kemper compared to approximately 70% at the end of both 2006 and 2007. Direct reporting of losses has enabled the Company not only to reduce claim cycle times, but also to better respond to and control loss costs. Kemper has also focused on reducing the number of days from when a loss is reported until the related claim is closed, while also controlling the overall loss and LAE costs. Specifically, Kemper has implemented several claims handling loss mitigation programs, including:

- Increased its utilization of alternative dispute resolution processes, such as mediation and arbitration, to facilitate settlements and reduce defense and legal costs;

- Increased its in-house legal expertise to better manage the litigation processes and expenses, including managing the external lawyers with whom Kemper contracts to defend claims; and,

- Increased its emphasis on attempting to settle third-party claims earlier in the claims process in an effort to reduce the ultimate claim and LAE payouts.

In 2005, a second wave of new claims handling procedures, which emphasized greater case reserve adequacy earlier in the lifecycle of a claim, began to occur in Kemper's claims organization. The impact of this second wave of new claims handling procedures became visible in Kemper's reserving data in late 2006 and early 2007 as evidenced by a dramatic rise in individual case loss reserve changes in excess of \$100,000 at early claims maturity valuation points. The second wave of new claims handling procedures had the effect of producing higher average paid and incurred loss amounts for recent accident quarters than historical averages would otherwise indicate. This second wave of new claims handling procedures compounded the effects of the improvements from the first wave of changes in claims handling procedures on the emerging loss development patterns.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****CRITICAL ACCOUNTING ESTIMATES (Continued)**

Kemper's actuaries typically use a variety of five generally accepted actuarial loss reserving estimation methodologies: the incurred loss development methodology, the paid loss development methodology, the Bornhuetter-Ferguson incurred loss development methodology, Bornhuetter-Ferguson paid loss development methodology and the frequency and severity methodology. Kemper continues to experience various changes which impact numerous variables that are difficult to quantify and/or impact the predictive value of prior development patterns. Accordingly, in some cases, Kemper's actuaries must make adjustments to these loss reserving estimation methodologies or use additional generally accepted actuarial loss reserving estimation methodologies until the development patterns fully emerge and Kemper's actuaries can fully rely on the unadjusted methodologies. These changes have occurred over several years and the impact of some changes is more fully developed than it is for other changes. Accordingly, Kemper's actuaries in some cases continue to place greater weight on certain emerging loss development trends, while in other cases placed greater weight on the adjusted loss reserving estimation methodologies or additional generally accepted actuarial loss reserving estimation methodologies in their actuarial indications. Beginning in 2007, the Company's senior actuary and senior management began placing greater reliance on the actuarial indications in determining the appropriate estimated level of reserves.

In 2005, the personal lines claims function of Multilines Insurance (MLI) was combined into the Kemper segment's claims function. In September 2005, Kemper converted all open MLI personal lines claims to its claims system and began including new claims from the MLI business in its claim system.

All of these changes have impacted the development patterns for Kemper's loss reserving data. Although the Company's actuaries were aware of, and gave consideration to, the changes in the Company's claims handling processes, including the merging of the Kemper and MLI claims functions, it takes several years to ascertain whether such changes in claims handling procedures will ultimately result in lower ultimate paid losses and LAE. Accordingly, the effects of the improvements and the changes in the claims handling processes have emerged and have been recognized over several years as the Company's actuaries have become more convinced that lower losses and LAE have in fact been realized. However, the Company cannot make any assurances that all such improvements and effects have fully emerged or will continue to emerge.

Unitrin Business Insurance Development

The Company attributes favorable development in its discontinued operations primarily to changes in its claims handling processes and the re-underwriting of its underlying book of business over the past several years.

Although the Company's actuaries were aware of, and gave consideration to, the changes in the Company's claims handling processes and the re-underwriting in estimating unpaid losses and LAE for Unitrin Business Insurance, it takes several years to ascertain whether such changes in claims handling procedures and re-underwriting will ultimately result in lower ultimate paid losses and LAE. Accordingly, the improvements have emerged and have been recognized over several years as the Company's actuaries have become more convinced that lower losses and LAE have in fact been realized. Due to the long-tail nature of some of Unitrin Business Insurance's liabilities, it may take 10 or more years to fully determine the impact of these actions. Accordingly, the Company cannot make any assurances that all such improvements have fully emerged or will continue to emerge.

In addition, the Company has experienced favorable development in some particularly long-tail lines such as asbestos, environmental and construction defect. The Company's reserves for asbestos, environmental and construction defects were \$13 million, \$5 million and \$53 million, respectively, at December 31, 2008. Development in these lines emerge over a longer period of time and thus are more difficult to ascertain. In 2008, the Company updated certain analyses for these long-tail lines using industry analyses as well as its own experience. See Note 8, Property and Casualty Insurance Reserves, to the Consolidated Financial Statements.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****CRITICAL ACCOUNTING ESTIMATES (Continued)***Estimated Variability of Property and Casualty Insurance Reserves*

The Company believes that its historical loss and LAE reserve development recognized to income illustrates the potential variability of the Company's estimate of Property and Casualty Insurance Reserves. Based on development recorded in the Company's consolidated financial statements through the application of its reserving methodologies over the past five years, the Company estimates that its Property and Casualty Insurance Reserves could vary from the amounts carried on the balance sheet as follows:

| DOLLARS IN MILLIONS | DEC. 31, 2008 | ESTIMATED VARIABILITY |
|--|----------------------|----------------------------------|
| Personal Lines | \$ 837.9 | ±18% |
| Commercial Lines | 397.4 | ±20% |
| Unallocated Ceded Reserves | 33.4 | NA |
| Total Property and Casualty Insurance Reserves | \$ 1,268.7 | ±19% |

The estimated variability shown above does not constitute a statistical range of actuarially determined probable outcomes, nor does it constitute a range of all possible outcomes. Rather, it is based solely on the Company's historical experience over the last five full years, which may not necessarily be indicative of future variability due to a number of factors including, but not limited to, changes in claims handling procedures, underwriting, mix of business by class and policy limit, growth in new lines of business or geographical areas, and the legal environment. The impact of changes in these factors is difficult to quantify and predict. Accordingly, the Company's actuaries must exercise considerable professional judgment in making their actuarial indications in light of these factors. Reserves in the Company's Kemper segment account for 38% of the Company's reserves for property and casualty insurance losses and LAE. Accordingly, the indicated estimated variability is more likely to result from changes in the reserves for the Kemper segment.

Although development will emerge in all of Unitrin's personal lines product lines, development in Kemper's personal automobile insurance product line could have the most significant impact. To further illustrate the sensitivity of Kemper's reserves for automobile insurance losses and LAE to changes in the cumulative development factors, the Company's actuaries estimated the impact of decreases in the cumulative development factors used in the incurred loss development methodology. For the most recent quarterly evaluation period, the Company assumed an average decrease of 11.1% in the cumulative development factor, gradually declining to an average decrease of 3.2% over the next 8 older evaluation quarters, gradually declining to average decrease of 0.4% over the next 15 older evaluation quarters and then gradually declining to 0% thereafter. Assuming that Kemper's automobile insurance loss and LAE reserves were based solely on the incurred loss development methodology and such assumed decreases in the cumulative development factors, the Company estimates that Kemper's automobile insurance loss and LAE reserves would have decreased by \$72 million at December 31, 2008 for all accident years combined.

To further illustrate the sensitivity of Kemper's reserves for automobile insurance losses and LAE to changes in the cumulative development factors, the Company's actuaries also estimated the impact of increases in the cumulative development factors used in the incurred loss development methodology. For the most recent quarterly evaluation period, the Company assumed an average increase of 11.1% in the cumulative development factor, gradually declining to an average increase of 3.2% over the next 8 older evaluation quarters, gradually declining to an average increase of 0.4% over the next 15 older evaluation quarters and then gradually declining to 0% thereafter. Assuming that Kemper's automobile insurance loss and LAE reserves were based solely on the incurred loss development methodology and such assumed increases in the cumulative development factors, the Company estimates that Kemper's automobile insurance loss and LAE reserves would have increased by \$72 million at December 31, 2008 for all accident years combined.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****CRITICAL ACCOUNTING ESTIMATES (Continued)**

In addition to the factors described above, other factors may also impact loss reserve development in future periods. These factors include governmental actions, including court decisions interpreting existing laws, regulations or policy provisions, developments related to insurance policy claims and coverage issues, adverse or favorable outcomes in pending claims litigation, the number and severity of insurance claims, the impact of inflation on insurance claims and the impact of residual market assessments. Although the Company's actuaries do not make specific numerical assumptions about these factors, changes in these factors from past patterns will impact historical loss development factors and in turn future loss reserve development. Significant positive changes in one or more factors will lead to positive future loss reserve development, which could result in the actual loss developing closer to, or even below, the lower end of the Company's estimated reserve variability. Significant negative changes in one or more factors will lead to negative loss reserve development, which could result in the actual loss developing closer to, or even above, the higher end of the Company's estimated reserve variability. Accordingly, due to these factors and the other factors enumerated throughout the MD&A and the inherent limitations of the loss reserving estimation methodologies, the estimated and illustrated reserve variability may not necessarily be indicative of the Company's future reserve variability, which could ultimately be greater than the estimated and illustrated variability. In addition, as previously noted, development will emerge in all of Unitrin's product lines over time. Accordingly, the Company's future reserve variability could ultimately be greater than the illustrated variability.

Unallocated Ceded Reserves are reinsured by an insurance subsidiary of SCOR (see Note 8, Property and Casualty Insurance Reserves, to the Consolidated Financial Statements). The Company does not anticipate that any variability of these reserves will have a financial impact on the Company's reported results of operations or liquidity and, accordingly, has not estimated any potential variability to these reserves. The Company does not allocate these reserves to its business segments.

Additional information pertaining to the estimation of and development of the Company's Property and Casualty Insurance Reserves is contained in Item 1 of Part I of this 2008 Annual Report on Form 10-K under the heading Property and Casualty Loss and Loss Adjustment Expense Reserves.

Reserve for Loan Losses

The Reserve for Loan Losses is estimated using the Company's estimate of ultimate charge-offs and recoveries of loans based on past experience adjusted for current economic conditions. Such charge-offs and recoveries emerge over a period of years. Accordingly, the Company's actual ultimate net charge-offs could differ materially from the Company's estimate due to a variety of factors including, but not limited to, trends and future conditions in the macroeconomic, socioeconomic and regulatory environment, the timing of charge-offs and recoveries, the value of collateral and changes in the overall credit quality of the loan portfolio. Actual net charge-off patterns may also differ materially from historical net charge-off patterns if there is a change in collection practices, the mix of loans or the credit quality of borrowers. For example, net charge-off patterns may differ in Fireside Bank's expansion states from Fireside Bank's historical experience. A 100 basis point increase in the Company's estimated ultimate rate of net charge-off would increase the Company's Reserve for Loan Losses at December 31, 2008 by \$21.6 million.

Goodwill Recoverability

The process of determining whether or not an asset, such as Goodwill, is impaired or recoverable relies on projections of future cash flows, operating results and market conditions. Such projections are inherently uncertain and, accordingly, actual future cash flows may differ materially from projected cash flows. In evaluating the recoverability of Goodwill, the Company performs a discounted cash flow analysis of the Company's reporting units. The discounted cash value may be different from the fair value that would result from an actual transaction between a willing buyer and a willing seller. Such analyses are particularly sensitive to

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

CRITICAL ACCOUNTING ESTIMATES (Continued)

changes in discount rates and investment rates. Changes to these rates might result in material changes in the valuation and determination of the recoverability of Goodwill. For example, an increase in the interest rate used to discount cash flows will decrease the discounted cash value. There is likely to be a similar, but not necessarily as large as, increase in the investment rate used to project the cash flows resulting from investment income earned on the Company's investments. Accordingly, an increase in the investment rate would increase the discounted cash value.

Pension Benefit Obligations

The process of estimating the Company's pension benefit obligations and pension benefit costs is inherently uncertain and the actual cost of benefits may vary materially from the estimates recorded. These liabilities are particularly volatile due to their long-term nature and are based on several assumptions. The main assumptions used in the valuation of the Company's pension benefit obligations are:

- a) Estimated mortality of the employees and retirees eligible for benefits;
- b) Estimated expected long-term rates of returns on investments;
- c) Estimated compensation increases;
- d) Estimated employee turnover; and
- e) Estimated rate used to discount the ultimate estimated liability to a present value.

A change in any one or more of these assumptions is likely to result in an ultimate liability different from the original actuarial estimate. Such changes in estimates may be material. For example, a one percentage point decrease in the Company's estimated discount rate would increase the pension benefit obligation at December 31, 2008 by \$52.9 million, while a one percentage point increase in the rate would decrease the pension benefit obligation at December 31, 2008 by \$44.8 million. A one percentage point decrease in the Company's estimated long-term rate of return on plan assets would increase the pension expense for the year ended December 31, 2008 by \$3.6 million, while a one percentage point increase in the rate would decrease pension expense by \$3.6 million for the same period.

CATASTROPHES

The Company manages its exposure to catastrophes and other natural disasters through a combination of geographical diversification, restrictions on the amount and location of new business production in such regions, and reinsurance. To limit its exposures to catastrophic events, the Company maintains various primary catastrophe reinsurance programs for its property and casualty insurance businesses. Coverage for each primary catastrophe reinsurance program is provided in various layers (see Note 20, Catastrophe Reinsurance, to the Consolidated Financial Statements for further discussion of these programs). In addition to these programs, the Company purchases reinsurance from the FHCF for hurricane losses in Florida at retentions lower than those described below for the Company's primary catastrophe reinsurance programs.

Catastrophe reinsurance premiums for the Company's primary reinsurance programs and the FHCF reduced earned premiums for the years ended December 31, 2008, 2007 and 2006, by the following:

Edgar Filing: UNITRIN INC - Form 10-K

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|---|----------------|----------------|----------------|
| Kemper | \$ 19.6 | \$ 19.4 | \$ 15.7 |
| Unitrin Specialty | 0.3 | 0.2 | 0.2 |
| Unitrin Direct | 0.2 | 1.1 | 0.5 |
| Life and Health Insurance | 10.5 | 8.5 | 6.1 |
| Total Ceded Catastrophe Reinsurance Premiums | \$ 30.6 | \$ 29.2 | \$ 22.5 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****CATASTROPHES (Continued)**

The Life and Health Insurance segment presented above includes reinsurance reinstatement premiums of \$4.4 million for the year ended December 31, 2008 to reinstate coverage following Hurricanes Dolly, Gustav and Ike.

Total catastrophe losses and LAE (including development), net of reinsurance recoveries, reported in continuing operations were \$144.9 million, \$39.4 million and \$56.9 million for the years ended December 31, 2008, 2007 and 2006, respectively. The Company reported the following catastrophe reserve development: adverse \$4.8 million, favorable \$4.6 million and adverse \$4.0 million in 2008, 2007 and 2006, respectively. Catastrophe losses and LAE (including development), net of reinsurance recoveries, for the years ended December 31, 2008, 2007 and 2006 are presented below.

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|---|-----------------|----------------|----------------|
| Kemper | \$ 97.4 | \$ 27.8 | \$ 44.2 |
| Unitrin Specialty | 2.9 | 0.5 | 0.8 |
| Unitrin Direct | 3.1 | 0.6 | 1.1 |
| Life and Health Insurance | 41.5 | 10.5 | 10.8 |
| Total Catastrophe Losses and LAE | \$ 144.9 | \$ 39.4 | \$ 56.9 |

In the third quarter of 2008, three major hurricanes that significantly impacted the Company (Dolly, Gustav and Ike) made landfall in the United States. A summary of the Company's estimated losses and LAE, net of reinsurance recoveries of \$65.4 million, from Hurricanes Dolly, Gustav and Ike reported in the Company's Consolidated Statements of Operations for the year ended December 31, 2008 by business segment were:

| <i>DOLLARS IN MILLIONS</i> | Dolly | Gustav | Ike | Total |
|---|---------------|----------------|----------------|----------------|
| Kemper | \$ 0.6 | \$ 12.1 | \$ 27.9 | \$ 40.6 |
| Unitrin Specialty | | 0.5 | 1.0 | 1.5 |
| Unitrin Direct | | | 0.5 | 0.5 |
| Life and Health Insurance | 6.8 | 7.3 | 8.7 | 22.8 |
| Total Loss and LAE, Net of Reinsurance | \$ 7.4 | \$ 19.9 | \$ 38.1 | \$ 65.4 |

The estimated losses presented above by the Life and Health Insurance segment are net of reinsurance recoveries of \$2.9 million, \$6.0 million and \$37.2 million related to Hurricanes Dolly, Gustav and Ike, respectively. In addition to the losses presented above, Insurance Expenses for the year ended December 31, 2008 includes an expense of \$3.9 million related to the Kemper segment's estimate of its share of assessments from the Texas Windstorm Insurance Association (TWIA). The Company's estimates for Hurricanes Dolly, Gustav and Ike include estimates for both direct losses and LAE and indirect losses from residual market assessments, such as TWIA. The process of estimating and establishing reserves for catastrophe losses is inherently uncertain and the actual ultimate cost of a claim, net of actual reinsurance recoveries, may vary materially from the estimated amount reserved. The Company's estimates of direct catastrophe losses are generally based on inspections by claims adjusters and historical loss development experience for areas that have not been inspected or for claims that have not yet been reported. The Company's estimates of direct catastrophe losses are based on the coverages provided by its insurance policies. The Company's homeowners and dwellings insurance policies do not provide coverage for losses caused by floods, but generally provide coverage for physical damage caused by wind or wind driven rain. Accordingly, the Company's estimates of direct losses for homeowners and dwellings insurance do not include losses caused by flood. Depending on the policy, automobile insurance may provide coverage for losses caused by flood. Estimates of the number and severity of claims ultimately reported are influenced by many variables including, but not limited to, repair or reconstruction costs and determination of cause of loss, that are difficult to quantify and will influence the final amount of claim settlements. All these factors, coupled with the impact of

the availability of labor and material on costs, require significant judgment in

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****CATASTROPHES (Continued)**

the reserve setting process. A change in any one or more of these factors is likely to result in an ultimate net claim cost different from the estimated reserve. The Company's estimates of indirect losses from residual market assessments are based on a variety of factors including, but not limited to, actual or estimated assessments provided by or received from the assessing entity, insurance industry estimates of losses, and estimates of the Company's market share in the assessable states. Actual assessments may differ materially from these estimated amounts.

KEMPER

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|------------------------------|----------|----------|----------|
| Earned Premiums: | | | |
| Automobile | \$ 590.0 | \$ 594.4 | \$ 611.6 |
| Homeowners | 288.8 | 283.7 | 284.7 |
| Other Personal | 51.9 | 48.2 | 48.3 |
| Total Earned Premiums | 930.7 | 926.3 | 944.6 |
| Net Investment Income | 19.1 | 44.0 | 50.4 |
| Other Income | 0.5 | 0.5 | 0.4 |
| Total Revenues | 950.3 | 970.8 | 995.4 |
| Incurred Losses and LAE | 673.8 | 618.1 | 586.2 |
| Insurance Expenses | 268.9 | 264.5 | 275.8 |
| Operating Profit | 7.6 | 88.2 | 133.4 |
| Income Tax Benefit (Expense) | 5.8 | (21.7) | (38.0) |
| Net Income | \$ 13.4 | \$ 66.5 | \$ 95.4 |

RATIOS BASED ON EARNED PREMIUMS

| | | | |
|--|--------|-------|-------|
| Incurred Loss and LAE Ratio (excluding Catastrophes) | 61.9% | 63.7% | 57.4% |
| Incurred Catastrophe Loss and LAE Ratio | 10.5 | 3.0 | 4.7 |
| Total Incurred Loss and LAE Ratio | 72.4 | 66.7 | 62.1 |
| Incurred Expense Ratio | 28.9 | 28.6 | 29.2 |
| Combined Ratio | 101.3% | 95.3% | 91.3% |

INSURANCE RESERVES

| <i>DOLLARS IN MILLIONS</i> | DEC. 31, 2008 | DEC. 31, 2007 |
|----------------------------|---------------|---------------|
| Insurance Reserves: | | |
| Personal Automobile | \$ 336.3 | \$ 378.8 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | |
|---------------------------------|-----------------|-----------------|
| Homeowners | 103.0 | 91.1 |
| Other | 36.8 | 32.5 |
| Total Insurance Reserves | \$ 476.1 | \$ 502.4 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****KEMPER (Continued)**

| <i>DOLLARS IN MILLIONS</i> | DEC. 31, 2008 | DEC. 31, 2007 |
|---|----------------------|----------------------|
| Loss Reserves: | | |
| Case | \$ 273.3 | \$ 274.1 |
| Incurred but Not Reported | 125.9 | 145.3 |
| Total Loss Reserves | 399.2 | 419.4 |
| LAE Reserves | 76.9 | 83.0 |
| Total Insurance Reserves | \$ 476.1 | \$ 502.4 |
| For The Year Ended | | |
| Favorable Loss and LAE Reserve Development, Net (excluding Catastrophes) | \$ 55.2 | \$ 42.6 |
| Favorable Catastrophe Loss and LAE Reserve Development, Net | 5.8 | 11.6 |
| Total Favorable Loss and LAE Reserve Development, Net | \$ 61.0 | \$ 54.2 |
| Loss and LAE Reserve Development as a Percentage of Insurance Reserves at Beginning of Year | 12.1% | 10.1% |

2008 Compared with 2007

Earned Premiums in the Kemper segment increased by \$4.4 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to higher earned premiums on homeowners and other personal lines, partially offset by lower earned premiums on automobile insurance. Earned premiums on homeowners insurance increased by \$5.1 million due primarily to higher average premium rates and, to a lesser extent, higher volume. Earned premiums on other personal insurance increased by \$3.7 million due primarily to higher volume. Earned premiums on automobile insurance decreased by \$4.4 million due primarily to lower average premium rates and lower volume from involuntary premium assignments.

Net Investment Income decreased by \$24.9 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to lower net investment income from certain investments in limited liability investment companies and limited partnerships which the Company accounts for under the equity method of accounting. The Kemper segment reported a net investment loss of \$17.4 million from these investments for year ended December 31, 2008, compared to net investment income of \$2.4 million for the same period in 2007.

Operating Profit in the Kemper segment decreased by \$80.6 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to higher incurred losses and LAE and the lower Net Investment Income.

Incurred Losses and LAE increased for the year ended December 31, 2008, compared to the same period in 2007, due primarily to higher catastrophe losses and LAE, partially offset by lower non-catastrophe losses and LAE and higher favorable loss and LAE reserve development (which recognizes changes in estimates of prior year loss and LAE reserves in the current period). Catastrophe losses and LAE (including development) were \$97.4 million for the year ended December 31, 2008, compared to \$27.8 million for the same period in 2007. The Kemper segment recognized catastrophe losses, totaling \$40.6 million, from Hurricanes Dolly, Gustav and Ike in 2008. See MD&A, Catastrophes, for additional information on Hurricanes Dolly, Gustav and Ike and the Company's catastrophe reinsurance programs. There were no major hurricane catastrophe losses in 2007. Catastrophe losses for the year ended December 31, 2008 also increased due to higher frequency and severity of wind and hail storms in the first half of 2008, compared to the same period in 2007. Loss and LAE reserve development had a favorable effect of \$61.0 million (including favorable development of \$5.8 million for catastrophes for the year ended December 31, 2008), compared to a favorable effect of \$54.2 million (including favorable development of \$11.6 million for catastrophes) for the same period in 2007.

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

KEMPER (Continued)

Homeowners insurance incurred losses and LAE increased due primarily to higher catastrophe losses and LAE and to a lesser extent the impact of lower favorable loss and LAE reserve development, due largely to lower favorable catastrophe loss and LAE reserve development. Catastrophe losses and LAE (excluding development) on homeowners insurance were \$90.4 million for the year ended December 31, 2008, compared to \$35.5 million for the same period in 2007. Catastrophe losses and LAE increased for the year ended December 31, 2008 due primarily to the aforementioned hurricanes and increased frequency and severity of wind and hail storms.

Loss and LAE reserve development on homeowners insurance had a favorable effect of \$13.5 million (including favorable development of \$5.2 million for catastrophes) for the year ended December 31, 2008, compared to a favorable effect of \$22.5 million (including favorable development of \$10.6 million for catastrophes) in 2007.

Other personal insurance incurred losses and LAE increased due primarily to higher catastrophe losses and LAE and unfavorable loss and LAE development, compared to favorable loss and LAE development in 2007. Catastrophe losses and LAE (including development) on other personal insurance were \$3.8 million for the year ended December 31, 2008, compared to \$0.6 million in 2007. Unfavorable loss and LAE reserve development on other insurance was \$0.7 million for the year ended December 31, 2008, compared to \$2.8 million of favorable loss and LAE development for the same period in 2007.

Automobile insurance incurred losses and LAE decreased due primarily to the impact of higher favorable loss and LAE reserve development. Loss and LAE reserve development on automobile insurance had a favorable effect of \$48.2 million for the year ended December 31, 2008, compared to a favorable effect of \$28.9 million in 2007. Catastrophe losses and LAE (including development) on automobile insurance were \$8.4 million for the year ended December 31, 2008, compared to \$2.3 million in 2007.

See MD&A, Critical Accounting Estimates, for information pertaining to the Company's process of estimating property and casualty insurance reserves for losses and LAE, development of property and casualty insurance losses and LAE, estimated variability of property and casualty insurance reserves for losses and LAE, and a discussion of some of the variables that may impact development of property and casualty insurance losses and LAE and the estimated variability of property and casualty insurance reserves for losses and LAE.

Insurance Expenses increased by \$4.4 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to assessments from TWIA related to Hurricane Ike.

Net Income in the Kemper segment decreased by \$53.1 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to the changes in Operating Profit. The Kemper segment's effective income tax rate differs from the federal statutory income tax rate due primarily to tax-exempt investment income and dividends received deductions. Tax-exempt investment income and dividends received deductions were \$24.8 million in 2008, compared to \$26.0 million in 2007.

2007 Compared with 2006

Earned Premiums in the Kemper segment decreased by \$18.3 million for the year ended December 31, 2007, compared to the same period in 2006. Earned premiums on automobile insurance decreased by \$17.2 million due primarily to lower volume. Earned premiums on homeowners insurance decreased by \$1.0 million due primarily to lower volume and, to a lesser extent, the higher cost of reinsurance, partially offset by higher average premium rates.

Net Investment Income decreased by \$6.4 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to lower yields on investments, due in part to lower yields on investments in

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

KEMPER (Continued)

limited liability investment companies and limited partnerships, and lower levels of investments. The Kemper segment reported a decrease in net investment income of \$3.2 million from its investments in limited liability investment companies and limited partnerships for the year ended December 31, 2007, compared to the same period in 2006.

Operating Profit in the Kemper segment decreased by \$45.2 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to higher incurred losses and LAE, partially offset by lower insurance expenses and the lower Net Investment Income.

Incurred losses and LAE increased for the year ended December 31, 2007 due primarily to higher non-catastrophe incurred losses and LAE, including the impact of lower favorable loss and LAE reserve development, partially offset by lower catastrophe losses and LAE, due largely to higher favorable catastrophe loss and LAE reserve development. Automobile insurance incurred losses and LAE increased due primarily to the impact of lower favorable loss and LAE reserve development and higher non-catastrophe losses and LAE as a percentage of earned premiums. Loss and LAE reserve development on automobile insurance had a favorable effect of \$28.9 million for the year ended December 31, 2007, compared to a favorable effect of \$49.1 million in 2006. Catastrophe losses and LAE (including development) on automobile insurance were \$2.3 million for the year ended December 31, 2007, compared to \$4.4 million in 2006. Homeowners insurance incurred losses and LAE increased due primarily to higher non-catastrophe losses and LAE, partially offset by the impact of higher favorable loss and LAE reserve development due largely to higher favorable catastrophe loss and LAE reserve development. Loss and LAE reserve development on homeowners insurance had a favorable effect of \$22.5 million (including favorable development of \$10.6 million for catastrophes) for the year ended December 31, 2007, compared to a favorable effect of \$14.7 million (including favorable development of \$0.9 million for catastrophes) in 2006. Favorable catastrophe loss and LAE reserve development for the year ended December 31, 2007 is due primarily to favorable development from catastrophes which occurred in the second half of 2006 and Hurricane Rita which occurred in 2005. Catastrophe losses and LAE (excluding development) on homeowners insurance were \$35.5 million for the year ended December 31, 2007, compared to \$38.4 million for the same period in 2006. Favorable loss and LAE reserve development on other insurance was \$2.8 million for the year ended December 31, 2007, compared to \$4.4 million for the same period in 2006.

Insurance Expenses decreased by \$11.3 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to lower commissions due to the lower earned premiums, lower premium taxes and other licensing and regulatory fees and assessments, and lower other underwriting expenses.

Net Income in the Kemper segment decreased by \$28.9 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to the changes in Operating Profit. The Kemper segment's effective income tax rate differs from the federal statutory income tax rate due primarily to tax-exempt investment income and dividends received deductions. Tax-exempt investment income and dividends received deductions were \$26.0 million in 2007, compared to \$25.6 million in 2006.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****UNITRIN SPECIALTY**

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|----------------------------|-----------------|-------------|-------------|
| Earned Premiums: | | | |
| Personal Automobile | \$ 414.0 | \$ 343.3 | \$ 326.1 |
| Commercial Automobile | 80.0 | 106.0 | 118.3 |
| Total Earned Premiums | 494.0 | 449.3 | 444.4 |
| Net Investment Income | 8.6 | 19.2 | 22.4 |
| Other Income | 0.2 | 0.1 | |
| Total Revenues | 502.8 | 468.6 | 466.8 |
| Incurred Losses and LAE | 397.0 | 340.9 | 335.6 |
| Insurance Expenses | 95.6 | 92.4 | 92.0 |
| Operating Profit | 10.2 | 35.3 | 39.2 |
| Income Tax Expense | (0.1) | (8.3) | (9.9) |
| Net Income | \$ 10.1 | \$ 27.0 | \$ 29.3 |

RATIOS BASED ON EARNED PREMIUMS

| | | | |
|--|--------------|-------|-------|
| Incurred Loss and LAE Ratio (excluding Catastrophes) | 79.8% | 75.8% | 75.3% |
| Incurred Catastrophe Loss and LAE Ratio | 0.6 | 0.1 | 0.2 |
| Total Incurred Loss and LAE Ratio | 80.4 | 75.9 | 75.5 |
| Incurred Expense Ratio | 19.4 | 20.6 | 20.7 |
| Combined Ratio | 99.8% | 96.5% | 96.2% |

INSURANCE RESERVES

| <i>DOLLARS IN MILLIONS</i> | DEC. 31, 2008 | DEC. 31, 2007 |
|----------------------------|----------------------|----------------------|
| Insurance Reserves: | | |
| Personal Automobile | \$ 175.7 | \$ 146.9 |
| Commercial Automobile | 107.2 | 116.8 |
| Other | 10.2 | 14.9 |
| Total Insurance Reserves | \$ 293.1 | \$ 278.6 |
| Loss Reserves: | | |
| Case | \$ 179.6 | \$ 160.0 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | |
|---|-----------------|----------|
| Incurring but Not Reported | 76.3 | 77.5 |
| Total Loss Reserves | 255.9 | 237.5 |
| LAE Reserves | 37.2 | 41.1 |
| Total Insurance Reserves | \$ 293.1 | \$ 278.6 |
| For The Year Ended | | |
| Favorable Loss and LAE Reserve Development, Net | \$ 5.5 | \$ 15.3 |
| Loss and LAE Reserve Development as a Percentage of Insurance Reserves at Beginning of Year | 2.0% | 5.2% |

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****UNITRIN SPECIALTY (Continued)***2008 Compared with 2007*

Earned Premiums in the Unitrin Specialty segment increased by \$44.7 million for the year ended December 31, 2008, compared to the same period in 2007, due to higher earned premiums on personal automobile insurance, partially offset by lower earned premiums on commercial automobile insurance. Personal automobile insurance earned premiums increased by \$70.7 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to higher volume, partially offset by lower average earned premium rates. Personal automobile insurance volume increased due primarily to lower overall premium rates in the state of California. Commercial automobile insurance earned premiums decreased by \$26.0 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to lower volume resulting from increased competition. In the fourth quarter of 2008, Unitrin Specialty implemented in certain key states several initiatives targeted to stabilize commercial automobile premium volume, including introducing a new commercial insurance product for light commercial vehicles, lowering down payment requirements for certain commercial automobile insurance risks and introducing improved internet-enabled commercial lines rating technology. In 2009, Unitrin Specialty intends to implement these initiatives in the remaining states where it writes commercial automobile insurance.

Net Investment Income decreased by \$10.6 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to lower net investment income from certain investments in limited liability investment companies and limited partnerships which the Company accounts for under the equity method of accounting. The Unitrin Specialty segment reported net investment losses of \$7.9 million from these investments for the year ended December 31, 2008, compared to net investment income of \$1.0 million in 2007.

Operating Profit in the Unitrin Specialty segment decreased by \$25.1 million for the year ended December 31, 2008, compared to 2007, due primarily to higher incurred losses and LAE as a percentage of earned premiums in both personal automobile insurance and commercial automobile insurance and the lower Net Investment Income. Unitrin Specialty's incurred losses related to Hurricanes Dolly, Gustav and Ike were \$1.5 million. See MD&A, *Catastrophes*, for additional information on Hurricanes Dolly, Gustav and Ike and the Company's catastrophe reinsurance programs.

Personal automobile insurance incurred losses and LAE as a percentage of earned premiums increased due primarily to the significant growth in new personal automobile insurance volume in California and lower favorable loss and LAE reserve development (which recognizes changes in estimates of prior year loss and LAE reserves in the current period) for the year ended December 31, 2008, compared to the same period in 2007. Historically, incurred losses and LAE as a percentage of earned premiums for personal automobile insurance have been higher for new business than they have been for renewal business. As the newer California book of business matures, Unitrin Specialty anticipates that incurred losses and LAE as a percentage of earned premiums will decrease. Personal automobile insurance loss and LAE reserve development had a favorable effect of \$1.7 million in 2008, compared to a favorable effect of \$4.2 million in 2007. For the year ended December 31, 2008, commercial automobile insurance incurred losses and LAE as a percentage of earned premiums increased due primarily to lower favorable loss and LAE reserve development. Commercial automobile insurance loss and LAE reserve development had a favorable effect of \$1.3 million in 2008, compared to a favorable effect of \$10.1 million in 2007. Loss and LAE reserve development on certain reinsurance pools in run-off, included in other insurance, had a favorable effect of \$2.5 million for the year ended December 31, 2008, compared to a favorable effect of \$1.0 million for the same period in 2007. See MD&A, *Critical Accounting Estimates*, for additional information pertaining to the Company's process of estimating property and casualty insurance reserves for losses and LAE, development of property and casualty insurance losses and LAE and estimated variability of property and casualty insurance reserves for losses and LAE.

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

UNITRIN SPECIALTY (Continued)

Net Income in the Unitrin Specialty segment decreased by \$16.9 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to the lower Operating Profit. The Unitrin Specialty segment's effective tax rate differs from the statutory tax rate due primarily to tax-exempt investment income and dividends received deductions. Tax-exempt investment income and dividends received deductions were \$11.2 million for the year ended December 31, 2008, compared to \$11.4 million for the same period in 2007.

2007 Compared with 2006

Earned Premiums in the Unitrin Specialty segment increased by \$4.9 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to higher earned premiums on personal automobile insurance, partially offset by lower earned premiums on commercial automobile insurance. Personal automobile insurance earned premiums increased by \$17.2 million in 2007 due primarily to higher volume, partially offset, to a lesser extent, by lower average premium rates. Commercial automobile insurance earned premiums decreased by \$12.3 million in 2007, due to lower volume and lower average premium rates. Average premium rates for commercial automobile insurance decreased primarily due to a change in the mix of business from heavier weight class vehicles with higher limits of liability insurance to lighter weight vehicles with lower limits of liability insurance.

Net Investment Income decreased by \$3.2 million for the year ended December 31, 2007, compared to the same period in 2006, due to lower yields on investments, due in part to lower yields on investments in limited liability investment companies and limited partnerships, and lower levels of investments.

Operating Profit in the Unitrin Specialty segment decreased by \$3.9 million for the year ended December 31, 2007, compared to 2006, due primarily to higher personal automobile insurance incurred losses and LAE and the lower Net Investment Income, partially offset by lower incurred losses and LAE in both commercial automobile insurance and certain reinsurance pools that are in run-off.

Personal automobile insurance loss and LAE as a percentage of earned premiums increased for the year ended December 31, 2007, compared to the same period in 2006, due primarily to a higher frequency of claims and lower favorable loss reserve development. Personal automobile insurance loss and LAE reserve development had a favorable effect of \$4.2 million in 2007, compared to a favorable effect of \$6.7 million in 2006. Commercial automobile insurance incurred losses and LAE as a percentage of earned premiums decreased in 2007 due primarily to higher favorable loss and LAE reserve development and, to a lesser extent, the change in the mix of lighter weight and heavier weight commercial vehicles insured by the Unitrin Specialty segment. Commercial automobile insurance loss and LAE reserve development had a favorable effect of \$10.1 million in 2007, compared to a favorable effect of \$2.2 million in 2006. Loss and LAE reserve development on certain reinsurance pools in run-off, included in other insurance, had a favorable effect of \$1.0 million in 2007, compared to no reserve development in 2006.

Net Income in the Unitrin Specialty segment decreased by \$2.3 million for the year ended December 31, 2007, compared to the same period in 2006. The Unitrin Specialty segment's effective tax rate differs from the statutory tax rate due primarily to tax-exempt investment income and dividends received deductions. Tax-exempt investment income and dividends received deductions were \$11.4 million in both 2007 and 2006.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****UNITRIN DIRECT**

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|----------------------------|-----------|-----------|----------|
| Earned Premiums: | | | |
| Automobile | \$ 283.8 | \$ 254.6 | \$ 225.9 |
| Homeowners | 6.4 | 2.9 | |
| Other Personal | 0.3 | 0.1 | |
| Total Earned Premiums | 290.5 | 257.6 | 225.9 |
| Net Investment Income | 4.6 | 8.9 | 9.3 |
| Other Income | 0.4 | 0.4 | 0.4 |
| Total Revenues | 295.5 | 266.9 | 235.6 |
| Incurred Losses and LAE | 246.7 | 219.3 | 182.3 |
| Insurance Expenses | 101.3 | 88.8 | 63.1 |
| Operating Loss | (52.5) | (41.2) | (9.8) |
| Income Tax Benefit | 20.5 | 16.3 | 5.1 |
| Net Loss | \$ (32.0) | \$ (24.9) | \$ (4.7) |

RATIOS BASED ON EARNED PREMIUMS

| | | | |
|--|--------|--------|--------|
| Incurred Loss and LAE Ratio (excluding Catastrophes) | 83.8% | 84.9% | 80.2% |
| Incurred Catastrophe Loss and LAE Ratio | 1.1 | 0.2 | 0.5 |
| Total Incurred Loss and LAE Ratio | 84.9 | 85.1 | 80.7 |
| Incurred Expense Ratio | 34.9 | 34.5 | 27.9 |
| Combined Ratio | 119.8% | 119.6% | 108.6% |

INSURANCE RESERVES

| <i>DOLLARS IN MILLIONS</i> | DEC. 31, 2008 | DEC. 31, 2007 |
|----------------------------|---------------|---------------|
| Insurance Reserves: | | |
| Personal Automobile | \$ 159.3 | \$ 139.6 |
| Homeowners | 3.1 | 2.2 |
| Other | 0.7 | 0.8 |
| Total Insurance Reserves | \$ 163.1 | \$ 142.6 |
| Loss Reserves: | | |
| Case | \$ 97.9 | \$ 93.3 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | |
|---|----------|----------|
| Incurring but Not Reported | 37.5 | 23.4 |
| Total Loss Reserves | 135.4 | 116.7 |
| LAE Reserves | 27.7 | 25.9 |
| Total Insurance Reserves | \$ 163.1 | \$ 142.6 |
| For The Year Ended | | |
| Adverse Loss and LAE Reserve Development, Net | \$ (3.2) | \$ (5.5) |
| Loss and LAE Reserve Development as a Percentage of Insurance Reserves at Beginning of Year | (2.2)% | (5.1)% |

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****UNITRIN DIRECT (Continued)*****Overall Business Condition and Initiatives***

The Unitrin Direct segment reported Operating Losses of \$52.5 million and \$41.2 million for the years ended December 31, 2008 and 2007, respectively. The Operating Loss increased due primarily to higher volume of insurance in the underperforming Unitrin Direct stand-alone book of business, which excludes business from the Merastar acquisition, and lower Net Investment Income.

Loss and LAE as a percentage of Earned Premiums for the Unitrin Direct stand-alone book of business was significantly higher than that required to produce a profit in both 2008 and 2007. Loss and LAE as a percentage of earned premiums for the Merastar book of business were moderately higher than required to produce a profit in 2008. Direct marketing initiatives in 2007 and the first half of 2008 contributed to the Unitrin Direct segment's relatively higher Insurance Expenses as a percentage of Earned Premiums in 2008 and 2007, compared to the Kemper and Unitrin Specialty segments which market their insurance products through independent agents. Direct marketing, as compared to independent agency marketing, initially results in higher expenses as a percentage of earned premiums because up-front marketing costs, to the extent they are not deferrable, are expensed as incurred, generally prior to when premiums are written and subsequently earned. Written premiums are recognized as earned premiums over the terms of the respective policies; therefore, sales of policies resulting from marketing spending typically take several months to result in earned premiums. The Unitrin Direct segment's direct marketing initiatives were intended to accelerate the Unitrin Direct segment's growth to achieve greater scale and have resulted in higher written premiums and a higher number of policies in force. However, such initiatives also resulted in poorer insurance risk selection than anticipated.

The Unitrin Direct segment has implemented and is continuing to implement several initiatives to improve its operating results. During the second half of 2008, Unitrin Direct began to moderate its marketing spending while modifying its direct mail marketing program to target a better response rate and placing greater emphasis on improving Losses and LAE as a percentage of Earned Premiums through improved premium rate adequacy and improved insurance risk selection. The Unitrin Direct segment has implemented and continues to implement rate increases in most states. The Unitrin Direct segment plans to continue to further reduce its marketing spending in 2009 and, accordingly, expects earned premiums, excluding the impact of the Direct Response acquisition described below, to decline in 2009. Typically, incurred losses and LAE as a percentage of earned premiums for personal automobile insurance are higher for new business than they are for renewal business. As the Unitrin Direct stand-alone book of business matures, the Company also expects losses and LAE as a percentage of Earned Premiums for the renewal book of business to decrease. Unitrin Direct anticipates its marketing spending to decrease in the range of \$5 million to \$10 million in 2009 due to the moderation of its marketing efforts. The Unitrin Direct segment also continues to improve operating scale by consolidating redundant back office operations and reducing staffing due to the moderation of its marketing efforts.

On August 29, 2008, Unitrin's subsidiary, Trinity, entered into a definitive agreement to acquire Direct Response in a cash transaction initially valued at approximately \$220 million, subject to certain purchase price adjustments. Such purchase price adjustments are currently estimated to reduce the purchase price to approximately \$200 million. Except for one approval yet to be received from a state insurance regulator, the Company has received all federal and state regulatory approvals necessary to close the transaction. The Company anticipates closing the transaction in the first quarter of 2009, subject to timely approval by such insurance regulator and the satisfaction of other customary closing conditions. Direct Response specializes in the sale of personal automobile insurance through direct mail and the Internet through web insurance portals and its own websites, *response.com* and *teachers.com*. The results for Direct Response will be included in the Unitrin Direct business segment from the date of acquisition. Direct Response had earned premiums of approximately \$153 million for the year ended December 31, 2008. The Company intends to consolidate its back office operations with those of Direct Response to further improve Unitrin Direct's operating scale over time.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****UNITRIN DIRECT (Continued)**

While the Unitrin Direct segment anticipates that these initiatives, along with the acquisition of Direct Response, will significantly improve its operating results in 2009, given the level of improvement required to be profitable and the current economic conditions, the Company does not anticipate that Unitrin Direct will be profitable in 2009.

2008 Compared with 2007

Earned Premiums in the Unitrin Direct segment increased by \$32.9 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to the June 29, 2007 acquisition of Merastar and higher volume from direct marketing initiatives. Earned Premiums in the Unitrin Direct segment for the year ended December 31, 2008 included earned premiums of \$45.6 million from Merastar, compared to \$22.5 million for the year ended December 31, 2007. See Note 3, Acquisitions of Businesses, to the Consolidated Financial Statements for additional information pertaining to the acquisition of Merastar.

Net Investment Income decreased by \$4.3 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to lower net investment income from certain investments in limited liability investment companies and limited partnerships which the Company accounts for under the equity method of accounting, partially offset by higher levels of investments allocated to the Unitrin Direct segment, due in part to the acquisition of Merastar. The Unitrin Direct segment reported a net investment loss of \$4.4 million from these investments for the year ended December 31, 2008, compared to net investment income of \$0.5 million for the same period in 2007.

Losses and LAE as a percentage of earned premiums for Unitrin Direct's stand-alone book of business increased from 85.5% for the year ended December 31, 2007 to 86.7% for the year ended December 31, 2008 due primarily to increased severity of automobile liability insurance losses, inadequate rates and higher catastrophe losses and LAE, partially offset by the impact of lower adverse loss and LAE reserve development (which recognizes changes in estimates of prior year reserves in the current period). Losses and LAE as a percentage of earned premiums for the Merastar book of business decreased from 80.6% for the year ended December 31, 2007 to 75.4% for the year ended December 31, 2008 due primarily to higher favorable loss and LAE development, partially offset by higher catastrophe losses and LAE. Adverse loss and LAE reserve development for the Unitrin Direct stand-alone book of business was \$5.8 million for the year ended December 31, 2008, compared to adverse development of \$6.9 million for the same period in 2007. Favorable development for the Merastar book of business was \$2.6 million for the year ended December 31, 2008, compared to favorable development of \$1.4 million in the same period in 2007. See MD&A, Critical Accounting Estimates, for additional information pertaining to the Company's process of estimating property and casualty insurance reserves for losses and LAE, development of property and casualty insurance losses and LAE and estimated variability of property and casualty insurance reserves for losses and LAE. Catastrophe losses and LAE for the Unitrin Direct stand-alone business were \$1.3 million for the year ended December 31, 2008, compared to \$0.4 million for the same period in 2007. Catastrophe losses and LAE for the Merastar book of business were \$1.8 million for the year ended December 31, 2008, compared to \$0.2 million in the same period in 2007. The Unitrin Direct segment's total catastrophe losses and LAE related to Hurricanes Dolly, Gustav and Ike were \$0.5 million for the year ended December 31, 2008. See MD&A, Catastrophes, for additional information on Hurricanes Dolly, Gustav and Ike and the Company's catastrophe reinsurance programs.

Insurance Expenses increased by \$12.5 million in 2008 due primarily to the inclusion of a full year of expenses from the Merastar acquisition, costs associated with closing redundant back office operations and higher bad debt expense related to premium receivables.

Unitrin Direct reported a Net Loss of \$32.0 million for the year ended December 31, 2008, compared to a Net Loss of \$24.9 million for the same period in 2007. Unitrin Direct's effective income tax rate differs from the

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****UNITRIN DIRECT (Continued)**

federal statutory income tax rate due primarily to tax-exempt investment income and dividends received deductions. Tax-exempt investment income and dividends received deductions were \$6.1 million in 2008, compared to \$5.2 million in 2007.

2007 Compared with 2006

Earned Premiums in the Unitrin Direct segment increased by \$31.7 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to direct marketing initiatives implemented in 2007 and the acquisition of Merastar. Earned Premiums in the Unitrin Direct segment in 2007 include earned premiums of \$22.5 million from Merastar since the date of acquisition. Excluding the impact on Earned Premiums from the Merastar acquisition, Earned Premiums in the Unitrin Direct segment increased by \$9.2 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to higher volume resulting from the direct marketing initiatives.

The Unitrin Direct segment reported an Operating Loss of \$41.2 million for the year ended December 31, 2007, compared to an Operating Loss of \$9.8 million for the same period in 2006. Operating results decreased due primarily to higher incurred losses and LAE as a percentage of earned premiums and higher marketing and other policy acquisition expenses as a percentage of earned premiums. Results for the Unitrin Direct segment in 2007 also included an operating loss of \$1.4 million related to the Merastar acquisition. Losses and LAE as a percentage of earned premiums increased in the Unitrin Direct segment for the year ended December 31, 2007, compared to the same period in 2006, due primarily to inadequate rates and higher adverse loss and LAE development. Unitrin Direct recognized adverse loss and LAE reserve development of \$5.5 million in 2007, compared to an adverse development of \$4.5 million in 2006. Marketing and other policy acquisition expenses as a percentage of earned premiums, excluding Merastar, increased from 10.6% for the year ended December 31, 2006 to 14.8% for the same period in 2007 due primarily to increased spending on direct mail, web, and television advertising. Insurance expenses also increased due primarily to additional staffing to support the higher number of policies in force.

Unitrin Direct reported a Net Loss of \$24.9 million for the year ended December 31, 2007, compared to a Net Loss of \$4.7 million for the year ended December 31, 2006. Unitrin Direct's effective income tax rate differs from the federal statutory income tax rate due primarily to tax-exempt investment income and dividends received deductions. Tax-exempt investment income and dividends received deductions were \$5.2 million in 2007, compared to \$4.7 million in 2006.

LIFE AND HEALTH INSURANCE

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|---|-----------------|-------------|-------------|
| Earned Premiums: | | | |
| Life | \$ 398.5 | \$ 387.8 | \$ 400.7 |
| Accident and Health | 160.1 | 157.9 | 158.3 |
| Property | 102.8 | 108.0 | 116.6 |
| Total Earned Premiums | 661.4 | 653.7 | 675.6 |
| Net Investment Income | 162.1 | 181.0 | 181.3 |
| Other Income | 1.1 | 1.2 | 11.2 |
| Total Revenues | 824.6 | 835.9 | 868.1 |
| Policyholders' Benefits and Incurred Losses and LAE | 447.7 | 393.9 | 404.5 |
| Insurance Expenses | 297.6 | 291.4 | 308.2 |
| Operating Profit | 79.3 | 150.6 | 155.4 |
| Income Tax Expense | (27.5) | (53.6) | (53.9) |

| | | | |
|------------|---------|---------|----------|
| Net Income | \$ 51.8 | \$ 97.0 | \$ 101.5 |
|------------|---------|---------|----------|

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****LIFE AND HEALTH INSURANCE (Continued)****INSURANCE RESERVES**

| <i>DOLLARS IN MILLIONS</i> | DEC. 31, 2008 | DEC. 31, 2007 |
|--------------------------------|----------------------|----------------------|
| Insurance Reserves: | | |
| Future Policyholder Benefits | \$ 2,912.5 | \$ 2,471.5 |
| Incurring Losses and LAE: | | |
| Life | 36.6 | 37.9 |
| Accident and Health | 23.6 | 23.5 |
| Property | 23.0 | 11.4 |
| Total Incurring Losses and LAE | 83.2 | 72.8 |
| Total Insurance Reserves | \$ 2,995.7 | \$ 2,544.3 |

2008 Compared with 2007

On April 1, 2008, Unitrin completed its previously announced acquisition of Primesco in a cash merger transaction valued at \$95.5 million, including transaction costs of \$0.2 million. Primesco's wholly-owned subsidiaries, Mutual Savings Life and Mutual Savings Fire, specialize in the sale of life, health and fire insurance products to persons of modest financial means in Alabama, Georgia, Mississippi and several other states in the Southeast. Results for Primesco and its subsidiaries are included in the Company's results of operations from the date of acquisition. See Note 3, Acquisition of Businesses, to the Consolidated Financial Statements for additional information pertaining to the acquisition of Primesco.

Earned Premiums in the Life and Health Insurance segment increased by \$7.7 million for the year ended December 31, 2008, compared to the same period in 2007. Earned Premiums in the Life and Health Insurance segment for the year ended December 31, 2008, included earned premiums of \$37.4 million resulting from the Primesco acquisition, of which \$29.3 million was from life insurance, \$5.4 million was from accident and health insurance and \$2.7 million was from property insurance.

Excluding the impact of the Primesco acquisition, Earned Premiums in the Life and Health Insurance segment decreased by \$29.7 million for the year ended December 31, 2008, compared to the same period in 2007. Earned premiums on life insurance decreased by \$18.6 million for the year ended December 31, 2008 due primarily to lower volume. Earned premiums on accident and health insurance decreased by \$3.2 million for the year December 31, 2008, as the volume of limited benefit medical and Medicare supplement products declined by \$8.2 million, while higher average premium rates for those same products increased earned premiums by \$5.0 million. Earned premiums on property insurance sold by the Life and Health Insurance segment's career agents decreased by \$7.9 million for the year ended December 31, 2008 due primarily to lower volume, due in part to the Company's strategy to reduce coastal exposures, and higher catastrophe reinsurance premiums. Catastrophe reinsurance premiums, which reduce the Life and Health Insurance segment's earned premiums on property insurance, included a reinsurance premium of \$4.4 million in 2008 to reinstate catastrophe reinsurance coverage following Hurricanes Dolly, Gustav and Ike. See MD&A,

Catastrophes, for additional information on Hurricanes Dolly, Gustav and Ike and the Company's catastrophe reinsurance programs. Excluding the impact of the reinsurance reinstatement premium, catastrophe reinsurance premiums decreased by \$2.7 million due primarily to the Company's strategy to reduce coastal exposures.

The Life and Health Insurance segment's property insurance products provide fire and allied lines coverage for modest value dwellings and personal property. Dwelling coverage represents approximately 43% of the segment's property insurance premiums. In January 2006, the Life and Health Insurance segment halted new sales of dwelling coverage in coastal areas. In the third quarter of 2007, the Life and Health Insurance segment

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****LIFE AND HEALTH INSURANCE (Continued)**

non-renewed dwelling coverage in certain coastal areas of the Gulf and southeastern United States. In the fourth quarter of 2008, the Life and Health Insurance segment halted new sales of dwelling coverage in all markets. The Life and Health Insurance segment believes that these actions have reduced its exposure to catastrophe risks and will continue to reduce its exposure to catastrophe risks over time. The Life and Health Insurance segment is also considering other actions to significantly reduce its exposure to catastrophe risks.

Net Investment Income decreased by \$18.9 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to lower net investment income from investments in limited liability investment companies and limited partnerships which the Company accounts for under the equity method of accounting, partially offset by \$16.6 million of net investment income from Primesco since the date of the acquisition. The Life and Health Insurance segment reported net investment losses of \$38.3 million from these investments in limited liability investment companies and limited partnerships for the year ended December 31, 2008, compared to net investment income of \$1.5 million for the same period in 2007.

Operating Profit in the Life and Health Insurance segment decreased by \$71.3 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to higher catastrophe losses and LAE, net of reinsurance, on property insurance sold by the Life and Health Insurance segment's career agents, the lower Net Investment Income and higher policyholders' benefits as a percentage of earned premiums on life insurance and accident and health insurance, partially offset by operating profit from the Primesco acquisition. Operating Profit in the Life and Health Insurance segment included \$7.9 million of operating profit for the year ended December 31, 2008 from the Primesco acquisition.

Catastrophe losses and LAE (including development), net of reinsurance, on property insurance were \$41.5 million for the year ended December 31, 2008, compared to \$10.5 million for the same period in 2007. Catastrophe losses and LAE for the year ended December 31, 2008 included \$22.8 million, net of reinsurance, from Hurricanes Dolly, Gustav and Ike. Catastrophe losses for the year ended December 31, 2008 also included unfavorable development of \$11.0 million due primarily to additional losses related to certain re-opened claims from Hurricane Rita. Catastrophe losses and LAE for the year ended December 31, 2007 included unfavorable development of \$6.9 million, due primarily to development on Hurricanes Katrina and Rita. The Life and Health Insurance segment has a number of pending legal matters related to Hurricane Rita and could continue to report either favorable or unfavorable development in future periods depending on the resolution of these matters.

Excluding the increase in catastrophe losses and LAE, Policyholders' Benefits and Incurred Losses and LAE increased in total for the year ended December 31, 2008, compared to the same period in 2007, due primarily to the inclusion of Primesco in 2008 and increased as a percentage of earned premiums due primarily to higher policyholders' benefits on life insurance as a percentage of earned premiums, due in part to an increase in mortality, and higher Accident and Health benefits as a percentage of earned premiums on accident and health insurance due to an increase in reported claims. Policyholders' Benefits and Incurred Losses and LAE from the Primesco acquisition were \$25.3 million for the year ended December 31, 2008.

Insurance Expenses increased by \$6.2 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to the inclusion of Primesco in 2008, partially offset by lower commission and other expenses. Insurance Expenses from the Primesco acquisition were \$20.7 million for the year ended December 31, 2008. Excluding the impact of the Primesco acquisition, commission expense decreased by \$11.1 million in 2008 due primarily to fewer career agents and the lower volume of insurance in-force.

Net Income in the Life and Health Insurance segment decreased by \$45.2 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to the lower Operating Profit.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****LIFE AND HEALTH INSURANCE (Continued)**

Future Policyholder Benefit reserves increased by \$441.0 million due primarily to the addition of insurance reserves related to the Primesco acquisition. Property Insurance reserves increased by \$11.6 million due primarily to reserves related to Hurricanes Dolly, Gustav and Ike.

2007 Compared with 2006

Earned Premiums in the Life and Health Insurance segment decreased by \$21.9 million for the year ended December 31, 2007, compared to the same period in 2006. Earned premiums on life insurance decreased by \$12.9 million due primarily to lower volume. Earned premiums on property insurance sold by the Life and Health Insurance segment's career agents decreased by \$8.6 million due primarily to lower volume related to the Company's strategy to reduce coastal exposures and, to a lesser extent, an increase in the cost of catastrophe reinsurance. In the third quarter of 2007, the Life and Health Insurance segment non-renewed and suspended sales of its dwelling insurance policies in certain coastal areas of the Gulf and southeastern United States. The cost of catastrophe reinsurance coverage was \$8.5 million for the year ended December 31, 2007, compared to \$6.1 million for the same period in 2006 (see MD&A, "Catastrophes").

In the fourth quarter of 2006, Reserve National entered into a reinsurance agreement whereby Reserve National assumed 100% of certain accident and health insurance business from a third party. The Life and Health Insurance segment reported earned premiums related to this reinsurance agreement of \$4.0 million for the year ended December 31, 2007. Excluding the impact of the reinsurance agreement, earned premiums on accident and health insurance decreased by \$4.4 million for the year ended December 31, 2007, compared to the same period in 2006, as lower volume of accident and health insurance, primarily limited benefit medical and Medicare supplement products, contributed \$10.5 million to the decrease in accident and health insurance earned premiums, while higher average premium rates on those same products accounted for an increase of \$6.1 million.

Net Investment Income decreased by \$0.3 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to lower yields on investments in limited liability investment companies and limited partnerships, partially offset by higher yields on investments in fixed maturities and equity securities and higher levels of investments. The Life and Health Insurance segment reported net investment income of \$1.5 million from its investments in limited liability investment companies and limited partnerships for the year ended December 31, 2007, compared to net investment income of \$12.5 million for the same period in 2006. Yields on equity securities in 2007 included a special \$5.2 million dividend on the Company's investment in IRI. Net Investment Income in 2006 did not include a corresponding dividend from the Company's investment in IRI.

Other Income decreased by \$10.0 million for the year ended December 31, 2007, compared to the same period in 2006. Other Income in 2006 included a gain of \$9.6 million, net of an initial deferred gain of \$2.6 million, recognized on the sale and leaseback of Reserve National's home office building. The deferred gain is being amortized over the 36-month term of the leaseback. Amortization of the deferred gain included in Other Income was \$0.8 million and \$0.4 million in 2007 and 2006, respectively. Other Income in 2006 also included a gain of \$1.0 million recognized on the sale of the Career Agency Companies' Louisiana office building.

Operating Profit in the Life and Health Insurance segment decreased by \$4.8 million for the year ended December 31, 2007, compared to the same period in 2006, due to the lower Other Income, partially offset by lower Insurance Expenses and lower Policyholders' Benefits and Incurred Losses and LAE.

Insurance Expenses decreased by \$16.8 million and also decreased as a percentage of earned premiums for the year ended December 31, 2007, compared to the same period in 2006, due primarily to lower commission expense and, to a lesser extent, lower administrative expenses. Commission expense was lower due primarily to lower volume, fewer active career agents, the continuing effects of changes in the Life and Health Insurance

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****LIFE AND HEALTH INSURANCE (Continued)**

segment's compensation plans and lower amortization of deferred policy acquisition costs, partially offset by the initial favorable impact in 2006 of the changes in the Life and Health Insurance segment's compensation plans.

Policyholders' Benefits and Incurred Losses and LAE declined for the year December 31, 2007, compared to the same period in 2006, due primarily to lower policyholders' benefits on life insurance, partially offset by higher incurred losses on property insurance sold by the Life and Health Insurance segment's career agents. Life insurance benefits decreased due primarily to improved mortality and a higher level of policy lapses in 2007. Incurred losses on property insurance increased due primarily to higher weather-related losses in 2007, compared to the same period in 2006, from events that were not severe enough to be classified as catastrophes by ISO.

Catastrophe losses and LAE (including development), net of reinsurance recoveries, on property insurance sold by the Life and Health Insurance segment's career agents were \$10.5 million and \$10.8 million in 2007 and 2006, respectively (see MD&A, "Catastrophes"). Catastrophe losses and LAE for the year ended December 31, 2007 included adverse development of \$4.2 million on Hurricane Rita related to the Company's estimate of the cost to settle certain legal matters that are not recoverable from reinsurance. Catastrophe losses and LAE for the years ended December 31, 2007 and 2006 included adverse development of \$1.8 million and \$4.4 million, net of reinsurance, respectively, on Hurricane Katrina.

Net Income in the Life and Health Insurance segment decreased by \$4.5 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to the lower Operating Profit.

FIRESIDE BANK

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|--|------------------|-------------|-------------|
| Interest, Loan Fees and Earned Discounts | \$ 237.4 | \$ 251.2 | \$ 237.3 |
| Other Automobile Finance Revenues | 4.9 | 9.0 | 7.7 |
| Total Automobile Finance Revenues | 242.3 | 260.2 | 245.0 |
| Net Investment Income | 4.5 | 4.9 | 3.9 |
| Total Revenues | 246.8 | 265.1 | 248.9 |
| Provision for Loan Losses | 110.0 | 166.8 | 62.4 |
| Interest Expense on Certificates of Deposits | 58.7 | 58.7 | 49.8 |
| General and Administrative Expenses | 94.2 | 105.6 | 91.9 |
| Write Off of Goodwill | 9.2 | | |
| Operating Profit (Loss) | (25.3) | (66.0) | 44.8 |
| Income Tax Benefit (Expense) | 3.0 | 27.2 | (18.7) |
| Net Income (Loss) | \$ (22.3) | \$ (38.8) | \$ 26.1 |
| Automobile Loan Originations | \$ 546.1 | \$ 793.3 | \$ 806.9 |
| Weighted-Average Yield on Certificates of Deposits - End of Year | 4.8% | 4.9% | |

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****FIRESIDE BANK (Continued)****AUTOMOBILE LOAN RECEIVABLES**

| <i>DOLLARS IN MILLIONS</i> | DEC. 31, 2008 | DEC. 31, 2007 |
|---|---------------|---------------|
| Sales Contracts and Loans Receivable | \$ 1,213.1 | \$ 1,390.8 |
| Unearned Discounts and Deferred Fees | (14.4) | (28.9) |
| Net Automobile Loan Receivables Outstanding | 1,198.7 | 1,361.9 |
| Reserve for Loan Losses | (120.1) | (148.4) |
| Automobile Loan Receivables | \$ 1,078.6 | \$ 1,213.5 |
| Percentage of Net Automobile Loan Receivables Outstanding: | | |
| Current Loan Balances | 61.6% | 61.2% |
| Delinquent Loan Balances: | | |
| Less than 30 Days Delinquent | 26.1 | 26.2 |
| 30 Days to 59 Days Delinquent | 8.6 | 8.1 |
| 60 Days to 89 Days Delinquent | 2.7 | 3.4 |
| Delinquent 90 Days and Greater | 1.0 | 1.1 |
| Total Delinquent Loan Balances | 38.4% | 38.8% |
| Ratio of Reserve for Loan Losses to Net Automobile Loan Receivables Outstanding | 10.0% | 10.9% |

RESERVE FOR LOAN LOSSES

| <i>DOLLARS IN MILLIONS</i> | YEAR ENDED DEC. 31, | |
|---|---------------------|----------|
| | 2008 | 2007 |
| Reserve for Loan Losses Beginning of Year | \$ 148.4 | \$ 68.8 |
| Provision for Loan Losses | 110.0 | 166.8 |
| Net Charge-off: | | |
| Automobile Loan Receivables Charged Off | (182.9) | (139.4) |
| Automobile Loan Receivables Recovered | 44.6 | 52.2 |
| Net Charge-off | (138.3) | (87.2) |
| Reserve for Loan Losses End of Year | \$ 120.1 | \$ 148.4 |

2008 Compared with 2007

The Fireside Bank segment reported an Operating Loss of \$25.3 million in 2008, compared to an Operating Loss of \$66.0 million in 2007. Automobile Finance Revenues decreased by \$17.9 million for the year ended December 31, 2008 compared the same period in 2007. The Provision for Loan Losses was \$110.0 million in 2008, compared to \$166.8 million in 2007. General and Administrative Expenses decreased by

Edgar Filing: UNITRIN INC - Form 10-K

\$11.4 million in 2008, compared to 2007. Operating Loss in 2008 included a charge of \$9.2 million to write off goodwill (see Note 7, Goodwill, to the Consolidated Financial Statements).

Interest, Loan Fees and Earned Discounts in the Fireside Bank segment decreased by \$13.8 million for the year ended December 31, 2008, compared to the same period in 2007, due to both lower average loans outstanding and lower average yield on the loans outstanding. The yield on loans outstanding was 18.11% at December 31, 2008, compared to 18.66% at December 31, 2007. Fireside Bank only makes loans that are

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

FIRESIDE BANK (Continued)

secured by automobiles. Fireside Bank has no loans outstanding that are secured by real estate. Fireside Bank does not sell or securitize any portion of its loan portfolio.

The Provision of Loan Losses for the year ended December 31, 2008 included \$77.7 million for loans originated in 2008 and a \$32.3 million increase in the Bank's estimated loss expectations for loans originated in previous years. The additions to the estimated loss expectations were primarily for loans originated in 2007 and 2006 and were caused primarily by a higher level of gross charge-off and lower recovery rates due to higher levels of unemployment, lower auction prices on repossessed vehicles and negative general economic conditions. Approximately 65% of Net Automobile Loan Receivables are concentrated in the state of California. Fireside Bank's estimated loss expectations for automobile loans originated in 2008 are lower than its current estimated loss expectations for loans originated in 2007 due in large part to the implementation of an improved risk-based-pricing and credit-scoring model in early 2008 to aid in the underwriting process. The implementation of this model resulted in the prospective elimination of certain unprofitable segments of business written in prior years. The segments of business eliminated represent in excess of 25% of the loans originated by Fireside Bank in 2007.

Automobile Loan Originations declined from \$793.3 million in 2007 to \$546.1 million in 2008, due primarily to the segments of business eliminated and an overall decrease in automobile sales, partially offset by the effects of decreased competition. Fireside Bank has implemented and continues to implement a number of initiatives that it expects to improve its performance. In the second and third quarters of 2008, Fireside Bank implemented two proprietary scorecards. Additionally in the third quarter of 2008 Fireside Bank tightened the underwriting criteria for certain borrowers who have limited credit history. Fireside Bank anticipates Automobile Loan Originations will continue to decline in 2009 due to the overall decrease in the automobile market and the segments of business eliminated.

Effective July 1, 2008, Fireside Bank ceased the loan payment deferral program that it had begun in the fourth quarter of 2007. Under the former program, qualifying customers were allowed to move delinquent payments to the end of the loan. Loan deferrals were only available once in a twelve-month period and twice during the life of a loan and only to customers that had demonstrated a renewed ability to make their loan payments by either making three consecutive loan payments or the equivalent of three payments. Customer accounts with loan deferrals represented less than 1% of Net Automobile Loan Receivables Due at December 31, 2008.

General and Administrative costs, as a percentage of Interest, Loan Fees and Earned Discounts, decreased from 42.0% for the year ended December 31, 2007, to 39.6% for the year ended December 31, 2008. This decrease was primarily due to the consolidation of branch operations from 33 branches at December 31, 2007 to 9 branches at December 31, 2008, and the centralization of collection operations into two call centers. Fireside Bank incurred \$5.5 million and \$1.9 million of restructuring charges related to the consolidation of branches and centralization of collections for the years ended December 31, 2008 and 2007 respectively. General and Administrative Expenses, excluding these restructuring charges, as a percentage of Interest, Loan Fees and Earned Discounts, decreased from 41.3% for the year ended December 31, 2007, to 37.3% for the year ended December 31, 2008. General and Administrative costs, as a percentage of Interest, Loan Fees and Earned Discounts are anticipated to increase in 2009 due primarily to the lower Net Automobile Loan Receivables Due.

Net Loss in the Consumer Finance segment declined from \$38.8 million in 2007 to \$22.3 million in 2008 due to the reduced operating loss. The Consumer Finance segment's effective tax rate differs from the Federal statutory tax rate due primarily to state income taxes and the charge to write off goodwill.

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

FIRESIDE BANK (Continued)

2007 Compared with 2006

Interest, Loan Fees and Earned Discounts in the Fireside Bank segment increased by \$13.9 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to higher levels of loans outstanding, partially offset by lower yield.

The Provision for Loan Losses increased by \$104.4 million for the year ended December 31, 2007, compared to the same period in 2006, due to higher net charge-off and an increase in the estimate of loan losses from prior years. The Provision for Loan Losses increased due to increased loss expectations driven by an increase in the amount of Automobile Loan Receivables charged off, a reduction in Automobile Loan Receivables Recovered as a percentage of Automobile Loan Receivables Charged Off, leading trends in the macroeconomic environment and, to a lesser extent, an increase in the level of Net Automobile Loan Receivables outstanding.

Interest Expense on Certificates of Deposits increased by \$8.9 million for the year ended December 31, 2007 compared to the same period in 2006 due to higher interest rates on Certificates of Deposits and higher levels of deposits.

General and Administrative Expenses, as a percentage of Interest, Loan Fees and Earned Discounts, increased from 38.7% for the year ended December 31, 2006, to 42.0% for the year ended December 31, 2007, due primarily to an increase in the number of collectors and higher related collection costs in 2007.

Operating results in the Fireside Bank segment decreased by \$110.8 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to the higher provision for loan losses.

Fireside Bank reported a Net Loss of \$38.8 million for the year ended December 31, 2007, compared to Net Income of \$26.1 million in 2006 due to the lower operating results. Fireside Bank's effective tax rate differs from the Federal statutory tax rate due primarily to state income taxes. State income taxes were a benefit of \$6.7 million in 2007, compared to expense of \$4.6 million in 2006.

INVESTMENT RESULTS

Net Investment Income was \$212.9 million, \$289.9 million and \$286.0 million for the years ended December 31, 2008, 2007 and 2006, respectively. Net Investment Income decreased by \$77.0 million in 2008, compared to 2007, due primarily to lower net investment income from certain investments in limited liability investment companies and limited partnerships which the Company accounts for under the equity method of accounting, lower short-term investment income and lower dividend income from Northrop and IRI, partially offset by higher investment income related to the acquisitions of businesses. Net Investment Income increased by \$3.9 million in 2007, compared to 2006, due primarily to higher dividend income from the Company's investments in Northrop preferred and common stock and IRI common stock and higher levels of investments, partially offset by lower net investment income from investments in limited liability investment companies and limited partnerships. The Company reported net investment losses of \$76.3 million from investments in limited liability investment companies and limited partnerships for the year ended December 31, 2008, compared to net investment income of \$6.7 million for the same period in 2007. Investment income from limited liability investment companies and limited partnerships decreased in 2008, compared to 2007, due primarily to the Company's pro rata share of unrealized losses from investments recognized in operations by certain of the limited liability investment companies and limited partnerships. The Company reported net investment income of \$6.7 million from investments in limited liability investment companies and limited partnerships for the year ended December 31, 2007, compared to net investment income of \$24.8 million for the same period in 2006. Investment income from limited liability investment companies and limited partnerships decreased in 2007,

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

INVESTMENT RESULTS (Continued)

compared to 2006, due primarily to the Company's pro rata share of unrealized losses from investments recognized in operations by certain of the limited liability investment companies and limited partnerships. Dividend income from the Company's investments in Northrop preferred and common stock decreased by \$14.2 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to the conversion of the higher yielding Northrop preferred stock into Northrop common stock during 2008 and to a lesser extent the sales of the Northrop common stock throughout the year and the timing of the Northrop preferred stock ex-dividend dates in 2007. Dividend income from the Company's investment in Northrop preferred stock increased by \$6.2 million for year ended December 31, 2007, compared to the same period in 2006, due to the timing of ex-dividend dates. Dividend income from other equity securities increased by \$6.8 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to a special dividend of \$5.2 million from the Company's equity investment in IRI. The Company cannot anticipate when or if similar dividends from its equity investments in IRI may occur in the future. Short-term investment income increased by \$6.8 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to higher levels of short-term investments. The Company invested the proceeds from the issuance of its 6.00% senior notes in short-term investments until the principal on its 5.75% senior notes was repaid in the third quarter of 2007 (see Note 9, Notes Payable, to the Consolidated Financial Statements).

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****INVESTMENT RESULTS (Continued)**

Net Comprehensive Investment Gains (Losses) are comprised of realized investment gains and losses reported in the Statement of Operations and unrealized investment gains and losses that are not reported in the Statement of Operations, but rather are reported in the Statement of Comprehensive Income (Loss). The components of Net Comprehensive Investment Gains (Losses) for the years ended December 31, 2008, 2007 and 2006 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|--|---------|--------|--------|
| Fixed Maturities: | | | |
| Recognized in Statement of Operations: | | | |
| Gains on Dispositions | \$ 4.8 | \$ 5.1 | \$ 5.0 |
| Losses on Dispositions | (6.8) | (4.0) | (4.4) |
| Losses from Write-downs | (65.9) | (10.4) | |
| Total Recognized in Statement of Operations | (67.9) | (9.3) | 0.6 |
| Recognized in Other Comprehensive Income (Loss) | (117.7) | 26.5 | (45.3) |
| Total Comprehensive Investment Gains (Losses) on Fixed Maturities | (185.6) | 17.2 | (44.7) |
| Northrop Preferred and Common Stock: | | | |
| Recognized in Statement of Operations: | | | |
| Gains on Dispositions | 53.1 | 58.6 | 5.6 |
| Losses on Dispositions | (13.1) | | |
| Total Recognized in Statement of Operations | 40.0 | 58.6 | 5.6 |
| Recognized in Other Comprehensive Income (Loss) | (281.3) | 43.0 | 61.8 |
| Total Comprehensive Investment Gains (Losses) on Northrop Preferred and Common Stock | (241.3) | 101.6 | 67.4 |
| Other Equity Securities: | | | |
| Recognized in Statement of Operations: | | | |
| Gains on Dispositions | 67.9 | 30.6 | 23.2 |
| Losses on Dispositions | (46.1) | (5.1) | (1.1) |
| Losses from Write-downs | (83.3) | (22.6) | (2.8) |
| Total Recognized in Statement of Operations | (61.5) | 2.9 | 19.3 |
| Recognized in Other Comprehensive Income (Loss) | (196.6) | (0.3) | 51.8 |
| Total Comprehensive Investment Gains (Losses) on Other Equity Securities | (258.1) | 2.6 | 71.1 |
| Real Estate: | | | |
| Recognized in Statement of Operations: | | | |
| Gains on Dispositions | 1.5 | 4.8 | 0.9 |
| Losses from Write-downs | | | (0.1) |
| Total Recognized in Statement of Operations | 1.5 | 4.8 | 0.8 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | |
|--|-------------------|----------|---------|
| Other Investments: | | | |
| Recognized in Statement of Operations: | | | |
| Gains on Dispositions | 0.1 | 1.2 | |
| Losses on Dispositions | (0.2) | (0.2) | (0.2) |
| Losses from Write-downs | (3.7) | | |
| Trading Securities Net Gains (Losses) | (2.0) | 0.5 | 0.4 |
| Total Recognized in Statement of Operations | (5.8) | 1.5 | 0.2 |
| Southern States: | | | |
| Gain on Disposition of Southern States Recognized in Statement of Operations | | 4.0 | |
| Total Comprehensive Investment Gains (Losses) | \$ (689.3) | \$ 131.7 | \$ 94.8 |
| Recognized in Statement of Operations | \$ (93.7) | \$ 62.5 | \$ 26.5 |
| Recognized in Other Comprehensive Income (Loss) | (595.6) | 69.2 | 68.3 |
| Total Comprehensive Investment Gains (Losses) | \$ (689.3) | \$ 131.7 | \$ 94.8 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****INVESTMENT RESULTS (Continued)**

Total Comprehensive Investment Gains (Losses) for the year ended December 31, 2008 included unrealized losses of \$593.6 million before tax and foreign currency translation adjustments on investments of \$2.0 million before tax. The unrealized losses on Northrop Preferred and Common Stock and Other Equity Securities were due primarily to the overall decline in the stock market in the fourth quarter of 2008. Total Comprehensive Investment Gains (Losses) for the year ended December 31, 2008 include realized gains on dispositions of \$127.4 million and realized losses on dispositions of \$66.2 million.

During the first nine months of 2008, the Company sold 2,713,800 shares of Northrop common stock at a realized gain of \$47.5 million and sold investments in other preferred and common stocks at a net realized gain of \$18.4 million, which included a realized gain of \$13.6 million from sales of the Company's investment in Baker Hughes, Inc. common shares. In the fourth quarter of 2008, the Company sold an additional 5,315,107 shares of Northrop common stock at a net realized loss of \$7.5 million and most of its investments in other common stocks at a net realized gain of \$3.4 million to limit its continued exposure to further declines in the stock market.

The Company regularly reviews its investment portfolio for factors that may indicate that a decline in the fair value of an investment is other than temporary. Losses arising from other than temporary declines in fair value are reported in the Consolidated Statements of Operations in the period that the decline was determined to be other than temporary. Total Comprehensive Investment Gains (Losses) for the years ended December 31, 2008, 2007 and 2006, include losses recognized in the Statement of Operations of \$152.9 million, \$33.0 million and \$2.8 million, respectively, from other than temporary declines in the fair values of investments. Pretax losses from write-downs of fixed maturities for the year ended December 31, 2008 included a pretax loss of \$33.5 million related to a single issuer that had previously defaulted and subsequently recapitalized. Pretax losses from write-downs of fixed maturities for the year ended December 31, 2007, included a pretax loss of \$8.3 million related to the same issuer. In addition, pretax losses from write-downs of fixed maturities for the year ended December 31, 2008 included a loss of \$18.8 million for another issuer that required recapitalization due to deteriorating economic conditions in the mobile home industry. Pretax losses from write-downs of other equity securities for the year ended December 31, 2008 included pretax losses of \$35.6 million as a result of the U.S. Government placing Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) into conservatorship and their deteriorating financial condition. Given the market conditions at the end of the third quarter of 2008, the Company concluded that it no longer had the intent at September 30, 2008 to hold certain common stocks until recovery and, accordingly, wrote down these common stocks by \$12.5 million in the third quarter of 2008. Additional pretax losses from write-downs of other equity securities for the year ended December 31, 2008 were primarily due to the deteriorating financial conditions of issuers in the financial services industry. Pretax losses from write-downs of other equity securities for the year ended December 31, 2007 were precipitated in part to the overall decline in the stock market in the second half of 2007. The Company wrote down the value of various holdings of equity securities. The Company cannot anticipate when or if similar investment losses may occur in the future.

On July 9, 2007, Republic Companies purchased Southern States General Agency, Inc. (Southern States), a subsidiary of Unitrin, from the Company. Net Realized Investment Gains for the year ended December 31, 2007, includes a pretax gain of \$4.0 million for the year ended December 31, 2007 resulting from this sale.

INVESTMENT QUALITY AND CONCENTRATIONS

The Company's fixed maturity investment portfolio is comprised primarily of high-grade municipal, corporate and agency bonds. At December 31, 2008, nearly 95% of the Company's fixed maturity investment portfolio was rated investment grade, which is defined as a security having a rating of AAA, AA, A or BBB from Standard &

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****INVESTMENT QUALITY AND CONCENTRATIONS (Continued)**

Poor's; a rating of Aaa, Aa, A or Baa from Moody's; or a rating from the NAIC of 1 or 2. The Company has not made significant investments in securities that are directly or indirectly related to sub-prime mortgage loans including, but not limited to, collateralized debt obligations and structured investment vehicles.

The following table summarizes the credit quality of the fixed maturity investment portfolio at December 31, 2008 and 2007:

| NAIC Rating | Standard & Poor's Equivalent Rating | 2008 | | 2007 | |
|---------------------------------------|-------------------------------------|------------------------|---------------------|------------------------|---------------------|
| | | Fair Value in Millions | Percentage of Total | Fair Value in Millions | Percentage of Total |
| 1 | AAA, AA, A | \$ 3,464.5 | 83.7% | \$ 3,339.1 | 90.6% |
| 2 | BBB | 449.5 | 10.9 | 220.8 | 6.0 |
| 3 | BB | 89.3 | 2.2 | 26.2 | 0.7 |
| 4 | B | 42.9 | 1.0 | 7.7 | 0.2 |
| 5 | CCC | 76.9 | 1.9 | 49.2 | 1.3 |
| 6 | In or Near Default | 12.8 | 0.3 | 43.7 | 1.2 |
| Total Investments in Fixed Maturities | | \$ 4,135.9 | 100.0% | \$ 3,686.7 | 100.0% |

Gross unrealized losses on the Company's investments in below-investment grade fixed maturities were \$33.4 million and \$1.3 million at December 31, 2008 and 2007, respectively. At December 31, 2008, the Company had \$1,308.5 million of investments in municipal bonds, of which \$591.4 million were enhanced with insurance from monoline bond insurers. The Company's municipal bond investment credit-risk strategy is to focus on the underlying credit rating of the issuer and not to rely upon the credit enhancement provided by the monoline bond insurer when making investment decisions. To that end, the average underlying rating of the Company's entire municipal bond portfolio is AA, the majority of which are direct obligations of a state.

The following table summarizes the credit enhanced ratings and underlying ratings of the Company's investments in obligations of states, municipalities and political subdivisions, which are included in the preceding table of the credit quality of the Company's entire portfolio of investments in fixed maturities, at December 31, 2008:

| Standard & Poor's Equivalent Rating | Credit Enhanced Rating | | Underlying Rating | |
|---|------------------------|---------------------|------------------------|---------------------|
| | Fair Value in Millions | Percentage of Total | Fair Value in Millions | Percentage of Total |
| AAA | \$ 262.4 | 20.1% | \$ 257.5 | 19.7% |
| AA | 919.2 | 70.2 | 907.2 | 69.3 |
| A | 113.6 | 8.7 | 130.5 | 10.0 |
| BBB | 11.5 | 0.9 | 8.3 | 0.6 |
| Below Investment Grade | 1.8 | 0.1 | 5.0 | 0.4 |
| Total Investments in State, Municipalities and Political Subdivisions | \$ 1,308.5 | 100.0% | \$ 1,308.5 | 100.0% |

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****INVESTMENT QUALITY AND CONCENTRATIONS (Continued)**

The following table summarizes the fair value of the Company's investments in Fixed Maturities by industry at December 31, 2008 and 2007:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|---|-------------------|-------------|
| States, Municipalities and Political Subdivisions | \$ 1,308.5 | \$ 1,364.1 |
| U.S. Government and Government Agencies and Authorities | 979.1 | 1,108.7 |
| Manufacturing | 877.2 | 626.2 |
| Finance, Insurance and Real Estate | 546.6 | 457.4 |
| Transportation, Communication and Utilities | 193.0 | 67.2 |
| Services | 119.6 | 37.0 |
| Mining | 44.3 | 4.9 |
| Wholesale Trade | 30.5 | 13.9 |
| Retail Trade | 25.4 | 7.3 |
| Agriculture, Forestry and Fishing | 10.3 | |
| Construction | 1.4 | |
| Total Investments in Fixed Maturities | \$ 4,135.9 | \$ 3,686.7 |

Forty-nine companies comprised over 75% of the Company's fixed maturity exposure to the Manufacturing industry at December 31, 2008, with the largest single exposure, Celerity, Inc., comprising 2.8%, or \$24.5 million, of the Company's fixed maturity exposure to such industry. Twenty-three companies comprised over 75% of the Company's exposure to the Finance, Insurance and Real Estate industry at December 31, 2008, with the largest single exposure, Special Value Opportunity Fund auction rate preferred stocks, comprising 11.8%, or \$64.7 million, of the Company's exposure to such industry.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****INVESTMENT QUALITY AND CONCENTRATIONS (Continued)**

The following table summarizes the fair value of the Company's ten largest investment exposures at December 31, 2008:

| <i>DOLLARS IN MILLIONS</i> | Fair Value |
|---|------------|
| Government National Mortgage Association: | |
| Fixed Maturities | \$ 415.6 |
| U.S. Treasury Bonds, Notes and Bills: | |
| Fixed Maturities | 245.0 |
| Short Term | 116.0 |
| Total U.S. Treasuries | 361.0 |
| Tennebaum Capital Partners Sponsored Entities: | |
| Fixed Maturities Redeemable Preferred Stocks | 64.7 |
| Limited Liability Investment Companies and Limited Partnerships | 132.3 |
| Total Tennebaum Capital Partners Sponsored Entities | 197.0 |
| Intermec: | |
| Investment in Investee | 168.1 |
| State of Louisiana and Political Subdivisions Thereof: | |
| Fixed Maturities | 140.1 |
| Fannie Mae: | |
| Fixed Maturities | 107.5 |
| Federal Home Loan Banks: | |
| Fixed Maturities | 87.0 |
| Freddie Mac: | |
| Fixed Maturities | 84.9 |
| Goldman Sachs and its Sponsored Entities: | |
| Fixed Maturities | 7.4 |
| Equity Securities Preferred and Common Stocks | 2.9 |
| Equity Securities Other Equity Interests | 14.5 |
| Mutual Funds | 0.2 |
| Limited Liability Investment Companies and Limited Partnerships | 53.4 |
| Total Goldman Sachs and its Sponsored Entities | 78.4 |
| State of Georgia and Political Subdivisions Thereof: | |
| Fixed Maturities | 67.4 |
| Total | \$ 1,707.0 |

The Company has exposure to the residential mortgage industry primarily by virtue of its investments in Government National Mortgage Association (Ginnie Mae), Fannie Mae, Federal Home Loan Banks (FHLB) and Freddie Mac. Fannie Mae, FHLB and Freddie Mac are each U.S. government sponsored and federally chartered entities, which are privately capitalized, whereas Ginnie Mae is a U.S. government-owned

Edgar Filing: UNITRIN INC - Form 10-K

corporation. Securities issued by Ginnie Mae are backed by the full faith and credit of the U.S. government. On September 7, 2008, Fannie Mae and Freddie Mac were placed in conservatorship. In connection with their conservatorship, Fannie Mae and Freddie Mac obtained additional capitalization from the U.S. Government in transactions in which, among other things, they issued senior preferred stock to the U.S. Government. Approximately 82% of the Company's investments in the fixed maturities of Fannie Mae, FHLB and Freddie Mac are in general obligations issued by Fannie Mae, FHLB and Freddie Mac, with the balance invested in various mortgage-backed securities (MBS). While each general obligation is fixed in its maturity, 98% of the Company's investments in these general obligations are callable by the issuer prior to their maturity. In contrast, principal

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****INVESTMENT QUALITY AND CONCENTRATIONS (Continued)**

payments of MBS securities vary with the underlying mortgages associated with them. The Company has no exposures to interest-only or principal-only investment strips. The Company's investments in Ginnie Mae securities consist of various mortgage pools and pass-through certificates. Ginnie Mae guarantees the payment of principal and interest on these securities, which vary with the underlying mortgages. In addition to the Company's investments in Fannie Mae, Ginnie Mae, FHLB and Freddie Mac securities, the Company had investments in other U.S. government sponsored or owned corporations totaling \$39.1 million at December 31, 2008. At December 31, 2008, the Company also owned \$6.2 million of MBS issued by private companies, of which \$3.4 million may be considered sub-prime.

At December 31, 2008, the Company's fixed maturity investments in U.S. Treasury securities consisted of various maturities principally ranging from less than one year to 22 years with an effective duration of approximately 5 years. The Company's short-term investments in U.S. Treasury securities consisted of \$78.6 million of U.S. Treasury Bills typically with maturities of less than one week and \$37.4 million of U.S. Treasury Bonds and Notes with a maturity of less than one year at the date of purchase. In addition to these investments, the Company had \$270.6 million invested in overnight repurchase agreements primarily collateralized by securities issued by the U.S. government and \$141.6 million invested in money market funds which primarily invest in U.S. Treasury securities. At the time of borrowing, the repurchase agreements generally require the borrower to provide to the Company collateral at least equal to the amount borrowed. The Company bears some investment risk in the event that a borrower defaults and the value of collateral falls below the amount borrowed. While money market fund managers strive to maintain a stable fund price equal to the amounts invested in their funds, investors in such funds bear investment risk in the event that the funds' investments decline in value. The money market funds in which the Company has invested have applied for insurance coverage under the U.S. Treasury Department Temporary Guarantee Program for Money Market Funds.

The Company had \$286.4 million invested in various limited liability investment companies and limited partnerships at December 31, 2008, of which \$44.1 million was included in the Company's Investments in Other Equity Securities and \$242.3 million was included in Other Investments. As limited liability investment companies and limited partnerships, these entities are required to follow certain specialized industry accounting which requires that unrealized gains and losses be reported in their statements of operations. The Company is required to account for some of its investments in these entities, namely those entities in which the Company's interest is not deemed minor, under the equity method of accounting. This specialized accounting requiring income or loss recognition, as the case may be, of unrealized gains and losses, along with the requirement to account for some of these investments under the equity method of accounting, adds a degree of volatility to the Company's net investment income. The Company had ownership interests totaling \$132.3 million in such entities sponsored by Tennenbaum Capital Partners, LLC (TCP) included in Other Investments at December 31, 2008. The Company also had a \$10.0 million unfunded, future capital commitment to these TCP-sponsored entities to fund future investments at December 31, 2008. Such capital commitment was funded in January of 2009. The Company's Investments in Fixed Maturities included an investment of \$64.7 million in two redeemable, auction rate preferred stocks, rated AA by S&P and issued by one of the TCP-sponsored entities at December 31, 2008. The Company owns no other auction rate preferred stocks. TCP is a private investment firm that specializes in investing in companies undergoing change due to industry trends, economic cycles or specific company circumstances. As such, the TCP-sponsored entities in which the Company invests employ a long-term investment strategy focused on opportunities investments that may include holdings in illiquid securities such as distressed debt or leveraged loans. From time to time, the Company may also invest directly in some of the companies in which the TCP sponsored entities invest. Such direct investments had a fair value of \$36.1 million at December 31, 2008. Goldman Sachs Group, Inc. (Goldman Sachs), a bank holding company and a leading global investment banking, securities and investment management firm, sponsors certain limited partnerships in

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

INVESTMENT QUALITY AND CONCENTRATIONS (Continued)

which the Company invests. The Company's investments in Goldman Sachs-sponsored entities focus on two distinct investment strategies. One strategy focuses on providing liquidity or partnering solutions for investors in existing private equity assets and providing capital or partnering solutions for portfolio managers, commonly referred to as secondary transactions. The other strategy focuses on investments in mezzanine securities, which principally include fixed income securities, such as debt and preferred stock, and may also include an equity component, such as warrants, options or common stock. Other Equity Securities and Other Investments include \$14.5 million and \$53.4 million, respectively, related to the Company's investments in Goldman Sachs-sponsored entities at December 31, 2008. The Company is also committed to making future contributions of \$65.1 million to Goldman Sachs-sponsored entities to fund future investments. In addition, Other Equity Securities includes \$2.9 million related to the Company's investments in Goldman Sachs preferred and common stock at December 31, 2008.

The Company has significant exposure to changes in the fair value of one public company, Intermec, by virtue of its investments in the common stock of this company. Intermec has described itself as a leader in global supply chain solutions and in the design, development, manufacture and integration of wired and wireless automated data collection, mobile computing systems, bar code printers, label media and RFID (radio frequency identification). Intermec's products and services are used by customers in many industries to improve productivity, quality and responsiveness of business operations, from supply chain management and enterprise resource planning to field sales and service. Intermec's products and services are sold globally to a diverse set of customers in markets such as manufacturing, warehousing, direct store delivery, retail, consumer goods, field services, government, security, healthcare, transportation and logistics. Based on shares outstanding reported in Intermec's quarterly report on Form 10-Q for the quarter ended September 30, 2008, the Company owned 20.5% of Intermec's common stock at December 31, 2008. Accordingly, the Company accounts for its investment in Intermec under the equity method of accounting. The Company reports its investment in Intermec at cost plus accumulated undistributed earnings, rather than fair value, in the Consolidated Balance Sheet. The fair value of the Company's investment in Intermec exceeded this carrying value by \$65.9 million at December 31, 2008.

The Company's Investments in Fixed Maturities included investments in the obligations of 46 states, and municipalities and political subdivisions thereof, with a fair value of \$1,308.5 million at December 31, 2008, of which \$1,264.2 million are callable prior to their maturity at or above par. Certain states provide premium tax incentives to insurance companies that invest in their states. The Company has large investment concentrations in Louisiana and Georgia, in particular, as a result of premium tax incentives.

SECURITIES LENDING, CREDIT DEFAULT SWAPS AND HEDGING ACTIVITIES

The Company does not directly participate, as either a lender or borrower of securities, in any securities lending program. The Company does not participate directly in credit default swaps. The Company does not engage directly in hedging activities including, but not limited to, activities involving interest rate swaps, forward foreign currency contracts, commodities contracts, exchange traded and over-the-counter options or warrants. The Company has limited exposure to such programs and activities by virtue of its investments in Highbridge Capital LP (Highbridge).

Highbridge is a limited partnership that specializes in arbitrage and absolute return investment strategies in the global equity and corporate debt securities markets and indirectly invests in funds that purchase and sell equities, futures, swaps, forward currency contracts, exchange traded and over-the-counter options, warrants, and both convertible and non-convertible corporate bonds. The Company's investment in Highbridge, which is reported in Other Equity Securities in the Consolidated Balance Sheet, was \$17.7 million at December 31, 2008. On October 23, 2008, the Company submitted a full redemption notice to the Highbridge general partner. On

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****SECURITIES LENDING, CREDIT DEFAULT SWAPS AND HEDGING ACTIVITIES (Continued)**

November 21, 2008, the general partner notified the Company that the general partner was imposing a restriction on the redemption of certain assets representing 70% of the Company's investment in Highbridge and that such assets would not be redeemed currently, but rather would be redeemed over several periods.

DISTRESSED AND MEZZANINE DEBT AND SECONDARY TRANSACTIONS INVESTMENTS

The Company owns investments in various limited liability investment companies and limited partnerships that primarily invest in distressed debt, mezzanine debt and secondary transactions. The Company's investments in these limited liability investment companies and limited partnerships, which are accounted for under the equity method of accounting and reported in Other Investments at December 31, 2008 and December 31, 2007, are summarized below:

| <i>DOLLARS IN MILLIONS</i> | ASSET CLASS | UNFUNDED | CARRYING VALUE | | STATED |
|--------------------------------------|------------------------|----------------|-----------------|-----------------|------------|
| | | COMMITMENT | DEC. 31, 2008 | DEC. 31, 2007 | FUND |
| | | DEC. 31, 2008 | DEC. 31, 2008 | DEC. 31, 2007 | DATE |
| Special Value Opportunity Fund, LLC | Distressed Debt | \$ | \$ 69.9 | \$ 94.1 | 7/13/2014 |
| Tennenbaum Opportunities Fund V, LLC | Distressed Debt | 10.0 | 43.3 | 42.8 | 10/10/2016 |
| Goldman Sachs Vintage Fund IV, L.P. | Secondary Transactions | 28.8 | 53.4 | 33.3 | 12/31/2016 |
| Special Value Continuation Fund, LLC | Distressed Debt | | 19.1 | 37.0 | 6/30/2016 |
| NY Life Investment Management | | | | | |
| Mezzanine Partners II, LP | Mezzanine Debt | 6.5 | 18.9 | 10.3 | 7/31/2016 |
| BNY Mezzanine Partners L.P. | Mezzanine Debt | 5.3 | 12.7 | 7.9 | 4/17/2016 |
| Other Funds | | 11.3 | 25.0 | 29.2 | 2015-2018 |
| Total | | \$ 61.9 | \$ 242.3 | \$ 254.6 | |

In addition, at December 31, 2008 the Company has unfunded commitments of \$67.1 million for investments in limited liability investment companies and limited partnerships that are not accounted for under the equity method of accounting.

INTEREST AND OTHER EXPENSES

Interest and Other Expenses was \$58.5 million, \$66.9 million and \$62.5 million in 2008, 2007 and 2006, respectively. Interest expense, excluding interest on a mortgage note payable included in real estate investment expense, was \$32.2 million, \$33.2 million and \$28.5 million in 2008, 2007 and 2006, respectively. Interest expense increased in 2007 due primarily to higher levels of debt outstanding resulting from the issuance of the Company's 6.00% senior notes due May 15, 2017 (the 6.00% Senior Notes), partially offset by repayment of the Company's 5.75% senior notes due July 1, 2007 (the 5.75% Senior Notes). Other Corporate Expenses were \$26.3 million, \$33.7 million and \$34.0 million in 2008, 2007 and 2006, respectively. Other Corporate Expenses decreased by \$7.4 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to lower compensation and employee benefit costs.

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

INCOME TAXES

The Company's effective income tax rate from continuing operations differs from the Federal statutory income tax rate due primarily to tax-exempt investment income and dividends received deductions, state income taxes and the write-off of Goodwill. Tax-exempt investment income and dividends received deductions were \$57.1 million, \$61.7 million and \$55.0 million in 2008, 2007 and 2006, respectively. In 2008, state income tax expense, net of federal benefit, was \$2.6 million, including \$3.6 million to establish a valuation allowance for deferred state income taxes. In 2007, state income tax benefit, net of federal expense, was \$8.9 million, including a benefit of \$5.3 million resulting from the expiration of a state's statute of limitations. State income tax expense, net of federal benefit, was \$4.3 million in 2006. In 2008, the Company wrote off \$9.2 million of Goodwill, which is not deductible for income taxes.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2008, there were approximately 1.4 million shares of the Company's outstanding common stock that could be repurchased under the Company's outstanding repurchase authorization. Common stock may be repurchased in the open market or in privately negotiated transactions from time to time subject to market conditions and other factors. The Company repurchased and retired 2,045,100 shares of its common stock in 2008 at a cost of \$69.0 million. The Company repurchased and retired 3,042,100 shares of its common stock in 2007 at a cost of \$139.5 million. The Company has repurchased and retired approximately 62.8 million shares of its common stock in open market transactions at an aggregate cost of approximately \$1.8 billion since 1990.

On June 24, 2005, the Company entered into a five-year, \$325 million, unsecured, revolving credit agreement, expiring June 30, 2010, with a group of financial institutions. The agreement provides for fixed and floating rate advances for periods up to one year at various interest rates. The agreement also contains various financial covenants, including limits on total debt to total capitalization and minimum risk-based capital ratios for the Company's largest insurance subsidiaries. The proceeds from advances under the revolving credit facility may be used for general corporate purposes. The Company had no outstanding advances under its unsecured, revolving credit agreement at December 31, 2008 or December 31, 2007. Undrawn letters of credit issued pursuant to the unsecured, revolving credit agreement were \$13.1 million at both December 31, 2008 and December 31, 2007. Accordingly, the amounts available for future borrowing were \$311.9 million at both December 31, 2008 and 2007. The agreement contains various financial and other covenants and minimum risk-based capital ratios for Unitrin's two largest insurance subsidiaries, United and Trinity. Management estimates that it could borrow the full amount under the agreement and still meet the financial covenants contained in the agreement.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****LIQUIDITY AND CAPITAL RESOURCES (Continued)**

The lenders participating in the Company's unsecured, revolving credit agreement and their aggregate commitments are presented below:

| Lender | Commitment in Millions |
|--|-----------------------------------|
| JPMorgan Chase Bank, N.A. | \$ 65.0 |
| Wells Fargo Bank, National Association | 65.0 |
| Wachovia Bank, National Association | 50.0 |
| The Bank of New York | 30.0 |
| The Northern Trust Company | 30.0 |
| Union Bank of California, N.A. | 30.0 |
| Fifth Third Bank (Chicago), a Michigan Banking Corporation | 15.0 |
| U.S. Bank, N.A. | 15.0 |
| Regions Bank | 10.0 |
| William Street Commitment Corporation | 10.0 |
| UMB Bank, N.A. | 5.0 |
| Total Commitment | \$ 325.0 |

On May 11, 2007, the Company issued \$360 million of its 6.00% Senior Notes due May 15, 2017 for an effective yield of 6.19%. The 6.00% Senior Notes are unsecured and may be redeemed in whole at any time or in part from time to time at the Company's option at specified redemption prices. The Company used the proceeds from the sale of the notes to repay the \$300 million principal aggregate amount of its 5.75% Senior Notes which were due on July 1, 2007 and for general corporate purposes. Interest expense under the 6.00% Senior Notes was \$22.0 million and \$14.1 million for the years ended December 31, 2008 and 2007, respectively.

In 2003, the Company issued \$200 million of its 4.875% senior notes due November 1, 2010 (the 4.875% Senior Notes) for an effective yield of 5.04%. The 4.875% Senior Notes are unsecured and may be redeemed in whole at any time or in part from time to time at the Company's option at specified redemption prices. Interest expense under the 4.875% Senior Notes was \$10.0 million for each of the years ended December 31, 2008, 2007 and 2006.

In 2002, the Company issued \$300 million of its 5.75% Senior Notes for an effective yield of 5.99%. The 5.75% Senior Notes were retired in 2007. Interest expense under the 5.75% Senior Notes was \$9.0 million and \$18.0 million for the years ended December 31, 2007 and 2006, respectively.

Unitrin directly held cash and investments totaling \$23.3 million at December 31, 2008, compared to \$416.1 million at December 31, 2007. Investments at December 31, 2007 included investments in Northrop preferred and common stocks totaling \$341.8 million. Unitrin sold its remaining Northrop holdings in 2008, generating gross proceeds of \$296.4 million. Unitrin's subsidiary, Trinity, held 895,674 shares of Northrop common stock with a fair value of \$40.3 million at December 31, 2008. Due in part to its sales of Northrop common stock, the Company anticipates that Unitrin will be required to make federal income tax payments of approximately \$43 million in the first quarter of 2009. Unitrin made a capital contribution of \$25 million to United in January of 2009. Unitrin borrowed \$25 million under its revolving credit facility to fund the contribution.

Unitrin does not anticipate making significant changes to its capital structure in 2009. Sources available for future shareholder dividend payments, capital contributions to subsidiaries, income tax payments and the payment of interest on Unitrin's senior notes include the receipt of dividends from Unitrin's subsidiaries and borrowings under Unitrin's revolving credit agreement. Various state insurance laws restrict the ability of Unitrin's insurance subsidiaries to pay dividends without regulatory approval. Such insurance laws generally

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****LIQUIDITY AND CAPITAL RESOURCES (Continued)**

restrict the amount of dividends paid in an annual period to the greater of statutory net income from the previous year or 10% of statutory capital and surplus. Unitrin's direct insurance subsidiaries paid dividends consisting of \$84.2 million in cash and 819,159 shares of Northrop common stock with a fair value of \$51.0 million to Unitrin during 2008. In 2009, Unitrin estimates that its direct insurance subsidiaries would be able to pay \$120 million in dividends to Unitrin without prior regulatory approval. Fireside Bank has agreed not to pay dividends without the prior approval of the FDIC and CDFI. The Company does not expect Fireside Bank to pay a dividend in 2009.

Given the decline in shareholders equity in 2008, the decline in cash and other securities held at the Unitrin Parent Company level, the capital contributions made to all of Unitrin's businesses during 2008 and in January 2009, the potential capital funding requirement associated with the Direct Response acquisition as discussed below, and the potential for additional realized or unrealized investment losses in the Company's investment portfolio, there can be no assurance that Unitrin will continue the payment of dividends to its shareholders at the level paid in 2008.

On April 1, 2008, the Company completed its acquisition of Primesco in a cash merger transaction valued at \$95.5 million, including transaction costs of \$0.2 million. The Company funded the acquisition primarily through borrowings under its revolving credit agreement which were repaid during the third quarter of 2008.

On August 29, 2008 Unitrin's subsidiary, Trinity, entered into a definitive agreement to acquire Direct Response in a cash transaction initially valued at approximately \$220 million, subject to certain purchase price adjustments. Such purchase price adjustments are currently estimated to reduce the purchase price to approximately \$200 million. At December 31, 2008 Trinity maintained cash and short-term investments sufficient to fund the acquisition price. Except for one approval yet to be received from a state insurance regulator, the Company has received all federal and state regulatory approvals necessary to close the transaction. The Company anticipates closing the transaction in the first quarter of 2009, subject to timely approval by such insurance regulator and the satisfaction of other customary closing conditions. Unitrin made a capital contribution of \$65.0 million to Trinity during the fourth quarter of 2008. Unitrin may make an additional capital contribution to Trinity in 2009 to maintain Trinity's risk-based capital at appropriate levels considering the addition of the Direct Response business. Unitrin would likely fund such a contribution through borrowings under its revolving credit agreement or the receipt of dividends from its other insurance subsidiaries. The amount of such contribution, if any, is dependent on Trinity's operating and investment results in 2009.

Quantitative measures established by bank regulations to ensure capital adequacy require Fireside Bank to maintain minimum amounts of capital. Bank regulations define capital calculations for Tier 1 capital, total risk-weighted assets and total risk-based capital. To be well-capitalized a financial institution must maintain a ratio of total capital to total risk-weighted assets of 10% or greater, a ratio of Tier 1 capital to total risk-weighted assets of 6% or greater and a ratio of Tier 1 capital to total average assets of 5% or greater. Fireside Bank had ratios of total capital to total risk-weighted assets of 20.3% at December 31, 2008 and 13.9% at December 31, 2007; a ratio of Tier 1 capital to total risk-weighted assets of 18.4% at December 31, 2008 and 13.0% at December 31, 2007; and a ratio of Tier 1 capital to total average assets of 15.6% at December 31, 2008 and 12.0% at December 31, 2007. Higher levels of capital, while undefined, are generally more prudent for Fireside Bank's sub-prime automobile loan business than would be required for lower risk businesses. Fireside Bank has agreed with its regulators to maintain a ratio of Tier 1 capital to total average assets of 15% or greater. During the third quarter of 2008, Unitrin made a capital contribution of \$60.0 million to its subsidiary, Fireside Securities Corporation (FSC), which, in turn, contributed the same amount to its subsidiary, Fireside Bank. The capital contributions were made to increase Fireside Bank's ratio of Tier 1 capital to total average assets above 15%. During the second half of 2007, Unitrin also made capital contributions totaling \$52.0 million to FSC, which, in turn, contributed the same amount to Fireside Bank. The capital contributions were made to replenish Fireside Bank's capital position.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****LIQUIDITY AND CAPITAL RESOURCES (Continued)**

The primary sources of funds for Unitrin's insurance subsidiaries are premiums and investment income. The primary uses of funds are the payment of policyholder benefits under life insurance contracts, claims under property and casualty insurance contracts and accident and health insurance contracts, the payment of commissions and general expenses and the purchase of investments. Generally, there is a time lag between when premiums are collected and when policyholder benefits and insurance claims are paid. Accordingly, during periods of growth, insurance companies typically experience positive operating cash flows and are able to invest a portion of their operating cash flows to fund future policyholder benefits and claims. During periods in which premium revenues decline, insurance companies may experience negative cash flow from operations and may need to sell investments to fund payments to policyholders and claimants. In addition, if Unitrin's property and casualty insurance subsidiaries experience several significant catastrophic events over a relatively short period of time, investments may have to be sold in advance of their maturity dates to fund payments, which could result in either investment gains or losses. The Company believes that Unitrin's property and casualty insurance subsidiaries have sufficient short-term liquidity to fund the payment of losses from Hurricanes Ike, Gustav and Dolly without the additional sale of investments. Management believes that its insurance subsidiaries maintain adequate levels of liquidity in the event that its property and casualty insurance subsidiaries experience several future catastrophic events over a relatively short period of time.

The primary sources of funds for Fireside Bank are customer deposits, repayments of automobile loans, interest on automobile loans and investment income. The primary uses of funds by Fireside Bank are automobile loans made to consumers, repayment of customer deposits, interest paid to depositors and general expenses.

Net Cash Provided by Operating Activities decreased by \$182.9 million for the year ended December 31, 2008, compared to the same period in 2007, due primarily to the lower operating results. Net Cash Provided by Operating Activities decreased by \$54.3 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to higher property and casualty claims paid.

Net Cash Used by Financing Activities increased by \$263.1 million for the year ended December 31, 2008, compared to the same period in 2007. During 2008, the Company borrowed and repaid \$232.0 million under its revolving credit agreement. During the second quarter of 2007, the Company issued its \$360 million senior secured notes for net proceeds of \$354.8 million. The Company repaid its \$300 million senior secured notes in the third quarter of 2007. The Company funds its Automobile Loan Receivables through the issuance of Certificates of Deposit. Automobile Loan Receivables declined by \$134.9 million in 2008. Net cash used by Certificates of Deposits withdrawals, net of Certificates of Deposits issued, was \$163.5 million for the year ended December 31, 2008, compared to net cash provided of \$111.6 million for the same period in 2007. The Company used \$69.0 million of cash during 2008 to repurchase shares of its common stock, compared to \$139.5 million of cash used to repurchase shares of its common stock for the same period in 2007.

Net Cash Used by Financing Activities decreased by \$24.3 million for the year ended December 31, 2007, compared to the same period in 2006. In 2007, the Company received \$354.8 million in net proceeds from the issuance of the 6.00% Senior Notes. Additionally, in 2007, the Company paid \$300.0 million to retire the 5.75% Senior Notes. There was no similar debt activity in 2006. Cash Provided by Financing Activities related to issuing certificates of deposits, net of withdrawals, increased by \$23.2 million in 2007, compared to the same period in 2006. The Company used \$139.5 million of cash in 2007 to repurchase shares of its common stock, compared to \$89.9 million of cash used to repurchase shares of its common stock in the same period in 2006.

Cash available for investment activities in total is dependent on cash flow from Operating Activities and Financing Activities and the level of cash the Company elects to maintain at the end of the year. Net Cash Provided by Investing Activities was \$356.2 million for the year ended December 31, 2008, compared to Net Cash Used by Investing Activities of \$222.9 million for the same period in 2007. Purchases of Fixed Maturities

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****LIQUIDITY AND CAPITAL RESOURCES (Continued)**

exceeded Sales of Fixed maturities by \$237.6 million in 2008, while Sales and Maturities of Fixed Maturities exceeded purchases of fixed maturities by \$179.0 million in 2007. Net cash provided by dispositions of short-term investments was \$132.3 million for the year ended December 31, 2008, compared to net cash used to acquire short-term investments of \$184.0 million for the same period in 2007. Cash used to acquire investments in limited liability investment companies and limited partnerships decreased by \$17.9 million in 2008, compared to 2007. Automobile Loan Originations decreased by \$247.2 million in 2008, compared to 2007. The repayment of automobile loan receivables decreased by \$72.8 million in 2008, compared to 2007. Cash provided by sales of Northrop common stock increased by \$292.3 million in 2008, compared to 2007, as the Company reduced its risk to further declines in the stock market in 2008. Cash received from dispositions of other equity securities, net of cash paid to acquire other equity securities was \$169.5 million in 2008, compared to net cash paid to acquire other equity securities, net of cash received from dispositions, of \$29.0 million in 2007, as the Company reduced its risk to further declines in the stock market in 2008. The Company received proceeds of \$68.8 million related to the disposition of its Unitrin Business Insurance operations in 2008. The Company used \$95.4 million of cash to acquire businesses in 2008, compared to \$46.9 million in 2007.

Net Cash Used by Investing Activities increased by \$136.8 million for the year ended December 31, 2007, compared to the same period in 2006. Net cash used to acquire short-term investments was \$184.0 million in 2007, compared to net cash provided by sales of short-term investments of \$63.3 million in 2006. The Company used \$46.9 million of cash to fund the acquisition of Merastar in 2007. Purchases of other equity securities, net of cash received from dispositions of other equity securities was \$29.0 million in 2007, compared to \$85.6 million in 2006. Cash used to acquire investments in limited liability investment companies and limited partnerships increased by \$32.2 million in 2007. The acquisition of automobile loan receivables, net of automobile loans repaid, used \$30.2 million less cash in 2007, compared to 2006. Cash provided by the sales and maturities of fixed maturities, net of purchases, decreased by \$25.4 million. Sales of Northrop Common Stock provided \$114.5 million more cash in 2007 than in 2006.

Cash increased by \$79.7 million from December 31, 2007 to December 31, 2008, due primarily to cash provided by operating activities. Cash decreased by \$53.4 million from December 31, 2006 to December 31, 2007. At the end of 2006, the Company temporarily did not fully invest its available funds due primarily to the implementation of certain premium tax strategies. The Company implemented similar premium tax strategies at the end of 2007, while maintaining a lower level of cash.

Unitrin and its subsidiaries have not formed special purpose entities or similar structured financing vehicles to access capital and/or manage risk or for any other purpose. The Company's retained earnings includes \$61.8 million and \$54.4 million representing the undistributed equity in net income and accumulated other comprehensive income of investee at December 31, 2008 and 2007, respectively.

OFF BALANCE SHEET ARRANGEMENTS

The Company has no material obligations under a guarantee contract meeting the characteristics identified in paragraph 3 of FIN 45, *Guarantor's Accounting and Disclosure Requirements, Including Indirect Guarantees of Indebtedness of Others*. The Company has no material retained or contingent interests in assets transferred to an unconsolidated entity. The Company has no material obligations, including contingent obligations, under contracts that would be accounted for as derivative instruments. The Company has no obligations, including contingent obligations, arising out of a variable interest in an unconsolidated entity held by, and material to, the Company, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with the Company. Accordingly, the Company has no material off balance sheet arrangements.

Table of Contents**Unitrin, Inc. and Subsidiaries****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****CONTRACTUAL OBLIGATIONS**

Estimated cash disbursements pertaining to the Company's contractual obligations at December 31, 2008, are as follows:

| <i>DOLLARS IN MILLIONS</i> | JAN. 1, 2009 TO DEC. 31, 2009 | JAN. 1, 2010 TO DEC. 31, 2011 | JAN. 1, 2012 TO DEC. 31, 2013 | AFTER DEC. 31, 2013 | TOTAL |
|---|-------------------------------------|-------------------------------------|-------------------------------------|------------------------|-------------|
| Long Term Debt Obligations | \$ 0.5 | \$ 200.9 | \$ 6.3 | \$ 360.0 | \$ 567.7 |
| Certificates of Deposits | 449.0 | 449.1 | 212.7 | | 1,110.8 |
| Operating Lease Obligations | 29.6 | 49.3 | 32.9 | 50.7 | 162.5 |
| Purchase Obligations | 4.4 | 2.5 | 0.3 | | 7.2 |
| Life and Health Insurance Policy Benefits | 278.8 | 473.0 | 462.0 | 6,199.9 | 7,413.7 |
| Property and Casualty Insurance Reserves | 624.3 | 407.8 | 134.3 | 102.3 | 1,268.7 |
| Other Contractual Obligations Reflected in Long Term Liabilities on the Consolidated Balance Sheet under GAAP | 80.3 | 100.3 | 49.0 | 75.7 | 305.3 |
| Total Contractual Obligations | \$ 1,466.9 | \$ 1,682.9 | \$ 897.5 | \$ 6,788.6 | \$ 10,835.9 |

Amounts included in Life and Health Insurance Policy Benefits within the contractual obligations table above represent the estimated cash payments to be made to policyholders and beneficiaries. Such cash outflows are based on the Company's current assumptions for mortality, morbidity and policy lapse, but are undiscounted with respect to interest. Policies must remain in force for the policyholder or beneficiary to receive the benefit under the policy. Depending on the terms of a particular policy, future premiums from the policyholder may be required for the policy to remain in force. The Company estimates that future cash inflows would total \$4.6 billion using the same assumptions used to estimate the cash outflows.

The Company's Life Insurance Reserves in the Company's Consolidated Balance Sheet are generally based on the historical assumptions for mortality and policy lapse and are on a discounted basis. Accordingly, the sum of the amounts presented above for Life and Health Insurance Policy Benefits significantly exceeds the amount of Life and Health Insurance Reserves reported on the Company's Consolidated Balance Sheet at December 31, 2008.

In addition to the purchase obligations included above, the Company had certain investment commitments totaling \$129.0 million at December 31, 2008. The funding of such investment commitments is dependent upon a number of factors, the timing of which is indeterminate.

The contractual obligations reported above also exclude the Company's liability of \$17.0 million for unrecognized tax benefits. The Company cannot make a reasonably reliable estimate of the amount and period of related future payments for such liability.

Other Contractual Obligations Reflected in Long Term Liabilities on the Consolidated Balance Sheet under GAAP primarily consist of interest obligations related to Long Term Debt Obligations and Certificates of Deposits.

Table of Contents

Unitrin, Inc. and Subsidiaries

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

ACCOUNTING CHANGES

In 2008, the Company changed its accounting for certain investments accounted for under the equity method of accounting to eliminate a reporting lag. The Company's financial statements have been adjusted for the retrospective application of a change in accounting principle pursuant to SFAS No. 154, *Accounting Changes and Correction of Errors*. See Note 2, Summary of Accounting Policies and Accounting Changes, to the Consolidated Financial Statements for the effect on the Company's Consolidated Financial Statements.

Changes in accounting standards that are most critical to the Company are discussed in Note 2, Summary of Accounting Policies and Accounting Changes, to the Consolidated Financial Statements under the heading Accounting Changes. The accounting changes discussed are:

SFAS No. 157, *Fair Value Measurements*;

SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*;

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*;

SFAS No. 141(R), *Business Combinations*;

SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*;

SFAS No. 161, *Disclosure about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133*;

SFAS No. 163, *Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60*;

FIN 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*;

FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*;
and

FSP SFAS 142-3, *Determination of the Useful Life of Intangible Assets*.

Table of Contents**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.****QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***Quantitative Information About Market Risk*

The Company's consolidated balance sheet includes five types of financial instruments subject to the material market risk disclosures required by the SEC:

- 1) Investments in Fixed Maturities;
- 2) Investments in Equity Securities;
- 3) Automobile Loan Receivables;
- 4) Certificates of Deposits; and
- 5) Notes Payable.

Investments in Fixed Maturities, Automobile Loan Receivables, Certificates of Deposits and Notes Payable are subject to material interest rate risk. The Company's Investments in Equity Securities include common and preferred stocks and, accordingly, are subject to material equity price risk and interest rate risk, respectively.

For purposes of this disclosure, market risk sensitive financial instruments are divided into two categories: financial instruments acquired for trading purposes and financial instruments acquired for purposes other than trading. The Company's market risk sensitive financial instruments are generally classified as held for purposes other than trading. The Company has no significant holdings of financial instruments acquired for trading purposes. The Company has no significant holdings of derivatives.

The Company measures its sensitivity to market risk by evaluating the change in its financial assets and liabilities relative to fluctuations in interest rates and equity prices. The evaluation is made using instantaneous changes in interest rates and equity prices on a static balance sheet to determine the effect such changes would have on the Company's market value at risk and the resulting pretax effect on Shareholders' Equity. The changes chosen represent the Company's view of adverse changes which are reasonably possible over a one-year period. The selection of the changes chosen should not be construed as the Company's prediction of future market events, but rather an illustration of the impact of such events.

For the interest rate sensitivity analysis presented below, the Company assumed an adverse and instantaneous increase of 100 basis points in the yield curve at December 31, 2008 and 2007, respectively, for Investments in Fixed Maturities. Such 100 basis point increase in the yield curve may not necessarily result in a corresponding 100 basis point increase in the interest rate for all investments in fixed maturities. For example, a 100 basis point increase in the yield curve for risk-free, taxable investments in fixed maturities may not result in a 100 basis point increase for tax-exempt investments in fixed maturities. For Investments in Fixed Maturities, the Company also anticipated changes in cash flows due to changes in the likelihood that investments would be called or prepaid prior to their contractual maturity. All other variables were held constant. For preferred stock equity securities and Automobile Loan Receivables, the Company assumed an adverse and instantaneous increase of 100 basis points in market interest rates from their levels at December 31, 2008 and 2007, respectively. All other variables were held constant. For Certificates of Deposits and Notes Payable, the Company assumed an adverse and instantaneous decrease of 100 basis points in market interest rates from their levels at December 31, 2008 and 2007, respectively. All other variables were held constant. The Company measured equity price sensitivity assuming an adverse and instantaneous 30% decrease and 10% decrease in the Standard and Poor's Stock Index (the S&P 500) from its levels at December 31, 2008 and 2007, respectively, with all other variables held constant. The Company's investments in common stock equity securities were correlated with the S&P 500 using the portfolio's weighted-average beta of 1.05 and 0.88 at December 31, 2008 and 2007, respectively. The portfolio's weighted-average beta was calculated using each security's beta for the five-year periods ended December 31, 2008 and 2007, respectively, and weighted on the fair value of such

Table of Contents

securities at December 31, 2008 and 2007, respectively. For equity securities without observable market inputs the Company assumed a beta of 1.00 and 1.40 at December 31, 2008 and 2007, respectively. Beta measures a stock's relative volatility in relation to the rest of the stock market, with the S&P 500 having a beta coefficient of 1.00.

The estimated adverse effects on the market value of the Company's financial instruments at December 31, 2008, using these assumptions were:

| <i>DOLLARS IN MILLIONS</i> | FAIR VALUE | PRO FORMA INCREASE (DECREASE) | | |
|----------------------------------|------------|-------------------------------|-------------------|-------------------|
| | | INTEREST RATE RISK | EQUITY PRICE RISK | TOTAL MARKET RISK |
| ASSETS | | | | |
| Investments in Fixed Maturities | \$ 4,135.9 | \$ (277.1) | \$ | \$ (277.1) |
| Investments in Equity Securities | 221.8 | (5.7) | (33.8) | (39.5) |
| Automobile Loan Receivables | 1,099.6 | (13.5) | | (13.5) |
| LIABILITIES | | | | |
| Certificates of Deposits | \$ 1,148.7 | \$ 19.3 | \$ | \$ 19.3 |
| Notes Payable | 433.9 | 18.7 | | 18.7 |

The estimated adverse effects on the market value of the Company's financial instruments at December 31, 2007, using these assumptions were:

| <i>DOLLARS IN MILLIONS</i> | FAIR VALUE | PRO FORMA INCREASE (DECREASE) | | |
|----------------------------------|------------|-------------------------------|-------------------|-------------------|
| | | INTEREST RATE RISK | EQUITY PRICE RISK | TOTAL MARKET RISK |
| ASSETS | | | | |
| Investments in Fixed Maturities | \$ 3,686.7 | \$ (248.1) | \$ | \$ (248.1) |
| Investments in Equity Securities | 1,303.6 | (3.9) | (108.8) | (112.7) |
| Automobile Loan Receivables | 1,230.3 | (16.5) | | (16.5) |
| LIABILITIES | | | | |
| Certificates of Deposits | \$ 1,269.7 | \$ 26.3 | \$ | \$ 26.3 |
| Notes Payable | 550.3 | 30.9 | | 30.9 |

The market risk sensitivity analysis assumes that the composition of the Company's interest rate sensitive assets and liabilities, including, but not limited to, credit quality, and equity price sensitive assets existing at the beginning of the period remains constant over the period being measured. It also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the time to maturity. Interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Also, any future correlation, either in the near term or the long term, between the Company's common stock equity securities portfolio and the S&P 500 may differ from the historical correlation as represented by the weighted-average historical beta of the common stock equity securities portfolio. Accordingly, the market risk sensitivity analysis may not be indicative of, is not intended to provide, and does not provide, a precise forecast of the effect of changes of market rates on the Company's income or shareholders equity. Further, the computations do not contemplate any actions the Company may undertake in response to changes in interest rates or equity prices.

To the extent that any adverse 100 basis point change occurs in increments over a period of time instead of instantaneously, the adverse impact on fair values would be partially mitigated because some of the underlying financial instruments would have matured. For example, proceeds from any maturing assets could be reinvested and any new liabilities would be incurred at the then current interest rates.

Table of Contents

Qualitative Information About Market Risk

Market risk is a broad term related to economic losses due to adverse changes in the fair value of a financial instrument and is inherent to all financial instruments. SEC disclosure rules focus on only one element of market risk – price risk. Price risk relates to changes in the level of prices due to changes in interest rates, equity prices, foreign exchange rates or other factors that relate to market volatility of the rate, index, or price underlying the financial instrument. The Company’s primary market risk exposures are to changes in interest rates and certain exposures to changes in equity prices.

The Company manages its interest rate exposures with respect to Investments in Fixed Maturities by investing primarily in investment-grade securities of moderate effective duration. The interest rate risks with respect to the fair value of Automobile Finance Receivables should be partially offset by the impact of interest rate movements on Certificates of Deposits which are issued to fund its receivables.

At December 31, 2008 and 2007, \$40.3 million and \$706.0 million, respectively, of the Company’s Investments in Equity Securities, which exclude the Company’s Investment in Investee (Intermec), was concentrated in the preferred and common stock of Northrop. Accordingly, the Company’s Investments in Equity Securities are sensitive to the nature of Northrop’s industry segments. Northrop describes itself as a \$32 billion global defense and technology company whose 120,000 employees provide innovative systems, products, and solutions in information and services, electronics, aerospace and shipbuilding to government and commercial customers worldwide.

Table of Contents

Item 8. Financial Statements and Supplementary Data.

Index to

Consolidated Financial Statements of

Unitrin, Inc. and its Subsidiaries

| | |
|---|-----|
| <u>Consolidated Balance Sheets at December 31, 2008 and 2007</u> | 80 |
| <u>Consolidated Statements of Operations for the Years Ended December 31, 2008, 2007 and 2006</u> | 81 |
| <u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2008, 2007 and 2006</u> | 82 |
| <u>Consolidated Statements of Shareholders' Equity and Comprehensive Income (Loss) for the Years Ended December 31, 2008, 2007 and 2006</u> | 83 |
| <u>Notes to the Consolidated Financial Statements</u> | |
| <u>Note 1 Basis of Presentation and Significant Estimates</u> | 84 |
| <u>Note 2 Summary of Accounting Policies and Accounting Changes</u> | 85 |
| <u>Note 3 Acquisitions of Businesses</u> | 95 |
| <u>Note 4 Discontinued Operations</u> | 96 |
| <u>Note 5 Investments</u> | 98 |
| <u>Note 6 Automobile Loan Receivables and Certificates of Deposits</u> | 102 |
| <u>Note 7 Goodwill</u> | 103 |
| <u>Note 8 Property and Casualty Insurance Reserves</u> | 104 |
| <u>Note 9 Notes Payable</u> | 106 |
| <u>Note 10 Leases</u> | 107 |
| <u>Note 11 Shareholders' Equity</u> | 108 |
| <u>Note 12 Long Term Equity Compensation</u> | 109 |
| <u>Note 13 Net Income (Loss) Per Share</u> | 112 |
| <u>Note 14 Other Comprehensive Income (Loss)</u> | 113 |
| <u>Note 15 Income from Investments</u> | 114 |
| <u>Note 16 Insurance Expenses</u> | 115 |
| <u>Note 17 Income Taxes</u> | 115 |
| <u>Note 18 Pension Benefits and Postretirement Benefits Other Than Pensions</u> | 119 |
| <u>Note 19 Business Segments</u> | 123 |
| <u>Note 20 Catastrophe Reinsurance</u> | 126 |
| <u>Note 21 Other Reinsurance</u> | 129 |
| <u>Note 22 Fair Value Measurements</u> | 130 |
| <u>Note 23 Contingencies</u> | 133 |
| <u>Note 24 Related Parties</u> | 134 |
| <u>Note 25 Quarterly Financial Information (Unaudited)</u> | 136 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Consolidated Balance Sheets**

| <i>DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS</i> | DECEMBER 31, | |
|--|---------------------|-------------------|
| | 2008 | 2007 |
| ASSETS | | |
| Investments: | | |
| Fixed Maturities at Fair Value (Amortized Cost: 2008 \$4,174.4; 2007 \$3,608.9) | \$ 4,135.9 | \$ 3,686.7 |
| Northrop Preferred Stock at Fair Value (Cost: 2007 \$177.5) | | 258.5 |
| Northrop Common Stock at Fair Value (Cost: 2008 \$38.6; 2007 \$245.5) | 40.3 | 447.5 |
| Other Equity Securities at Fair Value (Cost: 2008 \$216.8; 2007 \$436.5) | 181.5 | 597.6 |
| Investee (Intermec) at Cost Plus Cumulative Undistributed Earnings (Fair Value: 2008 \$168.1; 2007 \$257.1) | 102.2 | 90.7 |
| Short-term Investments at Cost which Approximates Fair Value | 548.6 | 658.7 |
| Other | 714.9 | 696.1 |
| Total Investments | 5,723.4 | 6,435.8 |
| Cash | | |
| | 184.2 | 103.1 |
| Automobile Loan Receivables at Cost (Fair Value: 2008 \$1,099.6; 2007 \$1,230.3) | 1,078.6 | 1,213.5 |
| Other Receivables | 686.5 | 634.8 |
| Deferred Policy Acquisition Costs | 489.2 | 437.4 |
| Goodwill | 334.6 | 314.7 |
| Current and Deferred Income Taxes | 201.4 | 17.2 |
| Other Assets | 120.9 | 109.9 |
| Assets of Discontinued Operations | | 128.0 |
| Total Assets | \$ 8,818.8 | \$ 9,394.4 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Insurance Reserves: | | |
| Life and Health | \$ 2,972.6 | \$ 2,533.0 |
| Property and Casualty | 1,268.7 | 1,322.9 |
| Total Insurance Reserves | 4,241.3 | 3,855.9 |
| Certificates of Deposits at Cost (Fair Value: 2008 \$1,148.7; 2007 \$1,269.7) | 1,110.8 | 1,274.3 |
| Unearned Premiums | 733.5 | 722.2 |
| Liabilities for Income Taxes | 68.2 | 258.7 |
| Notes Payable at Amortized Cost (Fair Value: 2008 \$433.9; 2007 \$550.3) | 560.8 | 560.1 |
| Accrued Expenses and Other Liabilities | 455.6 | 380.9 |
| Liabilities of Discontinued Operations | | 51.3 |
| Total Liabilities | 7,170.2 | 7,103.4 |
| Shareholders' Equity: | | |
| Common Stock, \$0.10 Par Value Per Share, 100 Million Shares Authorized, 62,314,503 and 64,254,818 Shares Issued and Outstanding at December 31, 2008 and 2007 | 6.2 | 6.4 |
| Paid-in Capital | 764.7 | 781.3 |
| Retained Earnings | 985.8 | 1,178.5 |
| Accumulated Other Comprehensive Income (Loss) | (108.1) | 324.8 |
| Total Shareholders' Equity | 1,648.6 | 2,291.0 |

Edgar Filing: UNITRIN INC - Form 10-K

Total Liabilities and Shareholders' Equity

\$ 8,818.8 \$ 9,394.4

The Notes to the Consolidated Financial Statements are an integral part of these financial statements.

Table of Contents**Unitrin, Inc. and Subsidiaries****Consolidated Statements of Operations**

| <i>DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS</i> | FOR THE YEARS ENDED DECEMBER 31, | | |
|---|---|-----------------|-----------------|
| | 2008 | 2007 | 2006 |
| REVENUES | | | |
| Earned Premiums | \$ 2,376.6 | \$ 2,286.9 | \$ 2,290.5 |
| Automobile Finance Revenues | 242.3 | 260.2 | 245.0 |
| Net Investment Income | 212.9 | 289.9 | 286.0 |
| Other Income | 4.1 | 3.5 | 14.4 |
| Net Realized Investment Gains (Losses) | (93.7) | 62.5 | 26.5 |
| Total Revenues | 2,742.2 | 2,903.0 | 2,862.4 |
| EXPENSES | | | |
| Policyholders Benefits and Incurred Losses and Loss Adjustment Expenses | 1,765.2 | 1,572.3 | 1,508.7 |
| Insurance Expenses | 736.5 | 705.8 | 712.0 |
| Automobile Finance Expenses | 204.1 | 272.5 | 154.2 |
| Interest Expense on Certificates of Deposits | 58.7 | 58.7 | 49.8 |
| Goodwill | 9.2 | | |
| Interest and Other Expenses | 58.5 | 66.9 | 62.5 |
| Total Expenses | 2,832.2 | 2,676.2 | 2,487.2 |
| Income (Loss) from Continuing Operations before Income Taxes and Equity in Net Income of Investee | (90.0) | 226.8 | 375.2 |
| Income Tax Benefit (Expense) | 46.2 | (49.9) | (116.8) |
| Income (Loss) from Continuing Operations before Equity in Net Income of Investee | (43.8) | 176.9 | 258.4 |
| Equity in Net Income of Investee | 5.8 | 1.2 | 9.2 |
| Income (Loss) from Continuing Operations | (38.0) | 178.1 | 267.6 |
| Discontinued Operations: | | | |
| Income from Discontinued Operations Before Income Taxes | 18.2 | 34.8 | 22.0 |
| Income Tax Expense | (9.8) | (7.5) | (2.6) |
| Income from Discontinued Operations | 8.4 | 27.3 | 19.4 |
| Net Income (Loss) | \$ (29.6) | \$ 205.4 | \$ 287.0 |
| Income (Loss) Per Share from Continuing Operations | \$ (0.60) | \$ 2.71 | \$ 3.94 |
| Income Per Share from Discontinued Operations | 0.13 | 0.42 | 0.29 |
| Net Income (Loss) Per Share | \$ (0.47) | \$ 3.13 | \$ 4.23 |
| Income (Loss) Per Share from Continuing Operations Assuming Dilution | \$ (0.60) | \$ 2.70 | \$ 3.92 |
| Income Per Share from Discontinued Operations Assuming Dilution | 0.13 | 0.42 | 0.28 |
| Net Income (Loss) Per Share Assuming Dilution | \$ (0.47) | \$ 3.12 | \$ 4.20 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | | | | |
|---------------------------------|-----------|-------------|-----------|------|-----------|------|
| Dividends Paid Per Share | \$ | 1.88 | \$ | 1.82 | \$ | 1.76 |
|---------------------------------|-----------|-------------|-----------|------|-----------|------|

The Notes to the Consolidated Financial Statements are an integral part of these financial statements.

Table of Contents**Unitrin, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

| <i>DOLLARS IN MILLIONS</i> | FOR THE YEARS ENDED DECEMBER 31, | | |
|---|----------------------------------|----------|----------|
| | 2008 | 2007 | 2006 |
| OPERATING ACTIVITIES | | | |
| Net Income (Loss) | \$ (29.6) | \$ 205.4 | \$ 287.0 |
| Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operations: | | | |
| Policy Acquisition Costs Deferred | (324.7) | (325.0) | (351.1) |
| Amortization of Deferred Policy Acquisition Costs | 324.6 | 330.3 | 342.6 |
| Equity in Net Income of Investee before Taxes | (8.9) | (2.0) | (14.3) |
| Equity in Losses (Earnings) of Limited Liability Investment Companies and Limited Partnerships | 77.1 | (6.4) | (24.8) |
| Distribution of Accumulated Earnings of Limited Liability Investment Companies and Limited Partnerships | 1.0 | 27.1 | 12.9 |
| Amortization of Investment Securities and Depreciation of Investment Real Estate | 10.1 | 6.2 | 7.2 |
| Provision for Loan Losses | 110.0 | 166.8 | 62.4 |
| Depreciation of Property and Equipment | 18.8 | 20.9 | 22.2 |
| Goodwill | 9.2 | | |
| Decrease (Increase) in Other Receivables | (5.6) | 69.1 | 97.5 |
| Decrease in Insurance Reserves and Unearned Premiums | (58.5) | (110.2) | (54.6) |
| Decrease in Liabilities for Income Taxes | (132.1) | (60.1) | (4.3) |
| Decrease in Accrued Expenses and Other Liabilities | (20.4) | (11.7) | (33.2) |
| Net Realized Investment Losses (Gains) | 93.7 | (62.5) | (26.5) |
| Gain on Disposition of Business | (8.1) | | |
| Other, Net | 12.6 | 4.2 | (16.6) |
| Net Cash Provided by Operating Activities | 69.2 | 252.1 | 306.4 |
| INVESTING ACTIVITIES | | | |
| Sales and Maturities of Fixed Maturities | 956.7 | 614.1 | 559.1 |
| Purchases of Fixed Maturities | (1,194.3) | (435.1) | (354.7) |
| Sales of Northrop Common Stock | 424.3 | 132.0 | 17.5 |
| Sales of Other Equity Securities | 344.6 | 103.5 | 84.5 |
| Purchases of Other Equity Securities | (175.1) | (132.5) | (170.1) |
| Acquisitions and Improvements of Investment Real Estate | (24.3) | (24.2) | (39.2) |
| Sales of Investment Real Estate | 3.2 | 8.7 | 1.8 |
| Acquisitions of Limited Liability Investment Companies and Limited Partnerships | (80.0) | (97.9) | (65.7) |
| Change in Short-term Investments | 132.3 | (184.0) | 63.3 |
| Repayments of Automobile Loan Receivables | 571.4 | 644.2 | 627.6 |
| Acquisitions of Automobile Loan Receivables | (546.1) | (793.3) | (806.9) |
| Acquisition of Businesses, Net of Cash Acquired | (95.4) | (46.9) | |
| Disposition of Businesses, Net of Cash Disposed | 68.8 | 3.9 | |
| Other, Net | (29.9) | (15.4) | (3.3) |
| Net Cash Provided (Used) by Investing Activities | 356.2 | (222.9) | (86.1) |
| FINANCING ACTIVITIES | | | |
| Certificates of Deposits Issued | 143.0 | 361.3 | 350.9 |
| Certificates of Deposits Withdrawals | (306.5) | (249.7) | (262.5) |
| Notes Payable Proceeds | 232.0 | 354.8 | 40.0 |
| Notes Payable Payments | (232.1) | (300.0) | (40.1) |
| Cash Dividends Paid | (118.4) | (119.9) | (119.8) |
| Common Stock Repurchases | (69.0) | (139.5) | (89.9) |
| Cash Exercise of Stock Options | 1.6 | 5.1 | 6.8 |
| Excess Tax Benefits from Share-based Awards | 0.3 | 1.3 | 3.4 |
| Other, Net | 3.4 | 4.0 | 4.3 |
| Net Cash Used by Financing Activities | (345.7) | (82.6) | (106.9) |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | |
|---|-----------------|----------|----------|
| Increase (Decrease) in Cash | 79.7 | (53.4) | 113.4 |
| Cash, Beginning of Year, Including Cash Reported in Discontinued Operations | 104.5 | 157.9 | 44.5 |
| Cash, End of Year, Including Cash Reported in Discontinued Operations | \$ 184.2 | \$ 104.5 | \$ 157.9 |
| Cash, End of Year, Reported in Discontinued Operations | | (1.4) | |
| Cash, End of Year | \$ 184.2 | \$ 103.1 | \$ 157.9 |

The Notes to the Consolidated Financial Statements are an integral part of these financial statements.

Table of Contents**Unitrin, Inc. and Subsidiaries****Consolidated Statements of Shareholders Equity and Comprehensive Income (Loss)****FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006**

| <i>DOLLARS AND SHARES IN MILLIONS, EXCEPT PER SHARE AMOUNT</i> | NUMBER OF SHARES | COMMON STOCK | PAID-IN CAPITAL | RETAINED EARNINGS | ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) | TOTAL SHAREHOLDERS EQUITY |
|---|-----------------------------|-------------------------|----------------------------|------------------------------|--|--|
| BALANCE, DECEMBER 31, 2005 As Reported | 68.5 | \$ 6.9 | \$ 711.4 | \$ 1,188.2 | \$ 251.2 | \$ 2,157.7 |
| Cumulative Effect of Change in Accounting (notes 1 and 2) | | | | 1.7 | | 1.7 |
| BALANCE, DECEMBER 31, 2005 As Adjusted | 68.5 | \$ 6.9 | \$ 711.4 | \$ 1,189.9 | \$ 251.2 | \$ 2,159.4 |
| Net Income | | | | 287.0 | | 287.0 |
| Other Comprehensive Income (note 14) | | | | | 43.1 | 43.1 |
| Total Comprehensive Income | | | | | | 330.1 |
| Cash Dividends to Shareholders (\$1.76 per share) | | | | (119.8) | | (119.8) |
| Repurchases of Common Stock | (2.0) | (0.2) | (21.6) | (68.1) | | (89.9) |
| Stock-based Compensation Cost (notes 2 and 12) | | | 11.9 | | | 11.9 |
| Share-based Awards, Net of Shares Exchanged (note 12) | 0.5 | | 57.6 | (52.2) | | 5.4 |
| Adjustment to Initially Apply SFAS No. 158, Net of Tax (note 2) | | | | | (7.3) | (7.3) |
| Other | | | (0.2) | | | (0.2) |
| BALANCE, DECEMBER 31, 2006 | 67.0 | \$ 6.7 | \$ 759.1 | \$ 1,236.8 | \$ 287.0 | \$ 2,289.6 |
| Net Income | | | | 205.4 | | 205.4 |
| Other Comprehensive Income (note 14) | | | | | 40.1 | 40.1 |
| Total Comprehensive Income | | | | | | 245.5 |
| Cash Dividends to Shareholders (\$1.82 per share) | | | | (119.9) | | (119.9) |
| Repurchases of Common Stock | (3.0) | (0.3) | (35.6) | (103.6) | | (139.5) |
| Stock-based Compensation Cost (notes 2 and 12) | | | 15.7 | | | 15.7 |
| Share-based Awards, Net of Shares Exchanged (note 12) | 0.3 | | 42.5 | (39.3) | | 3.2 |
| Equity in Investee s Adjustment to Initially Apply SFAS No. 158, Net of Tax (note 2) | | | | | (2.3) | (2.3) |
| Equity in Cumulative Effect of Investee s Adoption of FIN 48 | | | | (0.9) | | (0.9) |
| Other | | | (0.4) | | | (0.4) |
| BALANCE, DECEMBER 31, 2007 | 64.3 | \$ 6.4 | \$ 781.3 | \$ 1,178.5 | \$ 324.8 | \$ 2,291.0 |
| Net Loss | | | | (29.6) | | (29.6) |
| Other Comprehensive Loss (note 14) | | | | | (432.9) | (432.9) |
| Total Comprehensive Loss | | | | | | (462.5) |
| Cash Dividends to Shareholders (\$1.88 per share) | | | | (118.4) | | (118.4) |
| Repurchases of Common Stock | (2.0) | (0.2) | (24.9) | (43.9) | | (69.0) |
| Stock-based Compensation Cost (notes 2 and 12) | | | 7.4 | | | 7.4 |
| Share-based Awards, Net of Shares Exchanged (note 12) | | | 1.0 | (0.8) | | 0.2 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | | | | | | | | | |
|-----------------------------------|-------------|-----------|------------|-----------|--------------|-----------|--------------|-----------|----------------|-----------|----------------|
| Other | | | | (0.1) | | | | (0.1) | | | |
| BALANCE, DECEMBER 31, 2008 | 62.3 | \$ | 6.2 | \$ | 764.7 | \$ | 985.8 | \$ | (108.1) | \$ | 1,648.6 |

The Notes to the Consolidated Financial Statements are an integral part of these financial statements.

Table of Contents

Unitrin, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

NOTE 1. BASIS OF PRESENTATION AND SIGNIFICANT ESTIMATES

The Consolidated Financial Statements included herein have been prepared on the basis of GAAP and include the accounts of Unitrin, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

In 2008, the Company changed its accounting for certain investments accounted for under the equity method of accounting to eliminate a reporting lag. The Consolidated Financial Statements have been adjusted for the retrospective application of a change in accounting principle pursuant to SFAS No. 154, *Accounting Changes and Correction of Errors*. See Note 2, Summary of Accounting Policies and Accounting Changes, to the Consolidated Financial Statements for the effect on the Consolidated Financial Statements.

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

The fair values of Investments in Fixed Maturities, Investments in Equity Securities and Senior Notes Payable are estimated pursuant to the hierarchy of fair value under SFAS No. 157, *Fair Value Measurements*. The fair values of the Company's Investment in Investee and Investments in Northrop Preferred Stock and Northrop Common Stock are based on quoted market prices. The fair value of Automobile Loan Receivables is estimated by discounting the estimated future cash flows using the current rates at which loans would be made to borrowers with similar credit ratings and the same remaining maturities. The fair values of Certificates of Deposits have been estimated by discounting the future cash flows using the rates currently offered for deposits with similar remaining maturities. The carrying amounts reported in the Consolidated Balance Sheets approximate fair value for Cash, Short-term Investments and certain other assets and other liabilities because of their short-term nature.

The actual value at which such financial instruments could actually be sold or settled with a willing buyer or seller may differ from such estimated fair values depending on a number of factors including, but not limited to, current and future economic conditions, the quantity sold or settled, the presence of an active market and the availability of a willing buyer or seller.

The Reserve for Loan Losses is estimated using the Company's estimate of ultimate charge-offs and recoveries of loans based on past experience adjusted for current economic conditions. Such charge-offs and recoveries emerge over several years. Accordingly, the Company's actual ultimate net charge-off could materially differ from the Company's estimate due to a variety of factors including, but not limited to, trends and future conditions in the macroeconomic, socioeconomic and regulatory environment, the timing of charge-offs and recoveries, the value of collateral and changes in the overall credit quality of the loan portfolio.

The process of estimating and establishing reserves for losses and LAE for property and casualty insurance is inherently uncertain and the actual ultimate net cost of a claim may vary materially from the estimated amount reserved. The reserving process is particularly imprecise for claims involving asbestos, environmental matters, mold, construction defect and other emerging and/or long-tailed exposures, which may not be discovered or reported until years after the insurance policy period has ended. Management considers a variety of factors including, but not limited to, past claims experience, current claim trends and relevant legal, economic and social conditions, in estimating reserves. A change in any one or more factors is likely to result in the ultimate net claim cost to differ from the estimated reserve. Such changes in estimates may be material.

The process of determining whether or not an asset is impaired or recoverable relies on projections of future cash flows, operating results and market conditions. Projections are inherently uncertain and, accordingly, actual

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 1. BASIS OF PRESENTATION AND SIGNIFICANT ESTIMATES (Continued)**

future cash flows may differ materially from projected cash flows. As a result, the Company's assessment of the impairment of long-lived assets or the recoverability of assets such as Goodwill and Deferred Policy Acquisition Costs is susceptible to the risk inherent in making such projections.

NOTE 2. SUMMARY OF ACCOUNTING POLICIES AND ACCOUNTING CHANGES***Investments***

Investments in Fixed Maturities include bonds, notes and redeemable preferred stocks at fair value and are classified as available for sale. Investments in Other Equity Securities include common and non-redeemable preferred stocks and other equity interests at fair value and are classified as available for sale. Other equity interests consist of limited partnership interests in partnerships which the Company's interest is deemed minor under applicable accounting standards. Unrealized appreciation or depreciation, net of applicable deferred income taxes, on fixed maturities and equity securities is reported in Accumulated Other Comprehensive Income (Loss) included in Shareholders' Equity. Short-term Investments include fixed maturities that mature within one year from the date of purchase, money market mutual funds, Federal funds sold and repurchase agreements at cost, which approximates fair value. Other Investments primarily include loans to policyholders, real estate, investments in certain limited liability investment companies and limited partnerships and mortgage loans. Loans to policyholders and mortgage loans are carried at unpaid principal balance. Real estate is carried at cost, net of accumulated depreciation. Investments in limited liability investment companies and limited partnerships in which the Company's interest is not deemed minor under applicable accounting standards are accounted for under the equity method of accounting. Gains and losses on sales of investments are computed on the specific identification method and are reported in the Consolidated Statements of Operations in the period in which the sales occur. The Company regularly reviews its investment portfolio for factors that may indicate that a decline in fair value of an investment is other than temporary. Losses arising from other than temporary declines in fair value are computed on the specific identification method and reported in the Consolidated Statements of Operations in the period that the decline is determined to be other than temporary.

Investment in Investee (Intermec) is accounted for under the equity method of accounting in the accompanying financial statements. The Company's voting percentage and share of earnings or losses of an investee is determined using the most recent and sufficiently timely publicly available audited financial statements and subsequent unaudited interim reports, which results in accounting on a three-month-delay basis. The Company recognizes into income its equity share of changes in an investee's reported net assets resulting from an investee's issuance of stock that is not part of a broader corporate reorganization.

Automobile Loan Receivables

Automobile Loan Receivables consists primarily of sub-prime loans to residents of California and other western and midwestern states. Automobile Loan Receivables is stated net of unearned discount, deferred loan fees and costs and reserve for loan losses. Unearned discount arises when the loan amount includes unearned pre-computed interest. The Reserve for Loan Losses is maintained at a level that considers such factors as actual and expected loan loss experience and economic conditions to provide for estimated loan losses. Additions to the Reserve for Loan Losses are charged to expense. Actual loan losses or recoveries are charged or added, respectively as the case may be, to the Reserve for Loan Losses when incurred or received.

Deferred Policy Acquisition Costs

Costs directly associated with the acquisition of business, principally commissions and certain premium taxes and policy issuance costs, are deferred. Costs deferred on property and casualty insurance products and health insurance products are amortized over the term of the related policies. Costs deferred on traditional life insurance

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 2. SUMMARY OF ACCOUNTING POLICIES AND ACCOUNTING CHANGES (Continued)**

products are primarily amortized over the anticipated premium-paying period of the related policies in proportion to the ratio of the annual premiums to the total premiums anticipated, which is estimated using the same assumptions used in calculating policy reserves.

The Company accounts for the present value of the future profits embedded in life insurance in force acquired (VIF) based on actuarial estimates of the present value of estimated net cash flows. VIF is classified as Deferred Policy Acquisition Costs in the Consolidated Balance Sheets. VIF is amortized using the effective interest method using interest rates consistent with the rates in the underlying insurance contracts. The Company estimates that it will record VIF amortization, net of interest, of \$2.7 million, \$2.4 million, \$2.2 million, \$2.0 million and \$1.8 million in each of the next five years.

Goodwill

The Company accounts for Goodwill pursuant to the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*. Accordingly, Goodwill is not amortized, but rather is tested annually for recoverability or when certain triggering events require testing. The Company tests Goodwill in the first quarter of its fiscal year. In 2008, the Company determined that the Goodwill related to its investment in Fireside Bank was impaired and wrote off \$9.2 million of Goodwill. See Note 7, *Goodwill* to the Consolidated Financial Statements.

Insurance Reserves

Reserves for losses and LAE on property and casualty coverage represent the estimated claim cost and loss adjustment expense necessary to cover the ultimate net cost of investigating and settling all losses incurred and unpaid. Such estimates are based on individual case estimates for reported claims and estimates for incurred but not reported losses. These estimates are adjusted in the aggregate for ultimate loss expectations based on historical experience patterns and current economic trends, with any change in the probable ultimate liabilities being reported in the Consolidated Statements of Operations in the period of change. Such changes in estimates may be material.

For traditional life insurance products, the reserves for future policy benefits are estimated on the net level premium method based on rates for expected mortality, lapse rates and interest rates, including provisions for adverse mortality. These assumptions vary by such characteristics as plan, age at issue and policy duration. Mortality assumptions are based on the Company's historical experience and industry standards. Interest rate assumptions principally range from 3% to 7%. Lapse rate assumptions are based on actual and industry experience. Benefit reserves for universal life-type products represent policy account balances before applicable surrender charges.

Other Receivables, Other Assets and Accrued Expenses and Other Liabilities

Other Receivables primarily include amounts due from policyholders, reinsurance recoverables and accrued investment income. Other Assets primarily include property and equipment, prepaid expenses and insurance licenses acquired. Accrued Expenses and Other Liabilities primarily include outstanding checks, accrued salaries and commissions, pension benefits, postretirement medical benefits and accrued taxes, licenses and fees.

Recognition of Earned Premiums and Related Expenses

Property and casualty insurance and health insurance premiums are recognized and earned ratably over the periods to which the premiums relate.

Traditional life insurance premiums are recognized as revenue when due. Policyholders' benefits are associated with related premiums to result in recognition of profits over the periods for which the benefits are provided.

Table of Contents

Unitrin, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

NOTE 2. SUMMARY OF ACCOUNTING POLICIES AND ACCOUNTING CHANGES (Continued)

Premium revenues for universal life-type products consist of charges for the cost of insurance, policy administration and policy surrenders that have been assessed against policy account balances during the period.

Policyholders' Benefits and Incurred Losses and Loss Adjustment Expenses include provisions for future policy benefits under life and certain accident and health insurance contracts and provisions for reported claims, estimates for claims incurred but not reported and loss adjustment expenses. Benefit payments in excess of policy account balances are expensed.

Reinsurance

In the normal course of business, Unitrin's insurance subsidiaries reinsure certain risks above certain retention levels with other insurance enterprises. Amounts recoverable from reinsurers for benefits and losses for which Unitrin's insurance subsidiaries have not been relieved of their legal obligations to the policyholder are included in Other Receivables.

Gains related to long-duration reinsurance contracts are deferred and amortized over the life of the underlying reinsured policies. Losses related to long-duration reinsurance contracts are recognized immediately. Any gain or loss associated with reinsurance agreements for which Unitrin's insurance subsidiaries have been legally relieved of their obligations to the policyholder is recognized in the period of relief.

Automobile Finance Revenues and Expenses

Automobile Finance Revenues primarily include interest on Automobile Loan Receivables and miscellaneous revenues related to the loans. Interest income, including amortization of unearned discount and deferred loan fees, on Automobile Loan Receivables is recorded as interest is earned, using the effective yield method over the contractual life of the loans.

Automobile Finance Expenses includes Provisions for Loan Losses and General and Administrative Expenses.

Interest Expense on Certificates of Deposits is recorded using the effective yield method.

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change is enacted.

The Company accounts for uncertain tax positions in accordance with FIN 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. Accordingly, the Company reports a liability for unrecognized tax benefits resulting from uncertain tax positions taken, or expected to be taken, in an income tax return. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense.

Stock-based Compensation

Awards under the Company's stock-based compensation plans are accounted for under the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 2. SUMMARY OF ACCOUNTING POLICIES AND ACCOUNTING CHANGES (Continued)****Accounting Changes**

At December 31, 2008, the Company determined that reliable financial information for certain investments in limited liability investment companies that the Company had accounted for under the equity method of accounting using a reporting lag of three months had consistently become available during 2008 on a sufficiently timely basis for the Company to report such investees' results consistent with the Company's reporting date. When an investor that reports an investee's results on a lag under Accounting Principles Board Opinion (APB) No. 18, *The Equity Method of Accounting for Investments in Common Stock*, subsequently has the ability to obtain reliable and timely financial statements for the investee as of, or more consistent with, the investor's reporting date, the investor is required to change, or discontinue the use of, the reporting lag. Pursuant to Emerging Issues Task Force (EITF) 06-09, *Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee*, when an investor is required to change, or discontinue the use of, a reporting lag for an investee, it must account for the change, or elimination, of the lag as a change in accounting principle pursuant to SFAS No. 154, *Accounting Changes and Correction of Errors*. Under SFAS 154, changes in accounting principles are reported retrospectively as if the current accounting principle had been used in all periods presented. Accordingly, the Consolidated Financial Statements have been adjusted to eliminate the reporting lag for these investees.

The following individual line items in the Consolidated Balance Sheets at December 31, 2008 and 2007 were affected by the change in accounting principle:

| | As Computed without Change in Accounting | As Reported with Change in Accounting | Effect of Change |
|--|--|---|---------------------|
| DOLLARS IN MILLIONS | | | |
| Impact on Assets at December 31, 2008: | | | |
| Other Investments | \$ 759.1 | \$ 714.9 | \$ (44.2) |
| Current and Deferred Income Taxes | 185.9 | 201.4 | 15.5 |
| Impact on Liabilities and Shareholders' Equity at December 31, 2008: | | | |
| Retained Earnings | 1,014.5 | 985.8 | (28.7) |

| | As Originally Reported | As Adjusted | Effect of Change |
|--|------------------------------|----------------|---------------------|
| DOLLARS IN MILLIONS | | | |
| Impact on Assets at December 31, 2007: | | | |
| Other Investments | \$ 706.7 | \$ 696.1 | \$ (10.6) |
| Impact on Liabilities and Shareholders' Equity at December 31, 2007: | | | |
| Liabilities for Income Taxes | 262.5 | 258.7 | (3.8) |
| Retained Earnings | 1,185.3 | 1,178.5 | (6.8) |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 2. SUMMARY OF ACCOUNTING POLICIES AND ACCOUNTING CHANGES (Continued)**

The following individual line items in the Consolidated Statement of Operations for the year ended December 31, 2008 were affected by the change in accounting principle:

| | Year Ended December 31, 2008 | | |
|---|---|---|---------------------|
| | As Computed without Change in Accounting | As Reported with Change in Accounting | Effect of Change |
| <i>DOLLARS IN MILLIONS</i> | | | |
| Earned Premiums | \$ 2,376.6 | \$ 2,376.6 | \$ |
| Automobile Finance Revenues | 242.3 | 242.3 | |
| Net Investment Income | 247.5 | 212.9 | (34.6) |
| Other Income | 4.1 | 4.1 | |
| Net Realized Investment Gains (Losses) | (93.7) | (93.7) | |
| Total Revenues | 2,776.8 | 2,742.2 | (34.6) |
| Total Expenses | 2,832.2 | 2,832.2 | |
| Income (Loss) from Continuing Operations before Income Taxes and in Net Income of Investee | (55.4) | (90.0) | (34.6) |
| Income Tax Benefit (Expense) | 34.1 | 46.2 | 12.1 |
| Income (Loss) from Continuing Operations before Equity in Net Income of Investee | (21.3) | (43.8) | (22.5) |
| Equity in Net Income of Investee | 5.8 | 5.8 | |
| Income (Loss) from Continuing Operations | (15.5) | (38.0) | (22.5) |
| Discontinued Operations: | | | |
| Income from Discontinued Operations Before Income Taxes | 17.2 | 18.2 | 1.0 |
| Income Tax Expense | (9.4) | (9.8) | (0.4) |
| Income from Discontinued Operations | 7.8 | 8.4 | 0.6 |
| Net Income (Loss) | \$ (7.7) | \$ (29.6) | \$ (21.9) |
| Income (Loss) Per Share from Continuing Operations | \$ (0.24) | \$ (0.60) | \$ (0.36) |
| Income Per Share from Discontinued Operations | 0.12 | 0.13 | 0.01 |
| Net Income (Loss) Per Share | \$ (0.12) | \$ (0.47) | \$ (0.35) |
| Income (Loss) Per Share from Continuing Operations Assuming Dilution | \$ (0.24) | \$ (0.60) | \$ (0.36) |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | |
|--|-------------|-------------|-------------|
| Income Per Share from Discontinued Operations Assuming Dilution | 0.12 | 0.13 | 0.01 |
| Net Income (Loss) Per Share Assuming Dilution | \$ (0.12) | \$ (0.47) | \$ (0.35) |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 2. SUMMARY OF ACCOUNTING POLICIES AND ACCOUNTING CHANGES (Continued)**

The following individual line items in the Consolidated Statement of Operations for the year ended December 31, 2007 were affected by the change in accounting principle:

| <i>DOLLARS IN MILLIONS</i> | Year Ended December 31, 2007 | | |
|---|------------------------------|----------------|---------------------|
| | As Originally Reported | As Adjusted | Effect of Change |
| Earned Premiums | \$ 2,286.9 | \$ 2,286.9 | \$ |
| Automobile Finance Revenues | 260.2 | 260.2 | |
| Net Investment Income | 306.7 | 289.9 | (16.8) |
| Other Income | 3.5 | 3.5 | |
| Net Realized Investment Gains (Losses) | 62.5 | 62.5 | |
| Total Revenues | 2,919.8 | 2,903.0 | (16.8) |
| Total Expenses | 2,676.2 | 2,676.2 | |
| Income (Loss) from Continuing Operations before Income Taxes and in Net Income of Investee | 243.6 | 226.8 | (16.8) |
| Income Tax Benefit (Expense) | (55.8) | (49.9) | 5.9 |
| Income (Loss) from Continuing Operations before Equity in Net Income of Investee | 187.8 | 176.9 | (10.9) |
| Equity in Net Income of Investee | 1.2 | 1.2 | |
| Income (Loss) from Continuing Operations | 189.0 | 178.1 | (10.9) |
| Discontinued Operations: | | | |
| Income from Discontinued Operations Before Income Taxes | 37.1 | 34.8 | (2.3) |
| Income Tax Expense | (8.3) | (7.5) | 0.8 |
| Income from Discontinued Operations | 28.8 | 27.3 | (1.5) |
| Net Income (Loss) | \$ 217.8 | \$ 205.4 | \$ (12.4) |
| Income (Loss) Per Share from Continuing Operations | \$ 2.88 | \$ 2.71 | \$ (0.17) |
| Income Per Share from Discontinued Operations | 0.44 | 0.42 | (0.02) |
| Net Income (Loss) Per Share | \$ 3.32 | \$ 3.13 | \$ (0.19) |
| Income (Loss) Per Share from Continuing Operations Assuming Dilution | \$ 2.87 | \$ 2.70 | \$ (0.17) |
| Income Per Share from Discontinued Operations Assuming Dilution | 0.43 | 0.42 | (0.01) |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | |
|---|---------|---------|-----------|
| Net Income (Loss) Per Share Assuming Dilution | \$ 3.30 | \$ 3.12 | \$ (0.18) |
|---|---------|---------|-----------|

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 2. SUMMARY OF ACCOUNTING POLICIES AND ACCOUNTING CHANGES (Continued)**

The following individual line items in the Consolidated Statement of Operations for the year ended December 31, 2006 were affected by the change in accounting principle:

| <i>DOLLARS IN MILLIONS</i> | Year Ended December 31, 2006 | | |
|---|------------------------------|-------------|------------------|
| | As Originally Reported | As Adjusted | Effect of Change |
| Earned Premiums | \$ 2,290.5 | \$ 2,290.5 | \$ |
| Automobile Finance Revenues | 245.0 | 245.0 | |
| Net Investment Income | 280.8 | 286.0 | 5.2 |
| Other Income | 14.4 | 14.4 | |
| Net Realized Investment Gains (Losses) | 26.5 | 26.5 | |
| Total Revenues | 2,857.2 | 2,862.4 | 5.2 |
| Total Expenses | 2,487.2 | 2,487.2 | |
| Income (Loss) from Continuing Operations before Income Taxes and in Net Income of Investee | 370.0 | 375.2 | 5.2 |
| Income Tax Benefit (Expense) | (115.0) | (116.8) | (1.8) |
| Income (Loss) from Continuing Operations before Equity in Net Income of Investee | 255.0 | 258.4 | 3.4 |
| Equity in Net Income of Investee | 9.2 | 9.2 | |
| Income (Loss) from Continuing Operations | 264.2 | 267.6 | 3.4 |
| Discontinued Operations: | | | |
| Income from Discontinued Operations Before Income Taxes | 21.3 | 22.0 | 0.7 |
| Income Tax Expense | (2.4) | (2.6) | (0.2) |
| Income from Discontinued Operations | 18.9 | 19.4 | 0.5 |
| Net Income (Loss) | \$ 283.1 | \$ 287.0 | \$ 3.9 |
| Income (Loss) Per Share from Continuing Operations | \$ 3.89 | \$ 3.94 | \$ 0.05 |
| Income Per Share from Discontinued Operations | 0.28 | 0.29 | 0.01 |
| Net Income (Loss) Per Share | \$ 4.17 | \$ 4.23 | \$ 0.06 |
| Income (Loss) Per Share from Continuing Operations Assuming Dilution | \$ 3.87 | \$ 3.92 | \$ 0.05 |
| Income Per Share from Discontinued Operations Assuming Dilution | 0.28 | 0.28 | |
| Net Income (Loss) Per Share Assuming Dilution | \$ 4.15 | \$ 4.20 | \$ 0.05 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 2. SUMMARY OF ACCOUNTING POLICIES AND ACCOUNTING CHANGES (Continued)**

The following individual line items in the Consolidated Statements of Cash Flows for years the years ended December 31, 2008, 2007 and 2006 were affected by the change in accounting principle:

| | Year Ended December 31, 2008 | | |
|--|---|---|---------------------|
| | As Computed without Change in Accounting | As Reported with Change in Accounting | Effect of Change |
| <i>DOLLARS IN MILLIONS</i> | | | |
| Impact on Operating Activities for the year ended December 31, 2008: | | | |
| Net Income (Loss) | \$ (7.7) | \$ (29.6) | \$ (21.9) |
| Equity in (Earnings) Losses of Limited Liability Investment Companies and Limited Partnerships | 43.5 | 77.1 | 33.6 |
| Decrease in Liabilities for Income Taxes | (120.4) | (132.1) | (11.7) |
| Net Cash Provided by Operating Activities | 69.2 | 69.2 | |

| | Year Ended December 31, 2007 | | |
|--|------------------------------|----------------|---------------------|
| | As Originally Reported | As Adjusted | Effect of Change |
| <i>DOLLARS IN MILLIONS</i> | | | |
| Impact on Operating Activities for the year ended December 31, 2007: | | | |
| Net Income (Loss) | \$ 217.8 | \$ 205.4 | \$ (12.4) |
| Equity in (Earnings) Losses of Limited Liability Investment Companies and Limited Partnerships | (25.5) | (6.4) | 19.1 |
| Decrease in Liabilities for Income Taxes | (53.4) | (60.1) | (6.7) |
| Net Cash Provided by Operating Activities | 252.1 | 252.1 | |

| | Year Ended December 31, 2006 | | |
|--|------------------------------|----------------|---------------------|
| | As Originally Reported | As Adjusted | Effect of Change |
| <i>DOLLARS IN MILLIONS</i> | | | |
| Impact on Operating Activities for the year ended December 31, 2006: | | | |
| Net Income (Loss) | \$ 283.1 | \$ 287.0 | \$ 3.9 |
| Equity in (Earnings) Losses of Limited Liability Investment Companies and Limited Partnerships | (18.9) | (24.8) | (5.9) |
| Decrease in Liabilities for Income Taxes | (6.3) | (4.3) | 2.0 |
| Net Cash Provided by Operating Activities | 306.4 | 306.4 | |

There was no effect on Investing Activities or Financing Activities reported in the Consolidated Statements of Cash Flows for the years ended December 31, 2008, 2007 and 2006.

During 2008, 2007 and 2006, the following accounting guidance relevant to the Company has been issued by the FASB, and/or became effective.

Edgar Filing: UNITRIN INC - Form 10-K

In June 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized under SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on various related matters such as derecognition, interest and penalties, and disclosure. On January 1, 2007, the Company adopted FIN 48. The initial application of FIN 48 to the Company's tax positions had no effect on the Company's Shareholders' Equity. The Company accounts for its investment in its investee, Intermec, under the equity method of accounting on a three-month-delay basis.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 2. SUMMARY OF ACCOUNTING POLICIES AND ACCOUNTING CHANGES (Continued)**

Accordingly, the Company recognized its pro rata share of the effect of Intermecc's adoption of FIN 48 in the Company's consolidated financial statements in the second quarter of 2007. Based on Intermecc's disclosure in its Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2007, the impact of Intermecc's initial application of FIN 48 resulted in the Company recognizing a reduction in the Company's Shareholders' Equity of \$0.9 million, which was net of a tax benefit of \$0.5 million.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. On January 1, 2008, the Company adopted SFAS No. 157. The initial application of SFAS No. 157 did not have a material effect on the fair values reported by the Company. The additional disclosures required by SFAS No. 157 are presented in Note 22, *Fair Value Measurements*. On October 10, 2008, the FASB issued FASB Staff Position (FSP) SFAS No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*. FSP SFAS No. 157-3 does not change the fair value measurement principles in SFAS No. 157, but rather provides guidance of the application of those measurement principles in the extreme inactive markets that currently exist.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. SFAS No. 158 amends SFAS No. 87, *Employers' Accounting for Pensions*, SFAS No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and Termination Benefits*, SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and SFAS No. 132(R), *Employers' Disclosure about Pensions and Other Postretirement Benefits*. SFAS No. 158 requires the recognition of the funded status of a defined benefit postretirement plan (other than a multi-employer plan) as an asset or liability in the statement of financial position and the recognition of changes in the funded status through comprehensive income in the year in which such changes occur. The Company adopted the recognition provisions of SFAS No. 158 and initially applied them to the funded status of the Company's defined benefit postretirement plans and provided the required disclosures as of December 31, 2006. The initial recognition of the funded status of the Company's defined benefit postretirement plans resulted in a decrease in Shareholders' Equity of \$7.3 million, which was net of a tax benefit of \$5.5 million. The Company's investee, Intermecc, recognized the financial impact of SFAS No. 158 in its financial statements at December 31, 2006. The Company accounts for its investment in Intermecc under the equity method of accounting on a three-month-delay basis. Accordingly, the Company recognized a decrease of \$2.3 million, which was net of a tax benefit of \$1.3 million, to its Shareholders' Equity in the first quarter of 2007 for its pro rata share of the impact of Intermecc's adoption of SFAS No. 158.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. SFAS No. 159 permits the choice of measuring financial instruments and certain other items at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. On January 1, 2008, the Company adopted SFAS No. 159 and elected not to apply the provisions of SFAS No. 159 to its eligible financial assets and financial liabilities on the date of adoption. Accordingly, the initial application of SFAS No. 159 had no effect on the Company.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree and recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase. SFAS No. 141(R) also sets forth the disclosures required to be made in the financial statements to evaluate the

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 2. SUMMARY OF ACCOUNTING POLICIES AND ACCOUNTING CHANGES (Continued)**

nature and financial effects of the business combination. The Company is required to apply SFAS No. 141(R) prospectively to business combinations occurring on or after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*. SFAS No. 160 establishes accounting and reporting standards that require: that the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of operations; and changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. SFAS No. 160 also requires that any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value when a subsidiary is deconsolidated. SFAS No. 160 also sets forth the disclosure requirements to identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. SFAS No. 160 must be applied prospectively as of the beginning of the fiscal year in which SFAS No. 160 is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements are applied retrospectively for all periods presented. The Company does not have a noncontrolling interest in one or more subsidiaries. Accordingly, the Company does not anticipate that the initial application of SFAS No. 160 will have an impact on the Company.

In March 2008, the FASB issued SFAS No. 161, *Disclosure about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133*. SFAS No. 161 establishes, among other things, the disclosure requirements for derivative instruments and for hedging activities. SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, with the intent to provide users of financial statements with enhanced understanding of: how and why an entity uses derivative securities; how derivatives and hedges are being accounted for under SFAS No. 133; and how derivatives and hedges affect an entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008 with early adoption permitted. The Company estimates that the initial application of SFAS No. 161 will not be material.

In April 2008, the FASB issued FSP SFAS 142-3, *Determination of the Useful Life of Intangible Assets*. FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. Previously, under the provisions of SFAS No. 142, an entity was precluded from using its own assumptions about renewal or extension of an arrangement where there was likely to be substantial cost or material modifications. FSP SFAS 142-3 removes the requirement of SFAS No. 142 for an entity to consider whether an intangible asset can be renewed without substantial cost or material modification to the existing terms and conditions and requires an entity to consider its own experience in renewing similar arrangements. FSP SFAS 142-3 also increases the disclosure requirements for a recognized intangible asset to enable a user of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent or ability to renew or extend the arrangement. FSP SFAS 142-3 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Early adoption is prohibited. The guidance for determining the useful life of a recognized intangible asset is applied prospectively to intangible assets acquired after the effective date. Accordingly, the Company does not anticipate that the initial application of FSP SFAS No. 142-3 will have an impact on the Company. The disclosure requirements must be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 2. SUMMARY OF ACCOUNTING POLICIES AND ACCOUNTING CHANGES (Continued)**

In May 2008, the FASB issued SFAS No. 163, *Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60*. SFAS No. 163 clarifies how SFAS No. 60, *Accounting and Reporting by Insurance Enterprises*, applies to financial guarantee insurance contracts (GICs), including the recognition and measurement of premium revenue and claim liabilities and requires expanded disclosures about GICs. SFAS No. 163 does not apply to a GIC that is accounted for as a derivative instrument within the scope of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Except for certain disclosure requirements regarding insurance enterprise risk-management activities, SFAS No. 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and all interim periods within those fiscal years. Early adoption is generally not permitted. The Company estimates that the initial application of SFAS No. 163 will not be material.

In June 2008, the FASB issued FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. FSP EITF 03-6-1 concluded that all outstanding share-based payment awards that contain a right to receive nonforfeitable dividends participate in the undistributed earnings with common shareholders, and therefore, the issuing entity is required to apply the two-class method of computing basic and diluted earnings per share, pursuant to SFAS No. 128, *Earnings per Share*. FSP EITF 03-6-1 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Early adoption is prohibited. Upon adoption, all prior-period earnings per share data presented must be adjusted retrospectively to conform to FSP EITF 03-6-1. The Company estimates that its Basic Net Income per Share from Continuing Operations will decrease by no more than \$0.01 per common share on an annual basis on the initial and retrospective application of FSP EITF 03-6-1.

NOTE 3. ACQUISITIONS OF BUSINESSES

On April 1, 2008, the Company completed its acquisition of Primesco, including its wholly owned subsidiaries, Mutual Savings Life and Mutual Savings Fire in a cash merger transaction for a total purchase price of \$95.5 million, including transaction costs of \$0.2 million. The results of the acquired companies are included in the Consolidated Financial Statements from the date of acquisition and are reported in the Company's Life and Health Insurance segment.

The Company has not yet completed the process of estimating the fair value of the value of Insurance In Force acquired and Insurance Reserves assumed. The Company expects to complete this process and finalize the allocation of the purchase price by March 31, 2009. Based on the Company's preliminary allocation of the purchase price, assets acquired and liabilities assumed at the date of acquisition of Primesco were:

DOLLARS IN MILLIONS

| | |
|---|----------|
| Investments | \$ 399.1 |
| Other Receivables | 12.5 |
| Value of Insurance In Force (Reported in Deferred Policy Acquisition Costs) | 52.4 |
| Goodwill | 29.1 |
| Current and Deferred Income Taxes | 8.0 |
| Other Assets | 3.7 |
| Insurance Reserves | (400.9) |
| Unearned Premiums | (0.2) |
| Accrued Expenses and Other Liabilities | (8.2) |
| Total Purchase Price | \$ 95.5 |

On June 29, 2007, Trinity, a subsidiary of Unitrin, acquired Merastar in a cash transaction for a total purchase price of \$47.9 million, including transaction costs of \$0.7 million. Beginning with the Company's third quarter of

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 3. ACQUISITIONS OF BUSINESSES (Continued)**

2007, the results of the acquisition have been included in the Consolidated Financial Statements from the date of acquisition and are reported in the Company's Unitrin Direct segment. Merastar provides automobile and homeowners insurance and is licensed in 48 states.

The Company finalized the allocation of the purchase price to the fair value of the assets acquired and the liabilities assumed in the fourth quarter of 2007. The fair value of the net assets acquired exceeded the purchase price. Accordingly, in accordance with SFAS No. 141, *Business Combinations*, such excess has been allocated to reduce the fair value of non-financial assets acquired. Based on the Company's allocation of the purchase price, assets acquired and liabilities assumed at the date of acquisition of Merastar were:

DOLLARS IN MILLIONS

| | |
|---|----------------|
| Investments | \$ 58.7 |
| Cash | 1.0 |
| Other Receivables | 11.5 |
| Value of Insurance In Force (Reported in Deferred Policy Acquisition Costs) | 13.0 |
| Value of Licenses Acquired (Reported in Other Assets) | 5.8 |
| Other Assets | 0.6 |
| Insurance Reserves | (25.0) |
| Unearned Premiums | (12.5) |
| Liabilities for Income Taxes | (0.1) |
| Accrued Expenses and Other Liabilities | (5.1) |
| Total Purchase Price | \$ 47.9 |

NOTE 4. DISCONTINUED OPERATIONS

The Company accounts for its Unitrin Business Insurance operations as discontinued operations in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets*. On June 3, 2008, the Company completed its previously disclosed sale of its Unitrin Business Insurance operations to AmTrust for total consideration of \$101.8 million. Total consideration consisted of cash, other receivables of \$10.9 million, with an outstanding balance of \$0.7 million at December 31, 2008, and a note receivable from AmTrust valued at \$25.1 million. The note receivable is payable in four equal annual installments of \$7.5 million and is non-interest bearing. Net proceeds were \$94.5 million, including \$7.3 million of early contract termination fees and other transaction related costs. AmTrust acquired the renewal rights to the Unitrin Business Insurance book of business, certain legal entities, selected other assets, and the workforce that the Company employed to underwrite and process its Unitrin Business Insurance products. The Company retained Property and Casualty Insurance Reserves for unpaid insured losses that occurred prior to June 1, 2008, the effective date of the sale. In accordance with SFAS No. 144, the Company is not permitted to report these liabilities as Liabilities of Discontinued Operations. Accordingly, Property and Casualty Insurance Reserves as reported in the Company's Consolidated Balance Sheets at December 31, 2008 and December 31, 2007 include \$261.1 million and \$342.2 million, respectively, for unpaid insured losses and LAE incurred by Unitrin Business Insurance. However, pursuant to the provisions of SFAS No. 144, changes in the Company's estimate of such retained liabilities after the sale are reported as a separate component of the results of discontinued operations.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 4. DISCONTINUED OPERATIONS (Continued)**

Summary financial information included in Income from Discontinued Operations before Income Taxes for the years ended December 31, 2008, 2007 and 2006, are presented below:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|---|-----------|----------|----------|
| Earned Premiums | \$ 70.8 | \$ 171.5 | \$ 188.2 |
| Net Investment Income | 6.7 | 23.0 | 28.9 |
| Other Income | | | 1.9 |
| Total Revenues Included in Discontinued Operations | \$ 77.5 | \$ 194.5 | \$ 219.0 |
| Income from Discontinued Operations before Income Taxes: | | | |
| Results of Operations | \$ (19.9) | \$ 34.8 | \$ 22.0 |
| Change in Estimate of Retained Liabilities Arising from Discontinued Operations | 30.0 | | |
| Gain on Disposition | 8.1 | | |
| Income from Discontinued Operations before Income Taxes | \$ 18.2 | \$ 34.8 | \$ 22.0 |

The effective income tax rate for discontinued operations differs from the federal statutory income tax rate due primarily to goodwill that is not deductible for tax purposes in 2008, and tax-exempt investment income and dividends received deductions in 2008, 2007 and 2006. Tax-exempt investment income and dividends received deductions were \$5.4 million, \$13.6 million and \$14.7 million for the years ended December 31, 2008, 2007 and 2006, respectively.

The components of Assets of Discontinued Operations and Liabilities of Discontinued Operations at December 31, 2007 were:

| <i>DOLLARS IN MILLIONS</i> | |
|--|---------|
| Assets: | |
| Investments: | |
| Fixed Maturities at Fair Value (Amortized Cost \$29.7) | \$ 31.1 |
| Short-term Investments at Cost which Approximates Fair Value | 5.3 |
| Total Investments | 36.4 |
| Cash | 1.4 |
| Other Receivables | 39.5 |
| Deferred Policy Acquisition Costs | 15.0 |
| Goodwill | 30.0 |
| Other Assets | 5.7 |
| Total Assets of Discontinued Operations | 128.0 |
| Liabilities: | |
| Unearned Premiums | 50.8 |

Edgar Filing: UNITRIN INC - Form 10-K

| | |
|---|-------------|
| Accrued Expenses and Other Liabilities | 0.5 |
| Total Liabilities of Discontinued Operations | 51.3 |
| Net Assets of Discontinued Operations | \$ 76.7 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 5. INVESTMENTS**

The amortized cost and estimated fair values of the Company's Investments in Fixed Maturities at December 31, 2008 were:

| <i>DOLLARS IN MILLIONS</i> | AMORTIZED COST | GROSS UNREALIZED | | FAIR VALUE |
|---|-------------------|------------------|------------|------------|
| | | GAINS | LOSSES | |
| U.S. Government and Government Agencies and Authorities | \$ 934.6 | \$ 44.9 | \$ (0.4) | \$ 979.1 |
| States, Municipalities and Political Subdivisions | 1,295.6 | 34.2 | (21.3) | 1,308.5 |
| Corporate Securities: | | | | |
| Bonds and Notes | 1,765.0 | 47.0 | (129.5) | 1,682.5 |
| Redeemable Preferred Stocks | 179.2 | 0.3 | (13.7) | 165.8 |
| Investments in Fixed Maturities | \$ 4,174.4 | \$ 126.4 | \$ (164.9) | \$ 4,135.9 |

The amortized cost and estimated fair values of the Company's Investments in Fixed Maturities at December 31, 2007 were:

| <i>DOLLARS IN MILLIONS</i> | AMORTIZED COST | GROSS UNREALIZED | | FAIR VALUE |
|---|-------------------|------------------|-----------|------------|
| | | GAINS | LOSSES | |
| U.S. Government and Government Agencies and Authorities | \$ 1,099.8 | \$ 16.5 | \$ (7.6) | \$ 1,108.7 |
| States, Municipalities and Political Subdivisions | 1,321.9 | 43.8 | (1.6) | 1,364.1 |
| Corporate Securities: | | | | |
| Bonds and Notes | 1,107.9 | 36.7 | (11.4) | 1,133.2 |
| Redeemable Preferred Stocks | 79.3 | 1.5 | (0.1) | 80.7 |
| Investments in Fixed Maturities | \$ 3,608.9 | \$ 98.5 | \$ (20.7) | \$ 3,686.7 |

The amortized cost and estimated fair values of the Company's Investments in Fixed Maturities at December 31, 2008 by contractual maturity were:

| <i>DOLLARS IN MILLIONS</i> | AMORTIZED COST | FAIR VALUE |
|---|-------------------|------------|
| Due in One Year or Less | \$ 148.1 | \$ 148.8 |
| Due after One Year to Five Years | 412.3 | 399.1 |
| Due after Five Years to Fifteen Years | 1,848.0 | 1,841.2 |
| Due after Fifteen Years | 1,298.0 | 1,266.9 |
| Asset-backed Securities Not Due at a Single Maturity Date | 468.0 | 479.9 |
| Investments in Fixed Maturities | \$ 4,174.4 | \$ 4,135.9 |

The expected maturities of the Company's Investments in Fixed Maturities may differ from the contractual maturities because debtors may have the right to call or prepay obligations with or without call or prepayment penalties. Investments in Asset-backed Securities Not Due at a Single Maturity Date at December 31, 2008 consisted of securities issued by Ginnie Mae with a fair value of \$415.6 million, securities issued by Fannie Mae with a fair value of \$48.2 million, securities issued by Freddie Mac with a fair value of \$2.4 million and securities of other issuers with a

fair value of \$13.7 million.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 5. INVESTMENTS (Continued)**

Gross unrealized gains and gross unrealized losses on the Company's Investments in Northrop Common Stock and Other Equity Securities at December 31, 2008 were:

| <i>DOLLARS IN MILLIONS</i> | COST | GROSS UNREALIZED | | FAIR VALUE |
|-------------------------------|-------------|-------------------------|---------------|-------------------|
| | | GAINS | LOSSES | |
| Northrop Common Stock | \$ 38.6 | \$ 1.7 | \$ | \$ 40.3 |
| Other Equity Securities: | | | | |
| Preferred Stocks | \$ 150.1 | \$ 2.1 | \$ (32.3) | \$ 119.9 |
| Common Stocks | 15.8 | 2.6 | (0.9) | 17.5 |
| Other Equity Interests | 50.9 | 0.4 | (7.2) | 44.1 |
| Total Other Equity Securities | \$ 216.8 | \$ 5.1 | \$ (40.4) | \$ 181.5 |

Gross unrealized gains and gross unrealized losses on the Company's Investments in Northrop Preferred Stock, Northrop Common Stock and Other Equity Securities at December 31, 2007 were:

| <i>DOLLARS IN MILLIONS</i> | COST | GROSS UNREALIZED | | FAIR VALUE |
|-------------------------------|-------------|-------------------------|---------------|-------------------|
| | | GAINS | LOSSES | |
| Northrop Preferred Stock | \$ 177.5 | \$ 81.0 | \$ | \$ 258.5 |
| Northrop Common Stock | \$ 245.5 | \$ 202.0 | \$ | \$ 447.5 |
| Other Equity Securities: | | | | |
| Preferred Stocks | \$ 82.2 | \$ 8.0 | \$ (2.8) | \$ 87.4 |
| Common Stocks | 324.9 | 156.5 | (4.3) | 477.1 |
| Other Equity Interests | 29.4 | 3.8 | (0.1) | 33.1 |
| Total Other Equity Securities | \$ 436.5 | \$ 168.3 | \$ (7.2) | \$ 597.6 |

On April 4, 2008, Northrop redeemed all of its series B convertible preferred stock outstanding at a redemption rate of 1.299246 shares of Northrop common stock for each share of Northrop preferred stock. The Company had the right to convert its holdings of Northrop preferred stock into Northrop common stock at a more favorable conversion ratio than provided for in Northrop's redemption notice. Accordingly, in the first quarter of 2008, the Company converted its holdings of Northrop preferred stock into Northrop common stock at the rate of 1.822267 shares of Northrop common stock for each share of Northrop preferred stock. The Company received 3,234,181 shares of Northrop common stock in the conversion. As a result of the conversion, the Company was not entitled to receive a quarterly dividend on its investment in Northrop preferred stock, but was instead entitled to receive a dividend on the converted shares at a much lower dividend rate.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 5. INVESTMENTS (Continued)**

An aging of unrealized losses on the Company's Investments in Fixed Maturities and Other Equity Securities at December 31, 2008 is presented below:

| <i>DOLLARS IN MILLIONS</i> | LESS THAN 12 MONTHS | | 12 MONTHS OR LONGER | | TOTAL | |
|---|---------------------|-------------------|---------------------|-------------------|-------------------|-------------------|
| | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES |
| Fixed Maturities: | | | | | | |
| U.S. Government and Government Agencies and Authorities | \$ 57.2 | \$ (0.4) | \$ 4.0 | \$ | \$ 61.2 | \$ (0.4) |
| States, Municipalities and Political Subdivisions | 314.9 | (10.1) | 102.5 | (11.2) | 417.4 | (21.3) |
| Corporate Securities: | | | | | | |
| Bonds and Notes | 766.5 | (105.4) | 145.7 | (24.1) | 912.2 | (129.5) |
| Redeemable Preferred Stocks | 132.4 | (13.7) | | | 132.4 | (13.7) |
| Total Fixed Maturities | 1,271.0 | (129.6) | 252.2 | (35.3) | 1,523.2 | (164.9) |
| Other Equity Securities: | | | | | | |
| Preferred Stocks | 87.3 | (30.8) | 5.5 | (1.5) | 92.8 | (32.3) |
| Common Stocks | 4.1 | (0.9) | | | 4.1 | (0.9) |
| Other Equity Interests | 14.7 | (3.8) | 3.9 | (3.4) | 18.6 | (7.2) |
| Total Other Equity Securities | 106.1 | (35.5) | 9.4 | (4.9) | 115.5 | (40.4) |
| Total | \$ 1,377.1 | \$ (165.1) | \$ 261.6 | \$ (40.2) | \$ 1,638.7 | \$ (205.3) |

An aging of unrealized losses on the Company's Investments in Fixed Maturities and Other Equity Securities at December 31, 2007 is presented below:

| <i>DOLLARS IN MILLIONS</i> | LESS THAN 12 MONTHS | | 12 MONTHS OR LONGER | | TOTAL | |
|---|---------------------|-------------------|---------------------|-------------------|----------------|-------------------|
| | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES |
| Fixed Maturities: | | | | | | |
| U.S. Government and Government Agencies and Authorities | \$ 24.2 | \$ (0.1) | \$ 536.0 | \$ (7.5) | \$ 560.2 | \$ (7.6) |
| States, Municipalities and Political Subdivisions | 112.7 | (1.2) | 22.2 | (0.4) | 134.9 | (1.6) |
| Corporate Securities: | | | | | | |
| Bonds and Notes | 211.8 | (3.1) | 161.9 | (8.3) | 373.7 | (11.4) |
| Redeemable Preferred Stocks | 3.8 | (0.1) | | | 3.8 | (0.1) |
| Total Fixed Maturities | 352.5 | (4.5) | 720.1 | (16.2) | 1,072.6 | (20.7) |
| Other Equity Securities: | | | | | | |
| Preferred Stocks | 15.0 | (2.8) | 2.9 | | 17.9 | (2.8) |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | | | | |
|-------------------------------|----------|-----------|----------|-----------|------------|-----------|
| Common Stocks | 38.8 | (4.2) | 0.6 | (0.1) | 39.4 | (4.3) |
| Other Equity Interests | 5.2 | (0.1) | | | 5.2 | (0.1) |
| Total Other Equity Securities | 59.0 | (7.1) | 3.5 | (0.1) | 62.5 | (7.2) |
| Total | \$ 411.5 | \$ (11.6) | \$ 723.6 | \$ (16.3) | \$ 1,135.1 | \$ (27.9) |

Unrealized losses on fixed maturities were \$164.9 million at December 31, 2008, of which \$35.3 million related to fixed maturities that have continued in an unrealized loss position for more than 12 months. These fixed maturities are concentrated in states, municipalities and political subdivisions and investment-grade corporate bonds and notes, which the Company fully expects to recover.

Table of Contents

Unitrin, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

NOTE 5. INVESTMENTS (Continued)

Unrealized losses on fixed maturities were \$20.7 million at December 31, 2007, of which \$16.2 million related to fixed maturities that have continued in an unrealized loss position for more than 12 months. These fixed maturities are concentrated in U.S. Government and Government Agencies and Authorities and investment-grade corporate bonds and notes, which the Company fully expects to recover.

The Company regularly reviews its investment portfolio for factors that may indicate that a decline in fair value of an investment is other than temporary. Declines in the fair values of investments that are determined to be other than temporary are reported as losses in the Consolidated Statement of Operations in the period when such determination is made. See Note 15, Income from Investments. Based on evaluations at December 31, 2008 and 2007, of the prospects of the issuers, including, but not limited to, the length of time and magnitude of the unrealized loss, and the credit ratings of the issuers of the investments in the above fixed maturities, and the Company's intentions to sell or ability to hold the investments, the Company concluded that the declines in the fair values of the Company's investments in fixed maturities presented on the preceding page were temporary at the respective evaluation dates.

The Company considers various factors when considering if a decline in the fair value of an equity security is other than temporary including, but not limited to:

- a) The length of time and magnitude of the unrealized loss;
- b) The volatility of the investment;
- c) Analyst recommendations and price targets;
- d) Opinions of the Company's external investment managers;
- e) Market liquidity;
- f) Debt-like characteristics of perpetual preferred stocks and issuer ratings; and
- g) The Company's intentions to sell or ability to hold the investments.

The vast majority of the Company's equity securities at December 31, 2008 are perpetual preferred stocks of financial institutions. The Company considers the debt-like characteristics of these perpetual preferred stocks when evaluating impairment. The Company concluded that the declines in the fair values of the perpetual preferred stocks of these financial institutions were temporary in nature, largely driven by current market conditions, and since the Company intends to hold the securities until recovery, no impairments are necessary. Based on evaluations of factors above at December 31, 2008 and 2007, the Company concluded that the declines in the fair values of the Company's investments in equity securities presented on the preceding page were temporary at the respective evaluation dates.

The carrying value, fair value and approximate voting percentage for the Company's investment in the common stock of Intermec, which is accounted for under the equity method of accounting and reported as Investment in Investee in the Company's Consolidated Balance Sheets at December 31, 2008 and 2007 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|-------------------------------|----------|----------|
| Carrying Value | \$ 102.2 | \$ 90.7 |
| Fair Value | \$ 168.1 | \$ 257.1 |
| Approximate Voting Percentage | 20.5% | 20.7% |

Equity in Net Income of Investee was \$5.8 million, \$1.2 million and \$9.2 million for the years ended December 31, 2008, 2007 and 2006, respectively. Intermec recognized the financial impact of SFAS No. 158 in its financial statements at December 31, 2006. Intermec initially applied the provisions of FIN 48 on January 1, 2007. The Company accounts for its investment in Intermec under the equity method of accounting on a three-month-delay basis. Accordingly, the Company recognized a decrease of \$2.3 million, which was net of a tax

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 5. INVESTMENTS (Continued)**

benefit of \$1.3 million, to its Shareholders' Equity in the first quarter of 2007 for its pro rata share of the impact of Intermec's adoption of SFAS No. 158 and recognized a decrease of \$0.9 million, which was net of a tax benefit of \$0.5 million, to the Company's Shareholders' Equity in the second quarter of 2007 for its pro rata share of the impact of Intermec's adoption of FIN 48.

The carrying values of the Company's Other Investments at December 31, 2008 and 2007 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|---|-----------------|-----------------|
| Loans to Policyholders | \$ 209.9 | \$ 191.4 |
| Real Estate | 257.7 | 243.0 |
| Limited Liability Investment Companies and Limited Partnerships | 242.3 | 254.6 |
| Other | 5.0 | 7.1 |
| Total | \$ 714.9 | \$ 696.1 |

NOTE 6. AUTOMOBILE LOAN RECEIVABLES AND CERTIFICATES OF DEPOSITS

Automobile Loan Receivables consists primarily of sub-prime loans, which are secured by automobiles, to residents of California and other western and midwestern states. Automobile Loan Receivables is stated net of unearned discount, loan fees and reserve for loan losses.

The components of Automobile Loan Receivables at December 31, 2008 and 2007 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|--|-------------------|-------------------|
| Sales Contracts and Loans Receivables | \$ 1,213.1 | \$ 1,390.8 |
| Unearned Discounts and Deferred Fees | (14.4) | (28.9) |
| Net Automobile Loan Receivables Due | 1,198.7 | 1,361.9 |
| Reserve for Loan Losses | (120.1) | (148.4) |
| Automobile Loan Receivables | \$ 1,078.6 | \$ 1,213.5 |

An aging of Net Automobile Loan Receivables Outstanding at December 31, 2008 and 2007 is presented below:

| <i>DOLLARS IN MILLIONS</i> | AMOUNT DEC. 31, 2008 | AS A PERCENTAGE OF NET AUTOMOBILE LOAN RECEIVABLES OUTSTANDING | AMOUNT DEC. 31, 2007 | AS A PERCENTAGE OF NET AUTOMOBILE LOAN RECEIVABLES OUTSTANDING |
|----------------------------|-------------------------|--|-------------------------|--|
| Current Loan Balances | \$ 738.3 | 61.6% | \$ 833.1 | 61.2% |

Edgar Filing: UNITRIN INC - Form 10-K

Delinquent Loan Balances:

| | | | | |
|---|-------------------|---------------|-------------------|--------|
| Less than 30 Days Delinquent | 312.6 | 26.1 | 356.7 | 26.2 |
| 30 Days to 59 Days Delinquent | 103.0 | 8.6 | 111.1 | 8.1 |
| 60 Days to 89 Days Delinquent | 32.8 | 2.7 | 45.8 | 3.4 |
| Delinquent 90 Days and Greater | 12.0 | 1.0 | 15.2 | 1.1 |
| | | | | |
| Net Automobile Loan Receivables Outstanding | 1,198.7 | 100.0% | 1,361.9 | 100.0% |
| | | | | |
| Reserve for Loan Losses | (120.1) | | (148.4) | |
| | | | | |
| Automobile Loan Receivables | \$ 1,078.6 | | \$ 1,213.5 | |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 6. AUTOMOBILE LOAN RECEIVABLES AND CERTIFICATES OF DEPOSITS (Continued)**

Activity in the Reserve for Loan Losses for the years ended December 31, 2008, 2007 and 2006 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|---|----------|----------|---------|
| Reserve for Loan Losses Beginning of Year | \$ 148.4 | \$ 68.8 | \$ 62.6 |
| Provision for Loan Losses | 110.0 | 166.8 | 62.4 |
| Net Charge-off: | | | |
| Automobile Loan Receivables Charged-off | (182.9) | (139.4) | (105.6) |
| Automobile Loan Receivables Recovered | 44.6 | 52.2 | 49.4 |
| Net Charge-off | (138.3) | (87.2) | (56.2) |
| Reserve for Loan Losses End of Year | \$ 120.1 | \$ 148.4 | \$ 68.8 |

The weighted-average interest rates on Certificates of Deposits were 4.78% and 4.91% at December 31, 2008 and 2007, respectively. The range of interest rates on Certificates of Deposits was 0.05% to 5.85% at December 31, 2008 and 2.35% to 5.85% at December 31, 2007. Certificates of Deposits are generally fixed in maturity. The contractual maturities of Certificates of Deposits at December 31, 2008 and 2007 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|-------------------------------------|------------|------------|
| Due in One Year or Less | \$ 449.0 | \$ 422.5 |
| Due after One Year to Three Years | 449.2 | 414.9 |
| Due after Three Years to Five Years | 212.6 | 433.9 |
| Due after Five Years | | 3.0 |
| Total Certificates of Deposits | \$ 1,110.8 | \$ 1,274.3 |

NOTE 7. GOODWILL

Goodwill at December 31, 2008 and 2007 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|-----------------------------------|----------|----------|
| Kemper Segment | \$ 49.6 | \$ 49.6 |
| Unitrin Specialty Segment | 42.8 | 42.8 |
| Life and Health Insurance Segment | 242.2 | 213.1 |
| Fireside Bank | | 9.2 |
| Total Goodwill | \$ 334.6 | \$ 314.7 |

The Company tests goodwill for recoverability on an annual basis in the first quarter and between annual tests if circumstances or events indicate that the fair value of a reporting unit may have declined below its carrying value. The quoted value of Unitrin's common stock was significantly below the per share carrying value of the Company at December 31, 2008. Accordingly, the Company tested goodwill for each of its reporting

Edgar Filing: UNITRIN INC - Form 10-K

units for recoverability at December 31, 2008. The Company used discounted projections of future cash flows to estimate fair value of all reporting units except for Fireside Bank. In November 2008, the Company disclosed that it was pursuing strategic alternatives for Fireside Bank. In connection with its assessments of such strategic alternatives, the estimated fair value for Fireside Bank was based on discussions with and inquiries from third parties as well as the Company's own projections. For each reporting unit tested, except for Fireside Bank, the estimated fair value exceeded the carrying value of the reporting unit, and the Company concluded that the goodwill was recoverable. In the case of Fireside Bank, the carrying value exceeded the estimated fair value. Accordingly, pursuant to the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company was required to compute the implied fair value of Fireside Bank's goodwill and compare it with carried goodwill to determine if goodwill was impaired at December 31, 2008. Pursuant

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 7. GOODWILL (Continued)**

to SFAS No. 142, the implied fair value of goodwill is computed by allocating the estimated fair value of reporting unit to its assets and liabilities as if the reporting unit had been acquired in a business combination on the goodwill measurement date. Based on such allocation, the Company concluded that the Company's carrying value of goodwill for Fireside Bank exceeded the implied fair value of goodwill and that goodwill associated with Fireside Bank was impaired. Accordingly, the Company wrote off the entire carrying value of Goodwill for Fireside Bank.

Goodwill for the Life and Health Insurance segment increased in 2008 by \$29.1 million due to the acquisition of Primesco. See Note 3, Acquisitions of Businesses, for additional information pertaining to the acquisition of Primesco.

NOTE 8. PROPERTY AND CASUALTY INSURANCE RESERVES

Property and Casualty Insurance Reserve activity for the years ended December 31, 2008, 2007 and 2006 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|--|------------|------------|------------|
| Beginning Property and Casualty Insurance Reserves: | | | |
| Gross of Reinsurance at Beginning of Year | \$ 1,322.9 | \$ 1,432.6 | \$ 1,531.5 |
| Less Reinsurance Recoverables at Beginning of Year | 84.8 | 137.9 | 208.9 |
| Property and Casualty Insurance Reserves, Net of Reinsurance at Beginning of Year | 1,238.1 | 1,294.7 | 1,322.6 |
| Property and Casualty Insurance Reserves Acquired, Net of Reinsurance | 0.3 | 24.7 | |
| Incurred Losses and LAE related to: | | | |
| Current Year: | | | |
| Continuing Operations | 1,456.0 | 1,290.6 | 1,221.3 |
| Discontinued Operations | 62.0 | 117.3 | 134.6 |
| Total Incurred Losses and LAE related to Current Year | 1,518.0 | 1,407.9 | 1,355.9 |
| Prior Years: | | | |
| Continuing Operations | (49.6) | (55.4) | (65.8) |
| Discontinued Operations | (29.7) | (45.7) | (25.8) |
| Total Incurred Losses and LAE related to Prior Years | (79.3) | (101.1) | (91.6) |
| Total Incurred Losses and LAE | 1,438.7 | 1,306.8 | 1,264.3 |
| Paid Losses and LAE related to: | | | |
| Current Year: | | | |
| Continuing Operations | 943.5 | 831.3 | 730.3 |
| Discontinued Operations | 31.2 | 42.2 | 53.7 |
| Total Paid Losses and LAE related to Current Year | 974.7 | 873.5 | 784.0 |

Prior Years:

Edgar Filing: UNITRIN INC - Form 10-K

| | | | |
|---|-------------------|------------|------------|
| Continuing Operations | 439.0 | 433.6 | 431.2 |
| Discontinued Operations | 79.3 | 81.0 | 77.0 |
| Total Paid Losses and LAE related to Prior Years | 518.3 | 514.6 | 508.2 |
| Total Paid Losses and LAE | 1,493.0 | 1,388.1 | 1,292.2 |
| Property and Casualty Insurance Reserves, | | | |
| Net of Reinsurance at End of Year | 1,184.1 | 1,238.1 | 1,294.7 |
| Plus Reinsurance Recoverables at End of Year | 84.6 | 84.8 | 137.9 |
| Property and Casualty Insurance Reserves, | | | |
| Gross of Reinsurance at End of Year | \$ 1,268.7 | \$ 1,322.9 | \$ 1,432.6 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 8. PROPERTY AND CASUALTY INSURANCE RESERVES (Continued)**

Property and Casualty Insurance Reserves are estimated based on historical experience patterns and current economic trends. Actual loss experience and loss trends are likely to differ from these historical experience patterns and economic conditions. Loss experience and loss trends emerge over several years from the dates of loss inception. The Company monitors such emerging loss trends. Upon concluding, based on the data available, that an emerging loss trend will continue, the Company adjusts its property and casualty insurance reserves to recognize such trend. Changes in such estimates are included in the Consolidated Statements of Operations in the period of change.

In 2008, the Company reduced its property and casualty insurance reserves by \$79.3 million to recognize favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE reserves developed favorably by \$45.8 million and commercial lines insurance losses and LAE reserves developed favorably by \$33.5 million. The personal lines insurance losses and LAE reserves developed favorably due primarily to the emergence of more favorable loss trends than expected for the 2006 and 2005 accident years due to the improvements in the Company's claims handling procedures, partially offset by adverse development of \$8.9 million related to certain re-opened claims from Hurricane Rita in the 2005 accident year. The commercial lines insurance losses and LAE reserves developed favorably primarily in the Company's discontinued operations. During the fourth quarter of 2008, the Company's actuaries conducted their regular reserve review of retained insurance reserves of discontinued operations for all traditional reserving groups. In addition, the Company's actuaries updated certain commercial property and liability analyses using A.M Best's latest industry study to re-estimate asbestos and environmental liabilities and a more detail review by peril of other general liabilities, including construction defect liabilities. These additional procedures, along with the actuaries regular reserve reviews during 2008, resulted in favorable reserve development of \$29.7 million.

In 2007, the Company reduced its property and casualty insurance reserves by \$101.1 million to record favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE and commercial lines insurance losses and LAE developed favorably by \$44.4 million and \$56.7 million, respectively, in 2007. The reserve reductions were primarily due to the emergence of more favorable loss trends than expected for the 2006, 2005 and 2004 accident years, partially due to the improvements in the Company's claims handling procedures.

In 2006, the Company reduced its property and casualty insurance reserves by \$91.6 million to record favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE and commercial lines insurance losses and LAE developed favorably by \$63.6 million and \$28.0 million, respectively, in 2006. The reserve reductions were primarily due to the emergence of more favorable loss trends than expected for the 2005 and 2004 accident years, partially due to the improvements in the Company's claims handling procedures.

The Company cannot predict whether or not losses and LAE will develop favorably or unfavorably from the amounts reported in the Company's consolidated financial statements. However, the Company believes that such development will not have a material effect on the Company's consolidated financial position, but could have a material effect on the Company's consolidated financial results for a given period.

Reinsurance recoverables on property and casualty insurance reserves were \$84.6 million and \$84.8 million at December 31, 2008 and 2007, respectively. These reinsurance recoverables are concentrated with several reinsurers, the vast majority of which are highly rated by one or more of the principal investor and/or insurance company rating agencies. While most of the reinsurance recoverables were unsecured at December 31, 2008 and 2007, the agreements with the reinsurers generally provide for some form of collateralization upon the occurrence of certain events. The largest reinsurance recoverable on property and casualty insurance is from General Security National Insurance Company (GSNIC), a subsidiary of SCOR and is unsecured. In 2002, the

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 8. PROPERTY AND CASUALTY INSURANCE RESERVES (Continued)**

Company acquired two insurance companies from SCOR. Under the agreement governing the acquisition of these insurance companies, SCOR and/or GSNIC are responsible for all liabilities of these insurance companies incurred prior to the acquisition. Reinsurance recoverables at December 31, 2008 and 2007 included \$33.4 million and \$45.7 million, respectively, from GSNIC.

NOTE 9. NOTES PAYABLE

Total debt outstanding at December 31, 2008 and 2007 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|--|-----------------|-----------------|
| Senior Notes Payable at Amortized Cost: | | |
| 6.00% Senior Notes due May 15, 2017 | \$ 355.5 | \$ 355.0 |
| 4.875% Senior Notes due November 1, 2010 | 199.4 | 199.1 |
| Mortgage Note Payable at Amortized Cost | 5.9 | 6.0 |
| Total Debt Outstanding | \$ 560.8 | \$ 560.1 |

Interest Expense, including facility fees and accretion of discount, for the years ended December 31, 2008, 2007 and 2006 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|--|----------------|----------------|----------------|
| Notes Payable under Revolving Credit Agreements | \$ 1.5 | \$ 0.4 | \$ 0.5 |
| Senior Notes Payable: | | | |
| 6.00% Senior Notes due May 15, 2017 | 22.0 | 14.1 | |
| 4.875% Senior Notes due November 1, 2010 | 10.0 | 10.0 | 10.0 |
| 5.75% Senior Notes due July 1, 2007 | | 9.0 | 18.0 |
| Mortgage Note Payable | 0.4 | 0.4 | 0.4 |
| Interest Expense before Capitalization of Interest | 33.9 | 33.9 | 28.9 |
| Capitalization of Interest | (1.3) | (0.3) | |
| Total Interest Expense | \$ 32.6 | \$ 33.6 | \$ 28.9 |

Interest Paid, including facility fees, for the years ended December 31, 2008, 2007 and 2006 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|---|--------|--------|--------|
| Notes Payable under Revolving Credit Agreements | \$ 1.5 | \$ 0.2 | \$ 0.5 |
| Senior Notes Payable: | | | |
| 6.00% Senior Notes due May 15, 2017 | 21.6 | 11.1 | |
| 4.875% Senior Notes due November 1, 2010 | 9.8 | 9.8 | 9.8 |
| 5.75% Senior Notes due July 1, 2007 | | 17.2 | 17.2 |
| Mortgage Note Payable | 0.4 | 0.4 | 0.4 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | |
|---------------------|---------|---------|---------|
| Total Interest Paid | \$ 33.3 | \$ 38.7 | \$ 27.9 |
|---------------------|---------|---------|---------|

The Company has a five-year, \$325 million, unsecured, revolving credit agreement, expiring June 30, 2010, with a group of financial institutions. The agreement provides for fixed and floating rate advances for periods up to one year at various interest rates. The agreement also contains various financial covenants, including limits on total debt to total capitalization and minimum risk-based capital ratios for the Company's largest insurance subsidiaries. The proceeds from advances under the revolving credit facility may be used for general corporate

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 9. NOTES PAYABLE (Continued)**

purposes. The Company had no outstanding advances under its unsecured revolving credit agreements at December 31, 2008 and 2007. Undrawn letters of credit issued pursuant to the unsecured, revolving credit agreement were \$13.1 million at both December 31, 2008 and 2007. Accordingly, the amounts available for future borrowing were \$311.9 million at both December 31, 2008 and 2007.

On May 11, 2007, the Company issued \$360 million of its 6.00% Senior Notes due May 15, 2017. The 6.00% Senior Notes are unsecured and may be redeemed in whole at any time or in part from time to time at the Company's option at specified redemption prices. The Company issued the 6.00% Senior Notes for proceeds of \$354.8 million, net of transaction costs, for an effective yield of 6.19%. The Company used a portion of the proceeds from the sale of the 6.00% Senior Notes to repay the \$300 million aggregate principal amount of its 5.75% Senior Notes which matured on July 1, 2007.

In 2003, the Company issued \$200 million of its 4.875% Senior Notes due November 1, 2010 for an effective yield of 5.04%. The 4.875% Senior Notes are unsecured and may be redeemed in whole at any time or in part from time to time at the Company's option at specified redemption prices.

In 2002, the Company issued \$300 million of its 5.75% Senior Notes due July 1, 2007 for an effective yield of 5.99%. The 5.75% Senior Notes were retired in 2007.

NOTE 10. LEASES

The Company leases certain office space under non-cancelable operating leases, with initial terms typically ranging from 1 to 10 years, along with options that permit renewals for additional periods. The Company also leases certain equipment under non-cancelable operating leases, with initial terms typically ranging from 1 to 5 years. Minimum rent is expensed on a straight-line basis over the term of the lease.

Net rental expense for operating leases for the years ended December 31, 2008, 2007 and 2006 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|-----------------------------|----------------|----------------|----------------|
| Minimum Rental Expense | \$ 29.9 | \$ 26.8 | \$ 25.7 |
| Less Sublease Rental Income | (0.3) | | (0.1) |
| Net Rental Expense | \$ 29.6 | \$ 26.8 | \$ 25.6 |

Future minimum lease payments under operating leases at December 31, 2008 were:

| <i>DOLLARS IN MILLIONS</i> | OPERATING LEASES |
|----------------------------|-----------------------------|
| 2009 | \$ 29.6 |
| 2010 | 27.7 |
| 2011 | 21.6 |
| 2012 | 17.7 |
| 2013 | 15.2 |
| 2014 and Thereafter | 50.7 |

| | |
|-----------------------|----------|
| Total Future Payments | \$ 162.5 |
|-----------------------|----------|

The total of minimum rentals to be received in the future under non-cancelable subleases was \$1.0 million at December 31, 2008. Capital leases are not material.

Table of Contents

Unitrin, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

NOTE 11. SHAREHOLDERS' EQUITY

The Company is authorized to issue 20 million shares of \$0.10 par value preferred stock and 100 million shares of \$0.10 par value common stock. No preferred shares were issued or outstanding at December 31, 2008 and 2007.

On August 4, 2004, the Board of Directors declared a dividend distribution of one preferred share purchase right for each outstanding share of common stock of Unitrin, pursuant to a shareholder rights plan. The rights have a term of 10 years. The description and terms of the rights are set forth in a rights agreement between Unitrin and Computershare Trust Company, N.A., as rights agent.

At December 31, 2008, there are approximately 1.4 million shares of the Company's outstanding common stock that can be repurchased under the outstanding repurchase authorization of the Company's Board of Directors. Common stock can be repurchased in the open market or in privately negotiated transactions from time to time subject to market conditions and other factors. The Company repurchased and retired 2.0 million shares of its common stock in open market transactions at an aggregate cost of \$69.0 million in 2008. The Company repurchased and retired approximately 3.0 million shares of its common stock in open market transactions at an aggregate cost of \$139.5 million in 2007. The Company repurchased and retired approximately 2.0 million shares of its common stock in open market transactions at an aggregate cost of \$89.9 million in 2006. Common Stock, Paid-in Capital and Retained Earnings were reduced on a pro rata basis for the cost of the repurchased shares.

Various state insurance laws restrict the amount that an insurance subsidiary may pay in the form of dividends, loans or advances without the prior approval of regulatory authorities. Also, that portion of an insurance subsidiary's net equity which results from differences between statutory insurance accounting practices and GAAP would not be available for cash dividends, loans or advances. Unitrin's subsidiaries paid dividends of \$135.2 million in cash and securities to Unitrin in 2008. In 2009, Unitrin's insurance subsidiaries would be able to pay approximately \$120 million in dividends to Unitrin without prior regulatory approval. Fireside Bank has agreed not to pay dividends without the prior approval of the FDIC and CDFI. The Company does not expect Fireside Bank to pay a dividend in 2009. Retained Earnings at December 31, 2008, also includes \$61.8 million representing the undistributed equity in the net income and accumulated other comprehensive income of investee (Intermec).

Unitrin's insurance subsidiaries are required to file financial statements prepared on the basis of statutory insurance accounting practices which is a comprehensive basis of accounting other than GAAP. Statutory capital and surplus for the Company's life and health insurance subsidiaries was approximately \$300 million and was \$324.8 million at December 31, 2008 and 2007, respectively. Statutory capital and surplus for the Company's property and casualty insurance subsidiaries was approximately \$830 million and was \$1,145.4 million at December 31, 2008 and 2007, respectively. Statutory net income for the Company's life and health insurance subsidiaries was income of approximately \$47 million, was income of \$58.5 million and was income of \$84.9 million for the years ended December 31, 2008, 2007 and 2006, respectively. Statutory net income for the Company's property and casualty insurance subsidiaries was loss of approximately \$29 million, was income of \$119.4 million and was income of \$170.5 million for the years ended December 31, 2008, 2007 and 2006, respectively. Statutory capital and surplus and statutory net income exclude Fireside Bank and parent company operations.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 12. LONG TERM EQUITY COMPENSATION**

Unitrin has adopted a number of long-term equity-based compensation plans to attract, motivate and retain key employees and/or directors of the Company. The Company's stock option plans provide for the grant of stock options and stock settled stock appreciation rights (SARs). In addition, restricted stock and restricted stock units may be granted under the Company's 2005 Restricted Stock and Restricted Stock Unit Plan. Options outstanding and available for future grants under all of the Company's stock option plans at December 31, 2008, are:

| | OPTIONS OUTSTANDING | WEIGHTED- AVERAGE EXERCISE PRICE | OPTIONS AVAILABLE FOR FUTURE GRANTS |
|---------------------------------|------------------------|--|---|
| 1995 Director Plan | 242,177 | \$ 42.97 | 80,000 |
| 2002 Option Plan | 2,949,300 | 45.86 | 1,395,468 |
| 1997 Option Plan | 1,880,813 | 47.02 | |
| 1990 Option Plan | 52,959 | 48.11 | |
| Total Stock Option Plans | 5,125,249 | \$ 46.17 | 1,475,468 |

The Company has four stock option plans, all of which have been approved by the Company's shareholders. Stock options to purchase the Unitrin's common stock are granted to employees and directors at prices equal to the fair market value of Unitrin's common stock on the date of grant. Employee options generally vest over a period of three and one-half years and expire ten years from the date of grant. The Compensation Committee of the Board of Directors, or the Board's authorized designee, has sole discretion to determine the persons to whom options are granted, the number of shares covered by such options and the exercise price, vesting and expiration dates of such options. Options are non-transferable and are exercisable in installments. Prior to 2003, only non-qualified stock options had been granted. However, beginning in 2003, non-qualified stock options granted to employees were coupled with tandem stock appreciation rights (Tandem SARs), settled in Unitrin common stock.

Under the 1995 Director Plan, each new member of the Board of Directors who is not employed by the Company receives an initial option to purchase 4,000 shares of Unitrin common stock immediately upon becoming a director. Thereafter, on the date of each of Unitrin's annual meetings of shareholders, each such eligible director automatically receives an annual grant of options to purchase 4,000 shares of common stock for so long as they remain eligible directors. Options granted under the 1995 Director Plan are exercisable one year from the date of grant at an exercise price equal to the fair market value of the Unitrin's common stock on the date of grant and expire 10 years from the date of grant.

The Company's four stock option plans include provisions, subject to certain limitations beginning in 2006 and 2009 as described below, to automatically grant restorative, or reload stock options (Restorative Options), to replace shares of previously owned Unitrin common stock that an exercising option holder surrenders, either actually or constructively, to satisfy the exercise price and/or tax withholding obligations relating to the exercise. Restorative Options are subject to the same terms and conditions as the original options, including the expiration date, except that the exercise price is equal to the fair market value of Unitrin common stock on the date of grant and cannot be exercised until six months after the date of grant. The grant of a Restorative Option does not result in an increase in the total number of shares and options held by an employee but changes the mix of the two.

For original awards granted beginning in 2006 and Restorative Options granted thereunder, Restorative Options will be granted only if, on the date of exercise of the option giving rise to the Restorative Option, the market price of Unitrin common stock exceeds such option's exercise price by 15%. Further, Restorative Options will not be granted if the option giving rise to the Restorative Option is set to expire within twelve months. For original awards granted beginning in 2009, Restorative Options will not be granted upon the exercise of the original award.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 12. LONG TERM EQUITY COMPENSATION (Continued)**

In addition to the Company's four stock option plans, the Company has a restricted stock plan, which has been approved by Unitrin's shareholders. Under this plan, restricted stock and restricted stock units may be granted to all eligible employees. Recipients of restricted stock are entitled to full dividend and voting rights, and all awards are subject to forfeiture until certain restrictions have lapsed. As of December 31, 2008, 345,400 shares of restricted stock having a weighted-average grant date fair value of \$44.30 have been awarded, of which 42,638 shares were forfeited and 32,901 were tendered to satisfy tax withholding obligations. At December 31, 2008, there were 730,139 common shares available for future grants under the Company's restricted stock plan.

The Company uses the Black-Scholes option pricing model to estimate the fair value of each option on the date of grant. The expected terms of options are developed by considering the Company's historical share option exercise experience, demographic profiles, historical share retention practices of employees and assumptions about their propensity for early exercise in the future. Further, the Company aggregates individual awards into relatively homogenous groups that exhibit similar exercise behavior to obtain a more refined estimate of the expected term of options. Expected volatility is estimated using weekly historical volatility. The Company believes that historical volatility is currently the best estimate of expected volatility. The dividend yield used was the annualized yield on Unitrin common stock on the date of grant for original grants made in 2008, 2007 and 2006. For Restorative Options, the annualized yield on Unitrin common stock for the month prior to the grant of the Restorative Option was used for restorative grants made in 2008, 2007 and 2006. No assumption for future dividend rate changes was included in the expected dividend yield assumption. The risk free interest rate was the yield on the grant date of U.S. Treasury zero coupon issues with a maturity comparable to the expected term of the option. The assumptions used in the Black-Scholes pricing model for options granted during the years ended December 31, 2008, 2007 and 2006 were as follows:

| | 2008 | | 2007 | | 2006 | |
|---------------------------------------|--------|-----------|--------|---------|--------|---------|
| RANGE OF VALUATION ASSUMPTIONS | | | | | | |
| Expected Volatility | 22.36% | 24.52% | 17.47% | 22.55% | 18.79% | 23.60% |
| Risk Free Interest Rate | 2.18% | 3.39% | 3.31% | 4.94% | 4.30% | 5.14% |
| Expected Dividend Yield | 3.86% | 5.49% | 3.51% | 4.18% | 3.55% | 4.25% |
| WEIGHTED-AVERAGE EXPECTED LIFE | | | | | | |
| Employee Grants | 2.5 | 7.5 years | 2 | 7 years | 2 | 7 years |
| Director Grants | 4 | 6.5 years | 4 | 6 years | 4 | 6 years |

Option and SAR activity for the year ended December 31, 2008 is presented below:

| | SHARES SUBJECT TO OPTIONS | WEIGHTED- AVERAGE EXERCISE PRICE PER SHARE | WEIGHTED- AVERAGE REMAINING CONTACTUAL LIFE (IN YEARS) | AGGREGATE INTRINSIC VALUE (\$ IN MILLIONS) |
|--|---------------------------------|---|--|---|
| Outstanding at Beginning of the Year | 5,275,958 | \$ 46.95 | | |
| Granted | 497,941 | 37.31 | | |
| Exercised | (69,746) | 32.76 | | |
| Forfeited or Expired | (578,904) | 47.28 | | |
| Outstanding at December 31, 2008 | 5,125,249 | \$ 46.17 | 4.65 | \$ |
| Vested and Expected to Vest at December 31, 2008 | 5,072,766 | \$ 46.24 | 4.58 | \$ |
| Exercisable at December 31, 2008 | 4,460,686 | \$ 46.70 | 4.08 | \$ |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 12. LONG TERM EQUITY COMPENSATION (Continued)**

The weighted-average grant-date fair values of options granted during 2008, 2007 and 2006 were \$4.81, \$6.39 and \$5.79, respectively. Total intrinsic value of stock options exercised was \$0.4 million, \$7.4 million and \$14.3 million for the years ended December 31, 2008, 2007 and 2006, respectively. Cash received from option exercises was \$1.6 million, \$5.1 million and \$6.8 million for the years ended December 31, 2008, 2007 and 2006, respectively. Total tax benefits realized for tax deductions from option exercises were \$0.2 million, \$2.6 million and \$5.2 million for the years ended December 31, 2008, 2007 and 2006, respectively.

Activity related to nonvested restricted stock for the year ended December 31, 2008 is presented below:

| | RESTRICTED SHARES | WEIGHTED- AVERAGE GRANT-DATE FAIR VALUE PER SHARE |
|--|----------------------|---|
| Nonvested Balance at Beginning of the Year | 177,489 | \$ 46.44 |
| Granted | 93,900 | 37.14 |
| Vested | (49,632) | 44.76 |
| Forfeited | (25,450) | 44.59 |
| Nonvested Balance at December 31, 2008 | 196,307 | \$ 42.66 |

The total fair value of restricted stock that vested during the year ended December 31, 2008 was \$1.2 million. Tax benefits for tax deductions realized from such vesting of restricted stock were \$0.4 million.

For awards with a graded vesting schedule, the Company recognizes compensation expense on a straight-line basis over the requisite service period for each separately vesting portion of the awards as if each award were, in-substance, multiple awards. Compensation expense is recognized only for those awards expected to vest, with forfeitures estimated at the date of grant based on the Company's historical experience and future expectations. Share-based compensation expense for all of the Company's long-term equity based compensation plans was \$7.4 million, \$15.7 million and \$11.9 million for the years ended December 31, 2008, 2007 and 2006, respectively. Total unamortized compensation expense related to nonvested awards of such plans at December 31, 2008 was \$5.7 million, which is expected to be recognized over a weighted-average period of approximately 1.5 years.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 13. NET INCOME (LOSS) PER SHARE**

Net Income (Loss) Per Share and Net Income (Loss) Per Share Assuming Dilution for the years ended December 31, 2008, 2007 and 2006 were:

| <i>DOLLARS AND SHARES IN MILLIONS, EXCEPT PER SHARE AMOUNTS</i> | 2008 | 2007 | 2006 |
|--|------------------|-------------|-------------|
| Income (Loss) from Continuing Operations | \$ (38.0) | \$ 178.1 | \$ 267.6 |
| Dilutive Effect on Income from Continuing Operations from Investee s Equivalent Shares | | (0.1) | (0.2) |
| Income (Loss) from Continuing Operations Assuming Dilution | \$ (38.0) | \$ 178.0 | \$ 267.4 |
| Income from Discontinued Operations | 8.4 | 27.3 | 19.4 |
| Net Income (Loss) Assuming Dilution | \$ (29.6) | \$ 205.3 | \$ 286.8 |
| Weighted-Average Common Shares Outstanding | 62.7 | 65.6 | 67.9 |
| Dilutive Effect of Unitrin Share-based Compensation Plans | | 0.3 | 0.3 |
| Weighted-Average Common Shares and Equivalent Shares Outstanding Assuming Dilution | 62.7 | 65.9 | 68.2 |
| Income (Loss) Per Share from Continuing Operations | \$ (0.60) | \$ 2.71 | \$ 3.94 |
| Income Per Share from Discontinued Operations | 0.13 | 0.42 | 0.29 |
| Net Income (Loss) Per Share | \$ (0.47) | \$ 3.13 | \$ 4.23 |
| Income (Loss) Per Share from Continuing Operations Assuming Dilution | \$ (0.60) | \$ 2.70 | \$ 3.92 |
| Income Per Share from Discontinued Operations Assuming Dilution | 0.13 | 0.42 | 0.28 |
| Net Income (Loss) Per Share Assuming Dilution | \$ (0.47) | \$ 3.12 | \$ 4.20 |

At December 31, 2008, options outstanding to purchase 5.1 million shares of Unitrin common stock were excluded from the computation of Weighted-Average Common Shares and Equivalent Shares Outstanding Assuming Dilution for the year ended December 31, 2008 because the effect of inclusion would be anti-dilutive and because the exercise price exceeded the average market price. The computation of Weighted-Average Common Shares and Equivalent Shares Outstanding Assuming Dilution also excludes 0.2 million shares of restricted stock outstanding at December 31, 2008 because the effect of inclusion would be anti-dilutive.

Options outstanding at 2007 and 2006, to purchase 3.7 million and 1.2 million common shares, respectively, of Unitrin common stock were excluded from the computation of Net Income Per Share Assuming Dilution in 2007 and 2006, respectively, because the exercise price exceeded the average market price.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 14. OTHER COMPREHENSIVE INCOME (LOSS)**

Other Comprehensive Income for the years ended December 31, 2008, 2007 and 2006 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|---|------------|----------|---------|
| Other Comprehensive Income before Income Taxes: | | | |
| Unrealized Holding Gains (Losses) Arising During the Year | \$ (682.0) | \$ 121.4 | \$ 93.8 |
| Reclassification Adjustment for Amounts Included in Net Income | 88.4 | (52.2) | (25.5) |
| Unrealized Holding Gains (Losses) | (593.6) | 69.2 | 68.3 |
| Unrecognized Postretirement Benefit Costs Arising During the Year | (73.4) | (5.0) | |
| Amortization of Unrecognized Postretirement Benefit Costs | (2.3) | (2.0) | |
| Net Unrecognized Postretirement Benefit Costs | (75.7) | (7.0) | |
| Foreign Currency Translation Adjustments on Investments | (2.0) | | |
| Equity in Other Comprehensive Income (Loss) of Investee | 2.5 | 1.2 | (2.1) |
| Other Comprehensive Income (Loss) before Income Taxes | (668.8) | 63.4 | 66.2 |
| Income Tax Benefit (Expense): | | | |
| Unrealized Holding Gains and Losses Arising During the Year | 239.9 | (43.2) | (32.8) |
| Reclassification Adjustment for Amounts Included in Net Income | (30.9) | 18.3 | 9.0 |
| Unrealized Holding Gains (Losses) | 209.0 | (24.9) | (23.8) |
| Unrecognized Postretirement Benefit Costs Arising During the Year | 26.5 | 1.4 | |
| Amortization of Unrecognized Postretirement Benefit Costs | 0.6 | 0.6 | |
| Net Unrecognized Postretirement Benefit Costs | 27.1 | 2.0 | |
| Foreign Currency Translation Adjustments on Investments | 0.7 | | |
| Equity in Other Comprehensive (Income) Loss of Investee | (0.9) | (0.4) | 0.7 |
| Income Tax Benefit (Expense) | 235.9 | (23.3) | (23.1) |
| Other Comprehensive Income (Loss) | \$ (432.9) | \$ 40.1 | \$ 43.1 |

The components of Accumulated Other Comprehensive Income (Loss) at December 31, 2008 and 2007 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|---|-----------|----------|
| Net Unrealized Gains (Losses) on Investments, Net of Income Taxes | \$ (45.5) | \$ 338.2 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | |
|---|-------------------|----------|
| Net Unrealized Gains on Assets of Discontinued Operations, Net of Income Taxes | | 0.9 |
| Foreign Currency Translation Adjustments on Investments, Net of Income Taxes | (1.3) | |
| Equity in Accumulated Other Comprehensive Loss of Investee, Net of Income Taxes | (0.5) | (2.1) |
| Net Unrecognized Postretirement Benefit Costs, Net of Income Taxes | (60.8) | (12.2) |
| Total Accumulated Other Comprehensive Income (Loss) | \$ (108.1) | \$ 324.8 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 15. INCOME FROM INVESTMENTS**

Net Investment Income for the years ended December 31, 2008, 2007 and 2006 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|---|-----------------|-----------------|-----------------|
| Investment Income (Loss): | | | |
| Interest and Dividends on Fixed Maturities | \$ 234.8 | \$ 209.8 | \$ 213.6 |
| Dividends on Northrop Preferred Stock | | 15.5 | 9.3 |
| Dividends on Northrop Common Stock | 10.7 | 9.4 | 8.6 |
| Dividends on Other Equity Securities | 19.0 | 19.2 | 12.4 |
| Short-term Investments | 11.8 | 34.3 | 27.5 |
| Loans to Policyholders | 14.6 | 13.5 | 13.2 |
| Real Estate | 30.2 | 30.3 | 28.0 |
| Limited Liability Investment Companies and Limited Partnerships | (76.3) | 6.7 | 24.8 |
| Other | | | 0.1 |
| Total Investment Income | 244.8 | 338.7 | 337.5 |
| Investment Expenses: | | | |
| Real Estate | 23.8 | 24.0 | 21.1 |
| Other Investment Expenses | 1.4 | 1.8 | 1.5 |
| Total Investment Expenses | 25.2 | 25.8 | 22.6 |
| Net Investment Income Including Discontinued Operations | 219.6 | 312.9 | 314.9 |
| Net Investment Income Reported in Discontinued Operations | (6.7) | (23.0) | (28.9) |
| Net Investment Income | \$ 212.9 | \$ 289.9 | \$ 286.0 |

The components of Net Realized Investment Gains (Losses) for the years ended December 31, 2008, 2007 and 2006 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|----------------------------|--------|--------|--------|
| Fixed Maturities: | | | |
| Gains on Dispositions | \$ 4.8 | \$ 5.1 | \$ 5.0 |
| Losses on Dispositions | (6.8) | (4.0) | (4.4) |
| Losses from Write-downs | (65.9) | (10.4) | |
| Northrop Common Stock: | | | |
| Gains on Dispositions | 53.1 | 58.6 | 5.6 |
| Losses on Dispositions | (13.1) | | |
| Other Equity Securities: | | | |
| Gains on Dispositions | 67.9 | 30.6 | 23.2 |
| Losses on Dispositions | (46.1) | (5.1) | (1.1) |
| Losses from Write-downs | (83.3) | (22.6) | (2.8) |
| Real Estate: | | | |
| Gains on Dispositions | 1.5 | 4.8 | 0.9 |
| Losses from Write-downs | | | (0.1) |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | |
|---|------------------|---------|---------|
| Other Investments: | | | |
| Gains on Dispositions | 0.1 | 1.2 | |
| Losses on Dispositions | (0.2) | (0.2) | (0.2) |
| Losses from Write-downs | (3.7) | | |
| Trading Securities Net Gains (Losses) | (2.0) | 0.5 | 0.4 |
| Gain on Sale of Southern States | | 4.0 | |
| Net Realized Investment Gains (Losses) | \$ (93.7) | \$ 62.5 | \$ 26.5 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 15. INCOME FROM INVESTMENTS (Continued)**

On July 9, 2007, Republic Companies purchased Southern States, a directly owned subsidiary of Unitrin, from the Company. Net Realized Investment Gains for the year ended December 31, 2007 includes a pretax gain of \$4.0 million for the year ended December 31, 2007 resulting from this sale.

NOTE 16. INSURANCE EXPENSES

Insurance Expenses for the years ended December 31, 2008, 2007 and 2006 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|---|-------------|-------------|-------------|
| Commissions | \$ 377.4 | \$ 363.0 | \$ 389.4 |
| General Expenses | 310.3 | 293.8 | 285.7 |
| Taxes, Licenses and Fees | 48.3 | 45.6 | 45.5 |
| Total Costs Incurred | 736.0 | 702.4 | 720.6 |
| Policy Acquisition Costs: | | | |
| Deferred | (311.0) | (297.0) | (316.8) |
| Amortized | 311.5 | 300.4 | 308.2 |
| Net Policy Acquisition Costs Amortized (Deferred) | 0.5 | 3.4 | (8.6) |
| Insurance Expenses | \$ 736.5 | \$ 705.8 | \$ 712.0 |

Commissions for servicing policies are expensed as incurred, rather than deferred and amortized.

NOTE 17. INCOME TAXES

The current and deferred income tax assets as presented in the Consolidated Balance Sheets at December 31, 2008 and 2007 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|--|-------------|-------------|
| Current and Deferred Income Taxes: | | |
| Current Income Tax Assets | \$ 0.2 | \$ 1.5 |
| Deferred Income Tax Assets | 204.8 | 15.7 |
| Valuation Allowance for State Income Taxes | (3.6) | |
| Current and Deferred Income Taxes | \$ 201.4 | \$ 17.2 |

The components of Liabilities for Income Taxes as presented in the Consolidated Balance Sheets at December 31, 2008 and 2007 were:

Edgar Filing: UNITRIN INC - Form 10-K

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|---|----------------|-------------|
| Liabilities for Income Taxes: | | |
| Current Income Tax Liabilities | \$ 51.2 | \$ 31.1 |
| Deferred Income Tax Liabilities | | 207.5 |
| Liability for Unrecognized Tax Benefits | 17.0 | 20.1 |
| Liabilities for Income Taxes | \$ 68.2 | \$ 258.7 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 17. INCOME TAXES (Continued)**

The tax effects of temporary differences that give rise to significant portions of the Company's Net Deferred Tax Asset at December 31, 2008 and Net Deferred Tax Liability at December 31, 2007 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|--|----------|------------|
| Deferred Tax Assets: | | |
| Insurance Reserves | \$ 92.7 | \$ 94.9 |
| Unearned Premium Reserves | 49.4 | 53.7 |
| Tax Capitalization of Policy Acquisition Costs | 74.5 | 70.5 |
| Reserve for Loan Losses | 50.5 | 61.8 |
| Net Operating Loss Carryforward | 15.3 | 5.6 |
| Payroll and Employee Benefit Accruals | 74.4 | 51.2 |
| Other Investments | 62.1 | |
| Other | 28.3 | 21.3 |
| Total Deferred Tax Assets | 447.2 | 359.0 |
| Deferred Tax Liabilities: | | |
| Deferred Policy Acquisition Costs | 171.3 | 158.3 |
| Northrop Preferred Stock | | 88.2 |
| Northrop Common Stock | 13.0 | 153.5 |
| Investee (Intermec) | 30.6 | 28.5 |
| Other Investments | | 98.0 |
| Other | 27.5 | 24.3 |
| Total Deferred Tax Liabilities | 242.4 | 550.8 |
| Valuation Allowance | 3.6 | |
| Net Deferred Tax Asset (Liability) | \$ 201.2 | \$ (191.8) |

Deferred Tax Assets include a Net Operating Loss Carryforward of \$15.3 million at December 31, 2008 which included a federal net operating loss carryforward of \$12.7 million and a state net operating loss carryforward of \$2.6 million. The federal net operating loss carryforwards are scheduled to expire in years 2009 through 2026. At this time, the Company expects to fully utilize these federal net operating loss carryforwards. The state net operating loss carryforwards relate to Fireside Bank and the majority of which are scheduled to expire in 2029. A deferred tax asset valuation allowance of \$3.6 million was required at December 31, 2008 and was related to state income taxes for Fireside Bank. A deferred tax asset valuation allowance was not required as of December 31, 2007.

Income taxes paid were \$98.8 million and \$116.9 million in 2008 and 2007, respectively.

The Company has not provided Federal income taxes on \$14.7 million of Mutual Savings Life's income earned prior to 1984 which is not subject to income taxes under certain circumstances. Federal income taxes of \$5.1 million would be paid on such income if it is distributed to shareholders in the future or if it does not continue to meet certain limitations.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 17. INCOME TAXES (Continued)**

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of adoption, current income taxes receivable increased by \$9.2 million, current income taxes payable decreased \$0.1 million, deferred income tax liabilities decreased \$23.4 million and the liability for unrecognized tax benefits increased by \$32.7 million. There was no effect on the Company's Shareholders' Equity upon the Company's adoption of FIN 48. A reconciliation of the beginning and ending amount of unrecognized tax benefits for the years ended December 31, 2008 and 2007 is as follows:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|--|----------------|-------------|
| Beginning Balance | \$ 20.1 | \$ 32.7 |
| Reductions for Tax Positions of Current Period | (1.8) | (9.7) |
| Additions for Tax Positions of Prior Years | 27.9 | 28.4 |
| Reduction for Expiration of State Statute of Limitations | | (8.1) |
| Reduction for Expiration of Federal Statute of Limitations | (29.2) | (23.2) |
| Ending Balance | \$ 17.0 | \$ 20.1 |

For the year ended December 31, 2008, all of Unitrin's subsidiaries, except for Mutual Savings Life and Mutual Savings Fire, are eligible to be included in a consolidated Federal income tax return with Unitrin. For the years ended December 31, 2007 and 2006, all of Unitrin's subsidiaries, except for Primesco and its subsidiaries, were included in a consolidated Federal income tax return with Unitrin. The statute of limitations related to Unitrin and its eligible subsidiaries' consolidated Federal income tax returns is closed for all tax years up to and including 2004. The statute of limitations related to Primesco and its subsidiaries is closed for all years up to and including 2004. The expiration of the statute of limitations related to the various state income tax returns that Unitrin and its subsidiaries file varies by state. Unitrin's consolidated Federal income tax returns and Primesco's consolidated Federal income tax returns are not currently under examination. During 2008, the Illinois Department of Revenue issued a tentative Notice of Audit Results related to its examination of the Company's 2005 and 2006 Illinois tax returns that indicate no changes to the returns as filed. The California Franchise Tax Board is conducting an audit of Fireside Bank's 2004, 2005 and 2006 California tax returns. The Company does not expect any material modifications to the returns as filed to result from the audit.

Included in the balance of unrecognized tax benefits at December 31, 2008 and December 31, 2007 are tax positions of \$10.6 million and \$12.7 million, respectively, for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred income tax accounting, other than for interest and penalties, the disallowance of the shorter deductibility period would not affect the effective income tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense. The liability for unrecognized tax benefits included accrued interest of \$6.0 million and \$6.8 million at December 31, 2008 and December 31, 2007, respectively. Tax benefit for the year ended December 31, 2008 includes an interest benefit of \$0.8 million, which is comprised of an interest benefit of \$2.5 million resulting from the expiration of the statutes of limitations referred to above, and interest expense of \$1.7 million on unrecognized tax benefits for prior years. Tax expense for the year ended December 31, 2007 includes an interest benefit of \$0.3 million, which is comprised of an interest benefit of \$4.0 million resulting from the expiration of the statutes of limitations referred to above, and interest expense of \$3.7 million on unrecognized tax benefits for prior years.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 17. INCOME TAXES (Continued)**

The components of Income Tax Expense from Continuing Operations for the years ended December 31, 2008, 2007 and 2006 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|------------------------------------|------------|------------|------------|
| Current Tax Benefit (Expense) | \$ (115.1) | \$ (151.2) | \$ (110.1) |
| Deferred Tax Benefit (Expense) | 158.2 | 88.6 | (6.7) |
| Unrecognized Tax Benefit (Expense) | 3.1 | 12.7 | |
| Income Tax Benefit (Expense) | \$ 46.2 | \$ (49.9) | \$ (116.8) |

A reconciliation of the Statutory Federal Income Tax Expense and Rate to the Company's Effective Income Tax Expense and Rate from Continuing Operations for the years ended December 31, 2008, 2007 and 2006 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | | 2007 | | 2006 | |
|---|---------|-------|-----------|-------|------------|-------|
| | AMOUNT | RATE | AMOUNT | RATE | AMOUNT | RATE |
| Statutory Federal Income Tax Benefit (Expense) and Rate | \$ 31.5 | 35.0% | \$ (79.4) | 35.0% | \$ (131.3) | 35.0% |
| Tax Exempt Income and Dividends Received Deduction | 20.0 | 22.2 | 21.6 | (9.5) | 19.2 | (5.2) |
| State Income Taxes | (2.6) | (2.9) | 8.9 | (3.9) | (4.3) | 1.2 |
| Other, Net | (2.7) | (2.9) | (1.0) | 0.4 | (0.4) | 0.1 |
| Effective Income Tax Benefit (Expense) and Rate | \$ 46.2 | 51.4% | \$ (49.9) | 22.0% | \$ (116.8) | 31.1% |

During 2007, a benefit of \$5.3 million was recorded for state income taxes related to the tax year that ended on December 31, 2002, due to the expiration of a state's statute of limitations.

Comprehensive Income Tax Expense included in the Consolidated Financial Statements for the years ended December 31, 2008, 2007 and 2006 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|--|---------|-----------|------------|
| Income Tax Benefit (Expense): | | | |
| Continuing Operations | \$ 46.2 | \$ (49.9) | \$ (116.8) |
| Discontinued Operations | (9.8) | (7.5) | (2.6) |
| Equity in: | | | |
| Net Income of Investee | (3.1) | (0.7) | (5.1) |
| Other Comprehensive Income of Investee | (0.9) | (0.4) | 0.7 |
| Unrealized (Appreciation) Depreciation on Securities | 209.0 | (24.9) | (24.0) |
| Foreign Currency Translation Adjustments on Investments | 0.7 | | |
| Tax Effects from Benefit Plans - SFAS No. 158 | 27.1 | 2.0 | |
| Tax Effects from Long-Term Equity Compensation included in Paid-in Capital | (0.8) | 0.6 | 3.0 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | |
|--|----------|-----------|------------|
| Other | | | 0.2 |
| Comprehensive Income Tax Benefit (Expense) | \$ 268.4 | \$ (80.6) | \$ (144.8) |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 18. PENSION BENEFITS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS**

The Company sponsored two qualified defined benefit pension plans in 2008 and one plan in 2007 (the Pension Plans) covering most of its employees. The Pension Plans are generally non-contributory, but participation in one of the Pension Plans requires or required some employees to contribute of 3% of pay, as defined, per year. Benefits for participants who are or were required to contribute to the Pension Plans are based on compensation during plan participation and the number of years of participation. Benefits for the vast majority of participants who are not required to contribute to the Pension Plans are based on years of service and final average pay, as defined. The Company funds the Pension Plans in accordance with the requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

The Company sponsors an other than pension postretirement employee benefit plan (OPEB) that provides medical, dental and/or life insurance benefits to approximately 900 retired and 700 active employees (the OPEB Plan). The Company generally is self-insured for the benefits under the OPEB Plan. The medical plan generally provides for a limited number of years of medical insurance benefits at retirement based on the participant's attained age at retirement and number of years of service until specified dates and generally requires participant contributions, with most contributions adjusted annually.

Changes in Fair Value of Plan Assets and Changes in Benefit Obligations (the Projected Benefit Obligation in the case of the Pension Plans and the Accumulated Benefit Obligation in the case of the OPEB Plan) for the years ended December 31, 2008 and 2007 were:

| <i>DOLLARS IN MILLIONS</i> | PENSION BENEFITS | | OTHER THAN PENSION BENEFITS | |
|---|------------------|-----------|-----------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Fair Value of Plan Assets at Beginning of Year | \$ 366.0 | \$ 363.7 | \$ | \$ |
| Fair Value of Plan Assets Acquired | 4.0 | | | |
| Actual Return on Plan Assets | (69.8) | 19.6 | | |
| Employer Contributions | | | 4.3 | 4.2 |
| Plan Participants' Contributions | 0.1 | 0.1 | 1.3 | 1.3 |
| Benefits Paid | (18.0) | (17.4) | (5.6) | (5.5) |
| Settlement Benefits | (0.4) | | | |
| Fair Value of Plan Assets at End of Year | 281.9 | 366.0 | | |
| Benefit Obligation at Beginning of Year | 377.3 | 355.7 | 37.4 | 44.9 |
| Benefit Obligation Acquired | 3.1 | | | |
| Service Cost | 12.5 | 13.4 | 0.1 | 0.1 |
| Interest Cost | 20.9 | 20.0 | 2.0 | 2.1 |
| Plan Participants' Contributions | 0.1 | 0.1 | 1.3 | 1.3 |
| Benefits Paid | (18.0) | (17.4) | (5.6) | (5.5) |
| Modernization Act Subsidy Received | | | 0.4 | |
| Settlement Benefits | (0.4) | | | |
| Actuarial (Gains) Losses | (20.4) | 5.5 | (1.1) | (5.5) |
| Benefit Obligations at End of Year | 375.1 | 377.3 | 34.5 | 37.4 |
| Funded Status - Benefit Obligation in Excess of Plan Assets | \$ (93.2) | \$ (11.3) | \$ (34.5) | \$ (37.4) |
| Amount Recognized in Accumulated Other Comprehensive Income (Loss): | | | | |
| Accumulated Actuarial Gain (Loss) | \$ (122.5) | \$ (48.0) | \$ 26.3 | \$ 27.3 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | | |
|--|-------------------|-----------|----------------|---------|
| Prior Service Cost | 0.7 | 0.9 | | |
| Amount Recognized in Accumulated Other Comprehensive Income (Loss) | \$ (121.8) | \$ (47.1) | \$ 26.3 | \$ 27.3 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 18. PENSION BENEFITS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS (Continued)**

The Accumulated Benefit Obligation for the Pension Plans was \$351.0 million and \$350.7 million at December 31, 2008 and 2007, respectively. For the Company's pension plan with an accumulated benefit obligation in excess of plan assets at December 31, 2008, the Projected Benefit Obligation was \$372.2 million, the Accumulated Benefit Obligation was \$348.1 million and the Fair Value of Plan Assets was \$278.2 million. For the Company's pension plan with an accumulated benefit obligation in excess of plan assets at December 31, 2007, the Projected Benefit Obligation was \$377.3 million, the Accumulated Benefit Obligation was \$350.7 million and the Fair Value of Plan Assets was \$366.0 million.

The Company estimates that Pension Expense for the year ended December 31, 2009 will include expense of \$1.0 million resulting from the amortization of the related accumulated actuarial loss included in Accumulated Other Comprehensive Income (Loss) at December 31, 2008.

The Company estimates that OPEB Expense for the year ended December 31, 2009 will include income of \$2.2 million resulting from the amortization of the related accumulated actuarial gain included in Accumulated Other Comprehensive Income (Loss) at December 31, 2008.

The measurement dates of the assets and liabilities of all plans presented above for 2008 and 2007 were December 31, 2008 and December 31, 2007, respectively.

The assumed health care cost trend rate used in measuring the Accumulated Benefit Obligation for the OPEB Plan at December 31, 2008 was 7% for 2009, gradually declining to 5% in the year 2011 and remaining at that level thereafter for medical benefits and 9% for 2009, gradually declining to 5% in the year 2013 and remaining at that level thereafter for prescription drug benefits. The assumed health care cost trend rate used in measuring the Accumulated Benefit Obligation for the OPEB Plan at December 31, 2007 was 8% for 2008, gradually declining to 5% in the year 2011 and remaining at that level thereafter for medical benefits and 10% for 2008, gradually declining to 5% in the year 2013 and remaining at that level thereafter for prescription drug benefits.

A one percentage point increase in the assumed health care cost trend rate for each year would increase the Accumulated Benefit Obligation for the OPEB Plan at December 31, 2008 by \$2.3 million and 2008 OPEB expense by \$0.1 million. A one percentage point increase in the assumed health care cost trend rate for each year would increase the Accumulated Benefit Obligation for the OPEB Plan at December 31, 2007 by \$2.7 million and 2007 OPEB expense by \$0.2 million.

The OPEB Plan were unfunded at December 31, 2008 and 2007. Weighted-average asset allocations for the Pension Plans at December 31, 2008 and 2007 by asset category were:

| <i>ASSET CATEGORY</i> | 2008 | 2007 |
|---|-------------|-------------|
| Cash and Short-term Investments | 20% | 8% |
| U.S. Government and Government Agencies and Authorities | | 19 |
| Corporate Bonds and Notes | 31 | 18 |
| Equity Securities | 36 | 42 |
| Other Assets | 13 | 13 |
| Total | 100% | 100% |

The investment objective of the Pension Plans is to produce current income and long-term capital growth through a combination of equity and fixed income investments which, together with appropriate employer contributions and any required employee contributions, is adequate to provide for the payment of the benefit obligations of the Pension Plans. The assets of the Pension Plans may be invested in both fixed income and equity investments.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 18. PENSION BENEFITS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS (Continued)**

Fixed income investments may include cash and short-term instruments, U.S. Government securities, corporate bonds, mortgages and other fixed income investments. Equity investments may include various types of stock, such as large-cap, mid-cap and small-cap stocks, and may also include investments in investment companies and Unitrin common stock (subject to Section 407 and other requirements of ERISA). The Pension Plans have not invested in Unitrin common stock.

The trust investment committee for the Pension Plans periodically reviews the performance of the Pension Plans' investments and asset allocation. Several external investment managers, one of which is Fayez Sarofim & Co. (FS&C), manage the equity investments of the trust for the Pension Plans. One of Unitrin's directors, Mr. Fayez Sarofim, is Chairman of the Board, President and the majority shareholder of FS&C, a registered investment advisory firm (see Note 24, Related Parties, to the Consolidated Financial Statements). Each manager is allowed to exercise investment discretion, subject to limitations, if any, established by the trust investment committee for the Pension Plans. All other investment decisions are made by the Company, subject to general guidelines as set by the trust investment committee for the Pension Plans.

The Company determines its Expected Long Term Rate of Return on Plan Assets based primarily on the Company's expectations of future returns for the Pension Plans' investments, based on target allocations of the Pension Plans' investments. Additionally, the Company considers historical returns on comparable fixed income investments and equity investments and adjusts its estimate as deemed appropriate.

The components of Pension Expense for the years ended December 31, 2008, 2007 and 2006 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|--|---------|---------|---------|
| Service Cost Benefits Earned During the Year | \$ 12.5 | \$ 13.4 | \$ 14.1 |
| Interest Cost on Projected Benefit Obligation | 20.9 | 20.0 | 18.9 |
| Expected Return on Plan Assets | (25.2) | (24.6) | (22.7) |
| Net Amortization and Deferral | (0.1) | 0.5 | 1.8 |
| Pension Expense Recognized | 8.1 | 9.3 | 12.1 |
| Unrecognized Pension Loss Arising During the Year | 74.6 | 10.4 | |
| Amortization of Accumulated Unrecognized Pension Gain (Loss) | 0.1 | (0.5) | |
| Comprehensive Pension Expense | \$ 82.8 | \$ 19.2 | \$ 12.1 |

Total Pension Expense Recognized presented above includes service cost benefits earned and reported in discontinued operations of \$0.7 million, \$1.2 million and \$1.5 million for the years ended December 31, 2008, 2007 and 2006, respectively.

The components of OPEB Expense for the years ended December 31, 2008, 2007 and 2006 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|--|--------|--------|--------|
| Service Cost Benefits Earned During the Year | \$ 0.1 | \$ 0.1 | \$ 0.1 |
| Interest Cost on Accumulated Benefit Obligation | 2.0 | 2.1 | 2.5 |
| Net Amortization and Deferral | (2.2) | (2.5) | (1.9) |
| OPEB (Income) Expense Recognized | (0.1) | (0.3) | 0.7 |
| Unrecognized OPEB Gain Arising During the Year | (1.2) | (5.4) | |
| Amortization of Accumulated Unrecognized OPEB Gain | 2.2 | 2.5 | |

| | | | |
|-------------------------------------|--------|----------|--------|
| Comprehensive OPEB (Income) Expense | \$ 0.9 | \$ (3.2) | \$ 0.7 |
|-------------------------------------|--------|----------|--------|

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 18. PENSION BENEFITS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS (Continued)**

The actuarial assumptions used to develop the components of the Pension Expense for the years ended December 31, 2008, 2007 and 2006 were:

| | 2008 | 2007 | 2006 |
|--|-------|-------|-------|
| Discount Rate | 5.75% | 5.75% | 5.50% |
| Rate of Increase in Future Compensation Levels | 4.12 | 4.10 | 4.10 |
| Expected Long Term Rate of Return on Plan Assets | 7.00 | 7.00 | 7.00 |

The actuarial assumptions used to develop the components of the OPEB Expense for the years ended December 31, 2008, 2007 and 2006, were:

| | 2008 | 2007 | 2006 |
|--|-------|-------|-------|
| Discount Rate | 5.75% | 5.75% | 5.50% |
| Rate of Increase in Future Compensation Levels | 1.50 | 3.30 | 4.10 |

The actuarial assumptions used to develop the components of the Pension Projected Benefit Obligation at December 31, 2008 and 2007 were:

| | 2008 | 2007 |
|--|-------|-------|
| Discount Rate | 6.00% | 5.75% |
| Rate of Increase in Future Compensation Levels | 4.07 | 4.12 |

The actuarial assumptions used to develop the components of the OPEB Accumulated Benefit Obligation at December 31, 2008 and 2007 were:

| | 2008 | 2007 |
|--|-------|-------|
| Discount Rate | 6.00% | 5.75% |
| Rate of Increase in Future Compensation Levels | 1.50 | 1.50 |

The Company does not expect to be required to contribute to its Pension Plans in 2009, but could make a voluntary contribution pursuant to the maximum funding limits under ERISA. The Company expects to contribute \$4.3 million, net of expected Modernization Act Subsidy, to its OPEB Plan to fund benefit payments in 2009.

The following benefit payments (net of participant contributions), which consider expected future service, as appropriate, are expected to be paid:

| <i>DOLLARS IN MILLIONS</i> | YEARS ENDING DECEMBER 31, | | | | | | |
|-------------------------------------|---------------------------|---------|---------|---------|---------|----------|------|
| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2018 |
| Pension Benefits | \$ 17.8 | \$ 18.3 | \$ 18.9 | \$ 20.0 | \$ 21.0 | \$ 123.2 | |
| OPEB Benefits: | | | | | | | |
| Excluding Modernization Act Subsidy | \$ 4.9 | \$ 4.8 | \$ 4.8 | \$ 4.7 | \$ 4.5 | \$ 19.3 | |
| Expected Modernization Act Subsidy | (0.6) | (0.6) | (0.6) | (0.6) | (0.6) | (2.8) | |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | | | | |
|-------------------|--------|--------|--------|--------|--------|---------|
| Net OPEB Benefits | \$ 4.3 | \$ 4.2 | \$ 4.2 | \$ 4.1 | \$ 3.9 | \$ 16.5 |
|-------------------|--------|--------|--------|--------|--------|---------|

The Company also sponsors several defined contribution benefit plans covering most of its employees. The Company made contributions to those plans of \$7.0 million, \$6.8 million and \$7.2 million in 2008, 2007 and 2006, respectively. Under these plans, the participants have several investment alternatives, including Unitrin s

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 18. PENSION BENEFITS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS (Continued)**

common stock and the Dreyfus Appreciation Fund. FS&C is a sub-investment advisor of the Dreyfus Appreciation Fund. One of Unitrin's directors, Mr. Fayez Sarofim, is the Chairman of the Board, President and majority shareholder of FS&C (see Note 24, Related Parties, to the Consolidated Financial Statements). The fair value of participants' investments in Unitrin's common stock was \$9.0 million, or 4.5% of the total investments in the defined contribution benefit plans at December 31, 2008. The fair value of participants' investment in the Dreyfus Appreciation Fund was \$14.7 million, or 7.4% of the total investments in the defined contribution benefit plans at December 31, 2008.

NOTE 19. BUSINESS SEGMENTS

The Company is engaged, through its subsidiaries, in the property and casualty insurance, life and health insurance and automobile finance businesses. The Company conducts its operations through five operating segments: Kemper, Unitrin Specialty, Unitrin Direct, Life and Health Insurance and Fireside Bank.

The Kemper segment provides preferred and standard risk personal automobile insurance, homeowners insurance and other personal insurance through independent agents. The Unitrin Specialty segment provides automobile insurance to individuals and businesses in the non-standard and specialty market through independent agents. The non-standard automobile insurance market consists of individuals and companies that have difficulty obtaining standard or preferred risk insurance, usually because of their driving records. Unitrin Direct markets personal automobile insurance through direct mail and the Internet through web insurance portals, click-thrus and its own website. In addition, Merastar, which is included in the Unitrin Direct segment from the date of its acquisition (see Note 3, Acquisition of Businesses, to the Consolidated Financial Statements), specializes in the sale of personal automobile and homeowners insurance through employer-sponsored voluntary benefit programs. The Life and Health Insurance segment provides individual life, accident, health and hospitalization insurance. The Company's Life and Health Insurance employee-agents also market property insurance products under common management. The Fireside Bank segment makes sub-prime automobile loans primarily for the purchase of pre-owned automobiles and offers certificates of deposits.

The Company's earned premiums and automobile finance revenues are derived in the United States. The accounting policies of the segments are the same as those described in Note 2, Summary of Accounting Policies and Accounting Changes, to the Consolidated Financial Statements. Capital expenditures for long-lived assets by operating segment are immaterial.

The Company also does not allocate insurance reserves from its 2002 acquisition of certain insurance companies from SCOR (see Note 8, Property and Casualty Insurance Reserves, to the Consolidated Financial Statements). It is also the Company's management practice to allocate certain corporate expenses to its insurance operations. In accordance with SFAS No. 144, the Company is not permitted to allocate certain corporate expenses to discontinued operations. Accordingly, such amounts that the Company is not permitted to allocate to discontinued operations are reported in Other Expense, Net. The Company considers the management of certain investments, including Northrop preferred and common stock, Baker Hughes common stock and Intermec common stock, to be a corporate responsibility. Accordingly, the Company does not allocate dividend income from these investments to its operating segments. The Company does not allocate Net Realized Investment Gains (Losses) to its operating segments.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 19. BUSINESS SEGMENTS (Continued)**

Segment Assets at December 31, 2008 and 2007 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 |
|----------------------------|------------|------------|
| SEGMENT ASSETS | | |
| Kemper | \$ 1,448.4 | \$ 1,454.6 |
| Unitrin Specialty | 715.5 | 650.1 |
| Unitrin Direct | 380.8 | 317.5 |
| Life and Health Insurance | 4,270.5 | 3,905.3 |
| Fireside Bank | 1,383.0 | 1,450.3 |
| Corporate and Other, Net | 620.6 | 1,616.6 |
| Total Assets | \$ 8,818.8 | \$ 9,394.4 |

Segment Revenues for the years ended December 31, 2008, 2007 and 2006 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|----------------------------|----------|----------|----------|
| REVENUES | | | |
| Kemper: | | | |
| Earned Premiums | \$ 930.7 | \$ 926.3 | \$ 944.6 |
| Net Investment Income | 19.1 | 44.0 | 50.4 |
| Other Income | 0.5 | 0.5 | 0.4 |
| Total Kemper | 950.3 | 970.8 | 995.4 |
| Unitrin Specialty: | | | |
| Earned Premiums | 494.0 | 449.3 | 444.4 |
| Net Investment Income | 8.6 | 19.2 | 22.4 |
| Other Income | 0.2 | 0.1 | |
| Total Unitrin Specialty | 502.8 | 468.6 | 466.8 |
| Unitrin Direct: | | | |
| Earned Premiums | 290.5 | 257.6 | 225.9 |
| Net Investment Income | 4.6 | 8.9 | 9.3 |
| Other Income | 0.4 | 0.4 | 0.4 |
| Total Unitrin Direct | 295.5 | 266.9 | 235.6 |
| Life and Health Insurance: | | | |
| Earned Premiums | 661.4 | 653.7 | 675.6 |
| Net Investment Income | 162.1 | 181.0 | 181.3 |
| Other Income | 1.1 | 1.2 | 11.2 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | |
|--|-------------------|------------|------------|
| Total Life and Health Insurance | 824.6 | 835.9 | 868.1 |
| Fireside Bank: | | | |
| Interest, Loan Fees and Earned Discounts | 237.4 | 251.2 | 237.3 |
| Other Automobile Finance Revenues | 4.9 | 9.0 | 7.7 |
| Automobile Finance Revenues | 242.3 | 260.2 | 245.0 |
| Net Investment Income | 4.5 | 4.9 | 3.9 |
| Total Fireside Bank | 246.8 | 265.1 | 248.9 |
| Total Segment Revenues | 2,820.0 | 2,807.3 | 2,814.8 |
| Unallocated Dividend Income | 10.8 | 25.2 | 18.2 |
| Net Realized Investment Gains (Losses) | (93.7) | 62.5 | 26.5 |
| Other | 5.1 | 8.0 | 2.9 |
| Total Revenues | \$ 2,742.2 | \$ 2,903.0 | \$ 2,862.4 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 19. BUSINESS SEGMENTS (Continued)**

Segment Operating Profit for the years ended December 31, 2008, 2007 and 2006 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|---|-----------|----------|----------|
| SEGMENT OPERATING PROFIT (LOSS) | | | |
| Kemper | \$ 7.6 | \$ 88.2 | \$ 133.4 |
| Unitrin Specialty | 10.2 | 35.3 | 39.2 |
| Unitrin Direct | (52.5) | (41.2) | (9.8) |
| Life and Health Insurance | 79.3 | 150.6 | 155.4 |
| Fireside Bank | (25.3) | (66.0) | 44.8 |
| Total Segment Operating Profit | 19.3 | 166.9 | 363.0 |
| Unallocated Dividend Income | 10.8 | 25.2 | 18.2 |
| Net Realized Investment Gains (Losses) | (93.7) | 62.5 | 26.5 |
| Other Expense, Net | (26.4) | (27.8) | (32.5) |
| Income (Loss) from Continuing Operations before Income Taxes and Equity in Net Income of Investee | \$ (90.0) | \$ 226.8 | \$ 375.2 |

Segment Net Income for the years ended December 31, 2008, 2007 and 2006 was:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|--|-----------|----------|----------|
| SEGMENT NET INCOME (LOSS) | | | |
| Kemper | \$ 13.4 | \$ 66.5 | \$ 95.4 |
| Unitrin Specialty | 10.1 | 27.0 | 29.3 |
| Unitrin Direct | (32.0) | (24.9) | (4.7) |
| Life and Health Insurance | 51.8 | 97.0 | 101.5 |
| Fireside Bank | (22.3) | (38.8) | 26.1 |
| Total Segment Net Income | 21.0 | 126.8 | 247.6 |
| Net Income (Loss) From: | | | |
| Unallocated Dividend Income | 9.5 | 22.2 | 16.0 |
| Net Realized Investment Gains (Losses) | (61.0) | 40.5 | 17.2 |
| Other Expense, Net | (13.3) | (12.6) | (22.4) |
| Income (Loss) from Continuing Operations before Equity in Net Income of Investee | (43.8) | 176.9 | 258.4 |
| Equity in Net Income of Investee | 5.8 | 1.2 | 9.2 |
| Income (Loss) from Continuing Operations | \$ (38.0) | \$ 178.1 | \$ 267.6 |

Amortization of Deferred Policy Acquisition Costs by Operating Segment for the years ended December 31, 2008, 2007 and 2006 was:

Edgar Filing: UNITRIN INC - Form 10-K

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|----------------------------|-----------------|-------------|-------------|
| Kemper | \$ 166.7 | \$ 163.5 | \$ 165.4 |
| Unitrin Specialty | 65.1 | 56.6 | 60.9 |
| Unitrin Direct | 7.5 | 11.0 | 10.4 |
| Life and Health Insurance | 72.2 | 69.3 | 71.5 |
| Total Amortization | \$ 311.5 | \$ 300.4 | \$ 308.2 |

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 19. BUSINESS SEGMENTS (Continued)**

Earned Premiums by product line for the years ended December 31, 2008, 2007 and 2006 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|----------------------------|------------|------------|------------|
| EARNED PREMIUMS | | | |
| Life | \$ 398.5 | \$ 387.8 | \$ 400.7 |
| Accident and Health | 160.1 | 157.9 | 158.3 |
| Property and Casualty: | | | |
| Personal Lines: | | | |
| Automobile | 1,287.8 | 1,192.3 | 1,163.6 |
| Homeowners | 295.2 | 286.6 | 284.7 |
| Other Personal | 155.0 | 156.3 | 164.9 |
| Total Personal Lines | 1,738.0 | 1,635.2 | 1,613.2 |
| Commercial Lines: | | | |
| Automobile | 80.0 | 106.0 | 118.3 |
| Total Earned Premiums | \$ 2,376.6 | \$ 2,286.9 | \$ 2,290.5 |

NOTE 20. CATASTROPHE REINSURANCE

Catastrophes and storms are inherent risks of the property and casualty insurance business. These catastrophic events and natural disasters include hurricanes, tornadoes, earthquakes, hailstorms, wildfires, high winds and winter storms. Such events result in insured losses that are, and will continue to be, a material factor in the results of operations and financial position of the Company's property and casualty insurance companies. Further, because the level of these insured losses occurring in any one year cannot be accurately predicted, these losses may contribute to material year-to-year fluctuations in the results of the operations and financial position of these companies. Specific types of catastrophic events are more likely to occur at certain times within the year than others. This factor adds an element of seasonality to property and casualty insurance claims. The Company has adopted the industry-wide catastrophe classifications of storms and other events promulgated by ISO to track and report losses related to catastrophes. ISO classifies a disaster as a catastrophe when the event causes \$25.0 million or more in direct losses to property and affects a significant number of policyholders and insurers. ISO-classified catastrophes are assigned a unique serial number recognized throughout the insurance industry. The discussions that follow utilize ISO's definition of catastrophes.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 20. CATASTROPHE REINSURANCE (Continued)**

The Company manages its exposure to catastrophes and other natural disasters through a combination of geographical diversification, restrictions on the amount and location of new business production in such regions, and reinsurance. To limit its exposures to catastrophic events, the Company maintains various catastrophe reinsurance programs for its property and casualty insurance businesses. Coverage for each catastrophe reinsurance program effective January 1, 2008 is provided in various layers as presented below:

| (Dollars in Millions) | Catastrophe Losses and LAE | | Percentage of Coverage |
|--|-------------------------------|---------|---------------------------|
| | In Excess of | Up to | |
| Kemper Segment | | | |
| Retained | \$ | \$ 40.0 | 0.0% |
| 1st Layer of Coverage | 40.0 | 70.0 | 61.5% |
| 2nd Layer of Coverage | 70.0 | 150.0 | 93.0% |
| 3rd Layer of Coverage | 150.0 | 250.0 | 92.0% |
| Unitrin Direct and Unitrin Specialty Segments | | | |
| Retained | \$ | \$ 2.0 | 0.0% |
| 1st Layer of Coverage | 2.0 | 15.0 | 100.0% |
| Life and Health Segment Property Insurance Operations | | | |
| Retained | \$ | \$ 6.0 | 0.0% |
| 1st Layer of Coverage | 6.0 | 20.0 | 82.5% |
| 2nd Layer of Coverage | 20.0 | 50.0 | 100.0% |
| 3rd Layer of Coverage | 50.0 | 80.0 | 100.0% |

In the event that the Company's incurred catastrophe losses and LAE covered by any of its catastrophe reinsurance programs presented above exceed the retention for that particular layer, each of the programs above requires one reinstatement of such coverage. In such an instance, the Company is required to pay a reinstatement premium to the reinsurers to reinstate the full amount of reinsurance available under such layer. The reinstatement premium is a percentage of the original premium based on the ratio of the losses exceeding the Company's retention to the reinsurers' coverage limit. In 2008, the Kemper segment and the Life and Health Insurance segment also participated in a catastrophe reinsurance program providing coverage of 40% of the sum of first \$50 million of catastrophe losses of the Kemper segment in excess of \$250 million and catastrophe losses of the Life and Health Insurance segment in excess of \$80 million resulting from a single occurrence. Reinstatements are not permitted under this combined reinsurance program.

The catastrophe reinsurance program presented above for the Life and Health Insurance segment excludes business written by Mutual Savings Fire. Mutual Savings Fire participated in a separate reinsurance program in 2008 which provided reinsurance coverage of 95% of reinsured catastrophe losses of \$3.5 million above retention of \$0.5 million. The catastrophe reinsurance program for the Life and Health Insurance segment in 2008 also includes reinsurance coverage from FHCF for hurricane losses in Florida at retentions lower than those described above.

The annual reinsurance program covering the Kemper segment became effective on April 1, 2007 (the 2007 Kemper Program). The first layer of the 2007 Kemper Program provided coverage of approximately 62% of reinsured catastrophe losses of \$30 million above retention of \$40 million. The second layer of the 2007 Kemper Program provided coverage of approximately 90% of reinsured catastrophe losses of \$80 million above retention of \$70 million. The third layer of the 2007 Kemper Program provided coverage of approximately 90% of reinsured catastrophe losses of \$100 million above retention of \$150 million. Prior to the effective date of the 2007 Kemper program, reinsurance coverage was provided by an annual program that became effective July 1, 2006 (the 2006 Kemper Program), which was terminated effective with the Kemper 2007 Program. The

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 20. CATASTROPHE REINSURANCE (Continued)**

first layer of reinsurance coverage under the 2006 Kemper Program provided coverage of approximately 65% of reinsured catastrophe losses of \$30 million above retention of \$40 million. The second layer of reinsurance coverage under the 2006 Kemper Program provided coverage of approximately 88% of reinsured catastrophe losses of \$80 million above retention of \$70 million. The third layer of reinsurance coverage under the 2006 Kemper Program provided coverage of approximately 80% of reinsured catastrophe losses of \$100 million above retention of \$150 million.

The annual program covering the Company's Unitrin Direct and Unitrin Specialty segments and Unitrin Business Insurance provided, effective January 1, 2007, reinsurance coverage of 100% of reinsured catastrophe losses of \$36 million above retention of \$4 million. In 2006, the annual program covering these segments also provided reinsurance coverage of 100% of reinsured catastrophe losses of \$36 million above retention of \$4 million. The 2007 and 2006 annual programs covering these segments did not include Merastar. The annual program covering Merastar was effective on March 31, 2007 and provided reinsurance coverage of 97.5% of reinsured catastrophe losses of \$7.25 million above retention of \$0.75 million.

The annual program covering the property insurance operations of the Company's Life and Health Insurance segment was changed to provide, effective January 1, 2007, reinsurance coverage of 100% of reinsured catastrophe losses of \$120 million above retention of \$10 million. In 2006, the annual program covering this segment provided reinsurance coverage of 100% of reinsured catastrophe losses of \$90 million above retention of \$10 million. The catastrophe reinsurance programs for the Life and Health Insurance segment in 2007 and 2006 also included reinsurance coverage from the FHCF for hurricane losses in Florida at retentions lower than those described above.

In addition, in the event that the Company's incurred catastrophe losses and LAE covered by any of the various reinsurance programs in 2007 and 2006 exceeded the retention for a particular layer, each of the programs in 2007 and 2006 required one reinstatement of such coverage. In such an instance, the Company is required to pay a reinstatement premium to the reinsurers to reinstate the full amount of reinsurance available under such program.

Catastrophe reinsurance premiums for the Company's primary reinsurance programs and the FHCF reduced earned premiums for the years ended December 31, 2008, 2007 and 2006 by the following:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|---|----------------|-------------|-------------|
| Kemper | \$ 19.6 | \$ 19.4 | \$ 15.7 |
| Unitrin Specialty | 0.3 | 0.2 | 0.2 |
| Unitrin Direct | 0.2 | 1.1 | 0.5 |
| Life and Health Insurance | 10.5 | 8.5 | 6.1 |
| Total Ceded Catastrophe Reinsurance Premiums | \$ 30.6 | \$ 29.2 | \$ 22.5 |

The Life and Health Insurance segment presented above includes reinsurance reinstatement premiums of \$4.4 million for the year ended December 31, 2008 to reinstate coverage following Hurricanes Dolly, Gustav and Ike.

Total catastrophe losses and LAE (including development), net of reinsurance recoveries, reported in continuing operations were \$144.9 million, \$39.4 million and \$56.9 million for the years ended December 31, 2008, 2007 and 2006, respectively. The Company reported the following catastrophe reserve development: adverse \$4.8 million, favorable \$4.6 million and adverse \$4.0 million in 2008, 2007 and 2006, respectively. In the third quarter of 2008, three major hurricanes that significantly impacted the Company (Dolly, Gustav and Ike) made landfall in the United States. A summary of the Company's estimated losses and LAE, net of reinsurance

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 20. CATASTROPHE REINSURANCE (Continued)**

recoveries of \$65.4 million, from Hurricanes Dolly, Gustav and Ike reported in the Company's Consolidated Statements of Operations for the year ended December 31, 2008 by business segment were:

| <i>DOLLARS IN MILLIONS</i> | Dolly | Gustav | Ike | Total |
|---|---------------|----------------|----------------|----------------|
| Kemper | \$ 0.6 | \$ 12.1 | \$ 27.9 | \$ 40.6 |
| Unitrin Specialty | | 0.5 | 1.0 | 1.5 |
| Unitrin Direct | | | 0.5 | 0.5 |
| Life and Health Insurance | 6.8 | 7.3 | 8.7 | 22.8 |
| Total Loss and LAE, Net of Reinsurance | \$ 7.4 | \$ 19.9 | \$ 38.1 | \$ 65.4 |

The estimated losses presented above by the Life and Health Insurance segment are net of reinsurance recoveries of \$2.9 million, \$6.0 million and \$37.2 million related to Hurricanes Dolly, Gustav and Ike, respectively. In addition to the losses presented above, Insurance Expenses for the year ended December 31, 2008 includes an expense of \$3.9 million related to the Kemper segment's estimate of its share of assessments from TWIA. The Company's estimates for Hurricanes Dolly, Gustav and Ike include estimates for both direct losses and LAE and indirect losses from residual market assessments, such as TWIA. The process of estimating and establishing reserves for catastrophe losses is inherently uncertain and the actual ultimate cost of a claim, net of actual reinsurance recoveries, may vary materially from the estimated amount reserved. The Company's estimates of direct catastrophe losses are generally based on inspections by claims adjusters and historical loss development experience for areas that have not been inspected or for claims that have not yet been reported. The Company's estimates of direct catastrophe losses are based on the coverages provided by its insurance policies. The Company's homeowners and dwellings insurance policies do not provide coverage for losses caused by floods, but generally provide coverage for physical damage caused by wind or wind driven rain. Accordingly, the Company's estimates of direct losses for homeowners and dwellings insurance do not include losses caused by flood. Depending on the policy, automobile insurance may provide coverage for losses caused by flood. Estimates of the number and severity of claims ultimately reported are influenced by many variables including, but not limited to, repair or reconstruction costs and determination of cause of loss, that are difficult to quantify and will influence the final amount of claim settlements. All these factors, coupled with the impact of the availability of labor and material on costs, require significant judgment in the reserve setting process. A change in any one or more of these factors is likely to result in an ultimate net claim cost different from the estimated reserve. The Company's estimates of indirect losses from residual market assessments are based on a variety of factors including, but not limited to, actual or estimated assessments provided by or received from the assessing entity, insurance industry estimates of losses, and estimates of the Company's market share in the assessable states. Actual assessments may differ materially from these estimated amounts.

NOTE 21. OTHER REINSURANCE

In addition to the reinsurance programs described in Note 20, Catastrophe Reinsurance, to the Consolidated Financial Statements, Unitrin's insurance subsidiaries utilize other reinsurance arrangements to limit their maximum loss, provide greater diversification of risk and to minimize exposures on larger risks. The ceding of insurance does not discharge the primary liability of the original insurer. Accordingly, insurance reserve liabilities are reported gross of any estimated recovery from reinsurers in the Consolidated Balance Sheets. Amounts recoverable from reinsurers are estimated in a manner consistent with the insurance reserve liability and are included in Other Receivables in the Consolidated Balance Sheets.

Earned Premiums assumed and ceded on long-duration policies were not material for the years ended December 31, 2008, 2007 and 2006. Earned Premiums ceded on short-duration policies were not material for the years ended December 31, 2008, 2007 and 2006. Certain insurance subsidiaries assume business from other

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 21. OTHER REINSURANCE (Continued)**

insurance companies and involuntary pools. Earned Premiums assumed on short-duration policies for the years ended December 31, 2008, 2007 and 2006 were:

| <i>DOLLARS IN MILLIONS</i> | 2008 | 2007 | 2006 |
|-------------------------------|---------|---------|---------|
| Earned Premiums Assumed From: | | | |
| Capitol | \$ 50.9 | \$ 53.3 | \$ 56.2 |
| ORCC | 10.6 | 10.8 | 11.3 |
| Milwaukee Insurance Company | | 0.6 | 3.0 |
| Other | 5.4 | 2.5 | 2.3 |
| Total Earned Premiums Assumed | \$ 66.9 | \$ 67.2 | \$ 72.8 |

Effective January 1, 2007, Trinity, a subsidiary of Unitrin, and Milwaukee Insurance Company (MIC) entered into a new quota share reinsurance agreement whereby Trinity assumes 100% of policy liabilities occurring on MIC 's direct book of business on or after January 1, 2007, which business was administered by the Unitrin Business Insurance unit and the Kemper segment. Prior to January 1, 2007, Trinity and MIC were parties to a quota share reinsurance agreement whereby Trinity assumed 95% of the business written by MIC (administered by the Unitrin Business Insurance unit and the Kemper segment) and 95% of the business that MIC assumed from First NonProfit Insurance Company (FNP). The new quota share reinsurance agreement amended the 95% quota share reinsurance agreement so that policy liabilities occurring on MIC 's in-force direct book of business prior to January 1, 2007 remain ceded under the 95% agreement, as do FNP policy liabilities incurred prior to January 1, 2007. In connection with the new quota share reinsurance agreement, Trinity transferred to MIC the unearned premium reserves maintained by Trinity related to the FNP business, net of a ceding commission. MIC was owned by Mutual Insurers Holding Company (MIHC), which in turn was owned by MIC 's policyholders. Similarly, FNP was owned by First NonProfit Mutual Holding Company (FNMHC), which was owned by FNP 's policyholders. In November 2007, MIHC and FNMHC merged, and, accordingly, MIC and FNP became subsidiaries of the merged company. In the past, certain employees of the Company and its subsidiaries have been members of the boards of directors of one or more of MIC, MIHC, FNP and FNMHC. Effective in November 2007 and prior to the merger, the last remaining representatives of the Company resigned such board memberships. Accordingly, the only relationship that currently exists among the Company and/or its employees and these companies is the relationship of Trinity as a reinsurer of certain business pursuant to the above mentioned quota reinsurance agreement between Trinity and MIC.

Trinity and Capitol are parties to a quota share reinsurance agreement whereby Trinity assumes 100% of the business written by Capitol. Capitol is a mutual insurance company and, accordingly, is owned by its policyholders. Five employees of the Company serve as directors of Capitol 's five member board of directors. Nine employees of the Company also serve as directors of Capitol 's wholly owned subsidiary s, ORCC, nine member board of directors. Trinity and ORCC are parties to a quota share reinsurance agreement whereby Trinity assumes 100% of the business written by ORCC. Reliable, a subsidiary of Unitrin, provides certain administrative services to Capitol and ORCC. In addition, agents appointed by Reliable and employed by Unitrin 's subsidiary, United Insurance, are also appointed by Capitol and ORCC to sell property insurance products. United Insurance also provides claims administration services to ORCC. The Company also provides certain investment services to Capitol and ORCC.

NOTE 22. FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the Company adopted SFAS No. 157, *Fair Value Measurements*, which, among other matters, requires enhanced disclosures about assets and liabilities that are measured and reported at fair value on a recurring basis. The Company classifies its Investments in Fixed Maturities, Investments in Northrop Common Stock and Investments in Other Equity Securities as available for sale and reports these investments at fair value.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 22. FAIR VALUE MEASUREMENTS (Continued)**

The Company classifies certain investments in mutual funds included in Other Investments as trading securities and reports these investments at fair value. The Company has no material liabilities that are measured and reported at fair value.

SFAS No. 157 defines fair value and establishes a hierarchal framework which prioritizes and ranks the market price observability used in fair value measurements. Market price observability is affected by a number of factors, including the type of asset or liability and the characteristics specific to the asset or liability being measured. Assets and liabilities with readily available, active, quoted market prices or for which fair value can be measured from actively quoted prices generally are deemed to have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value. Under SFAS No. 157, the inputs used to measure fair value must be classified into one of three levels as follows:

Level 1 - Quoted prices in an active market for identical assets or liabilities;

Level 2 - Observable inputs other than Level 1, quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, and model-derived prices whose inputs are observable or whose significant value drivers are observable; and

Level 3 - Assets and liabilities whose significant value drivers are unobservable.

Observable inputs are based on market data obtained from independent sources, while unobservable inputs are based on the Company's market assumptions. Unobservable inputs require significant management judgment or estimation. In some cases, the inputs used to measure an asset or liability may fall into different levels of the fair value hierarchy. In those instances, the fair value measurement is required to be classified using the lowest level of input that is significant to the fair value measurement. Such determination requires significant management judgment. In accordance with SFAS No. 157, the Company is not permitted to adjust quoted market prices in an active market, even if the Company owns a large investment, the sale of which could reasonably impact the quoted price.

The valuation of assets measured at fair value in the Company's Consolidated Balance Sheet at December 31, 2008 is summarized below:

| | Fair Value Dec. 31, 2008 | Fair Value Measurements | | |
|-------------------------------------|--------------------------------|--|---|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <i>DOLLARS IN MILLIONS</i> | | | | |
| Available for Sale Securities: | | | | |
| Fixed Maturities | \$ 4,135.9 | \$ 254.0 | \$ 3,677.1 | \$ 204.8 |
| Northrop Common Stock | 40.3 | 40.3 | | |
| Other Equity Securities | 181.5 | 7.5 | 114.6 | 59.4 |
| Total Available for Sale Securities | 4,357.7 | 301.8 | 3,791.7 | 264.2 |
| Trading Securities: | | | | |
| Other Investments: | 3.8 | 3.8 | | |
| Total | \$ 4,361.5 | \$ 305.6 | \$ 3,791.7 | \$ 264.2 |

Edgar Filing: UNITRIN INC - Form 10-K

The Company's investments in available for sale securities reported as Fixed Maturities and classified as Level 1 in the above table primarily consist of U.S. Treasury Bonds and Notes. The Company's investments in available for sale securities reported as Other Equity Securities and classified as Level 1 in the above table primarily

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 22. FAIR VALUE MEASUREMENTS (Continued)**

consist of investments in publicly-traded common stocks. The Company's investments in available for sale securities reported as Fixed Maturities and classified as Level 2 in the above table primarily consist of investments in corporate bonds and redeemable preferred stocks, state and municipal bonds, and bonds and mortgage-backed securities of U.S. government agencies. The Company's investments in available for sale securities reported as Other Equity Securities and classified as Level 2 in the above table primarily consist of investments in preferred stocks. The Company uses a leading, nationally recognized provider of market data and analytics to price the vast majority of the Company's Level 2 measurements. The provider utilizes evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information. Because many fixed maturity securities do not trade on a daily basis, the provider's evaluated pricing applications apply available information through processes such as benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing to prepare evaluations. In addition, the provider uses model processes to develop prepayment and interest rate scenarios. The pricing provider's models and processes also take into account market convention. For each asset class, teams of its evaluators gather information from market sources and integrate relevant credit information, perceived market movements and sector news into the evaluated pricing applications and models. The Company generally validates the measurements obtained from its primary pricing provider by comparing them with measurements obtained from one additional pricing provider that provides either prices from recent market transactions or quotes in inactive markets or evaluations based on its own proprietary models. The Company investigates significant differences related to the values provided. On completion of its investigation, management exercises judgment to determine the price selected and whether adjustments, if any, to the price obtained from the Company's primary pricing provider would warrant classification of the price as Level 3. In instances where a measurement cannot be obtained from either pricing provider, the Company generally will evaluate bid prices from one or more binding quotes obtained from market makers to value investments in inactive markets and classified by the Company as Level 2. The Company generally classifies securities when it receives non-binding quotes or indications as Level 3 securities unless the Company can validate the quote or indication against recent transactions in the market. For securities classified as Level 3, the Company either uses valuations provided by third party fund managers, third party appraisers or the Company's own internal valuations. These valuations typically employ valuation techniques including earning multiples based on comparable public securities, industry specific non-earnings based multiples, and discounted cash flow models. Valuations classified as Level 3 by the Company generally consist of investments in various private placement securities of non-rated entities. In rare cases, if the private placement security has only been outstanding for a short amount of time, the Company, after considering the initial assumptions used in acquiring an investment, will rely on the original purchase price as representative of the fair value.

Additional information pertaining to the Company's investments in Fixed Maturities and Other Equity Securities classified as Level 3 at December 31, 2008 is presented below:

| | Fair Value |
|---|-------------------|
| | Dec. 31, |
| | 2008 |
| <i>DOLLARS IN MILLIONS</i> | |
| Fixed Maturities | |
| Corporate Bonds and Notes Due at a Single Maturity Date | \$ 134.2 |
| Redeemable Preferred Stocks | 70.6 |
| Total Fixed Maturities Classified as Level 3 | 204.8 |
| Other Equity Securities: | |
| Common Stocks | 10.4 |
| Preferred Stocks | 4.9 |
| Other Equity Interests | 44.1 |
| Total Other Equity Securities Classified as Level 3 | 59.4 |

Total Investments Classified as Level 3

\$ 264.2

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 22. FAIR VALUE MEASUREMENTS (Continued)**

Additional information pertaining to the changes in the fair value of the Company's investments classified as Level 3 for the year ended December 31, 2008 is presented below:

| <i>DOLLARS IN MILLIONS</i> | Year Ended December 31, 2008 |
|---|------------------------------------|
| Balance at Beginning of Period | \$ 218.9 |
| Total Gains (Losses): | |
| Included in Statement of Operations | (53.4) |
| Included in Other Comprehensive Income (Loss) | (29.3) |
| Purchases, Sales and Settlements, Net | 126.5 |
| Transfers in and/or out of Level 3 | 1.5 |
| Balance at December 31, 2008 | \$ 264.2 |

Included in the Statement of Operations for the year ended December 31, 2008 for investments classified as Level 3 is a net realized loss of \$31.3 million related to the write down of subordinated fixed maturity obligations of a single issuer subsequent to a capital restructuring, net of a gain realized \$2.2 million from the partial disposition of a subordinated fixed maturity obligation from the capital restructuring of the same issuer which the Company had previously written down due to an other than temporary decline in fair value. Losses Included in Statement of Operations for the year ended December 31, 2008 include a realized loss of \$18.8 million to write down a subordinated fixed maturity obligation of a single issuer due to a capital restructuring. Other Comprehensive Income (Loss) for investments classified as Level 3 include an unrealized loss of \$13.6 million for the year ended December 31, 2008 related to an overall decline in the fair value of the Company's investments in fifteen limited liability investment companies and limited partnerships in which the Company's ownership is considered minor and are therefore not accounted for under the equity method of accounting. Other Comprehensive Income (Loss) for investments classified as Level 3 includes an unrealized loss of \$4.5 million for the year ended December 31, 2008 related to a decline in the fair value of two redeemable, auction rate preferred stocks of a single issuer. The Company attributes the unrealized loss related to these preferred stocks to liquidity issues in the market for auction rate preferred stocks, rather than credit issues related to the issuer of the securities. Accordingly, the Company expects to fully recover its investment on or before the date that the securities mature.

NOTE 23. CONTINGENCIES

In the ordinary course of their businesses, Unitrin and its subsidiaries are involved in a number of legal proceedings including lawsuits and regulatory examinations and inquiries. Some of these proceedings include matters particular to the Company or one or more of its subsidiaries, while others pertain to business practices in the industries in which Unitrin or its subsidiaries operate. Some lawsuits seek class action status that, if granted, could expose Unitrin or its subsidiaries to potentially significant liability by virtue of the size of the putative classes. These matters can raise complicated issues and may be subject to many uncertainties, including but not limited to: (i) the underlying facts of the matter; (ii) unsettled questions of law; (iii) issues unique to the jurisdiction where the matter is pending; (iv) damage claims, including claims for punitive damages, that are disproportionate to the actual economic loss incurred; and (v) the legal, regulatory and political environment faced by large corporations generally and the insurance and banking sectors specifically. Accordingly, the outcomes of these matters are difficult to predict, and the amounts or ranges of potential loss at particular points in time are in most cases difficult or impossible to ascertain.

During the course of 2008, Unitrin and certain of its subsidiaries, like many property and casualty insurers, were forced to defend numerous individual lawsuits, mass actions and statewide putative class actions in Louisiana and Texas arising out of Hurricanes Katrina and Rita. In these matters, the plaintiffs seek compensatory and

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 23. CONTINGENCIES (Continued)**

punitive damages, and equitable relief. The Company and its relevant subsidiaries believe they have meritorious defenses to these proceedings and are defending them vigorously.

Fireside Bank is defending two class action lawsuits in California state courts alleging that its post-repossession notices to defaulting borrowers failed to comply with certain aspects of California law. The plaintiffs seek: (i) compensatory damages, including a refund of deficiency balances collected from customers who received the allegedly defective notices; (ii) punitive damages; and (iii) equitable relief. Statewide classes have been certified in these matters and Fireside Bank successfully moved to have the two cases treated on a coordinated basis. Fireside Bank is contesting the allegations that its post-repossession notices were deficient and believes it has meritorious defenses to these lawsuits.

The Company believes that resolution of its pending legal proceedings will not have a material adverse effect on the Company's financial position. However, given the unpredictability of the legal environment, there can be no assurance that one or more of these matters will not produce a loss which could have a material adverse effect on the Company's financial results for any given period.

The legal and regulatory environment within which Unitrin and its subsidiaries conduct their business is often unpredictable. Industry practices that were considered legally-compliant and reasonable for years may suddenly be deemed unacceptable by virtue of an unexpected court or regulatory ruling. Anticipating such shifts in the law and the impact they may have on the Company and its operations is a difficult task and there can be no assurances that the Company will not encounter such shifts in the future.

NOTE 24. RELATED PARTIES

One of Unitrin's directors, Mr. Fayez Sarofim, is the Chairman of the Board, President and the majority shareholder of Fayez Sarofim & Co. (FS&C), a registered investment advisory firm. Certain of Unitrin's insurance company subsidiaries and FS&C were parties to agreements under which FS&C provided investment management services to these subsidiaries. Under these investment advisory arrangements, FS&C was entitled to a fee calculated and payable quarterly based upon the fair market value of the assets under management. During 2008, FS&C sold all of the investments it managed for Unitrin's insurance company subsidiaries. Accordingly, Unitrin's insurance company subsidiaries had no investments managed by FS&C at December 31, 2008. Unitrin's insurance company subsidiaries had \$226.2 million and \$208.2 million in assets invested with FS&C for investment management at December 31, 2007 and 2006, respectively. Unitrin's insurance company subsidiaries paid, in the aggregate, \$0.5 million per year to FS&C for the years ended 2008, 2007 and 2006.

In addition, FS&C continues to provide investment management services with respect to certain funds of the Company's pension plans. The Company's pension plans had \$68.5 million, \$99.6 million and \$92.4 million, respectively, in assets with FS&C for investment management at December 31, 2008, 2007 and 2006, respectively. The Company's pension plans paid, in the aggregate, \$0.2 million per year to FS&C for the years ended 2008, 2007 and 2006.

With respect to the Company's 401(k) Savings Plan, one of the alternative investment choices afforded to participating employees is the Dreyfus Appreciation Fund, an open-end, diversified managed investment fund. FS&C provides investment management services to the Dreyfus Appreciation Fund as a sub-investment advisor. According to published reports filed by FS&C with the SEC, the Dreyfus Appreciation Fund pays monthly fees to FS&C according to a graduated schedule computed at an annual rate based on the value of the Dreyfus Appreciation Fund's average daily net assets. The Company does not compensate FS&C for services rendered to the Dreyfus Appreciation Fund. Participants in the Company's 401(k) Savings Plan had allocated \$14.7 million, \$25.3 million and \$27.0 million for investment in the Dreyfus Appreciation Fund at December 31, 2008, 2007

Table of Contents

Unitrin, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

NOTE 24. RELATED PARTIES (Continued)

and 2006, respectively, representing 7%, 9% and 10% of the total amount invested in the Company's 401(k) Savings Plan at December 31, 2008, 2007 and 2006, respectively.

Unitrin's Life and Health Insurance segment paid \$0.5 million and \$0.3 million to Intermec for the years ended December 31, 2008 and 2007, respectively for the maintenance of hand held computers previously purchased from Intermec.

The Company believes that the transactions described above have been entered into on terms no less favorable to the Company than could have been negotiated with non-affiliated third parties.

On October 3, 2008, Eric J. Draut, Unitrin's Chief Financial Officer and a member of Unitrin's Board of Directors, was elected a director of Intermec.

As described in Note 21, Other Reinsurance, to the Consolidated Financial Statements, the Company also has certain relationships with mutual insurance holding companies which are owned by the policy-holders of their insurance subsidiaries.

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 25. QUARTERLY FINANCIAL INFORMATION (Unaudited)**

| <i>DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS</i> | THREE MONTHS ENDED (UNAUDITED) | | | | YEAR ENDED |
|---|--------------------------------|------------------|-------------------|------------------|------------------|
| | MARCH 31, 2008 | JUNE 30, 2008 | SEPT. 30, 2008 | DEC. 31, 2008 | DEC. 31, 2008 |
| Revenues: | | | | | |
| Earned Premiums | \$ 575.9 | \$ 596.3 | \$ 599.5 | \$ 604.9 | \$ 2,376.6 |
| Automobile Finance Revenues | 63.4 | 62.1 | 60.1 | 56.7 | 242.3 |
| Net Investment Income | 45.9 | 81.4 | 63.7 | 21.9 | 212.9 |
| Other Income | 0.5 | 0.9 | 1.2 | 1.5 | 4.1 |
| Net Realized Investment Gains (Losses) | 6.2 | 5.0 | (44.6) | (60.3) | (93.7) |
| Total Revenues | 691.9 | 745.7 | 679.9 | 624.7 | 2,742.2 |
| Expenses: | | | | | |
| Policyholders Benefits and Incurred Losses and Loss Adjustment Expenses | 410.7 | 448.2 | 494.3 | 412.0 | 1,765.2 |
| Insurance Expenses | 172.3 | 182.8 | 190.8 | 190.6 | 736.5 |
| Automobile Finance Expenses | 53.9 | 69.6 | 47.8 | 32.8 | 204.1 |
| Interest Expense on Certificates of Deposit | 15.7 | 15.0 | 14.2 | 13.8 | 58.7 |
| Goodwill | | | | 9.2 | 9.2 |
| Interest and Other Expenses | 16.7 | 15.0 | 14.6 | 12.2 | 58.5 |
| Total Expenses | 669.3 | 730.6 | 761.7 | 670.6 | 2,832.2 |
| Income (Loss) from Continuing Operations before Income Taxes and Equity in Net Income of Investee | 22.6 | 15.1 | (81.8) | (45.9) | (90.0) |
| Income Tax Benefit (Expense) | (4.1) | 0.8 | 31.2 | 18.3 | 46.2 |
| Income (Loss) from Continuing Operations before Equity in Net Income of Investee | 18.5 | 15.9 | (50.6) | (27.6) | (43.8) |
| Equity in Net Income of Investee | 2.2 | 1.1 | 1.0 | 1.5 | 5.8 |
| Income (Loss) from Continuing Operations | 20.7 | 17.0 | (49.6) | (26.1) | (38.0) |
| Discontinued Operations: | | | | | |
| Income (Loss) from Discontinued Operations Before Income Taxes | (10.2) | (1.6) | 6.7 | 23.3 | 18.2 |
| Income Tax Benefit (Expense) | 4.7 | (4.4) | (2.3) | (7.8) | (9.8) |
| Income (Loss) from Discontinued Operations | (5.5) | (6.0) | 4.4 | 15.5 | 8.4 |
| Net Income (Loss) | \$ 15.2 | \$ 11.0 | \$ (45.2) | \$ (10.6) | \$ (29.6) |
| Income (Loss) Per Share from Continuing Operations (a) | \$ 0.33 | \$ 0.27 | \$ (0.79) | \$ (0.42) | \$ (0.60) |
| Income (Loss) Per Share from Discontinued Operations (a) | (0.09) | (0.09) | 0.07 | 0.25 | 0.13 |
| Net Income (Loss) Per Share (a) | \$ 0.24 | \$ 0.18 | \$ (0.72) | \$ (0.17) | \$ (0.47) |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | | | | | | | | |
|---|----|---------------|----|---------------|----|---------------|----|---------------|----|---------------|
| Income (Loss) Per Share from Continuing Operations Assuming Dilution (a) | \$ | 0.33 | \$ | 0.27 | \$ | (0.79) | \$ | (0.42) | \$ | (0.60) |
| Income (Loss) Per Share from Discontinued Operations Assuming Dilution | | (0.09) | | (0.09) | | 0.07 | | 0.25 | | 0.13 |
| Net Income (Loss) Per Share Assuming Dilution (a) | \$ | 0.24 | \$ | 0.18 | \$ | (0.72) | \$ | (0.17) | \$ | (0.47) |

(a) *The sum of quarterly per share amounts does not equal per share amounts for the year due to differences in weighted-average shares and/or equivalent shares outstanding for each of the periods presented.*

Table of Contents**Unitrin, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****NOTE 25. QUARTERLY FINANCIAL INFORMATION (Unaudited) (Continued)**

| <i>DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS</i> | THREE MONTHS ENDED (UNAUDITED) | | | | YEAR ENDED |
|---|--------------------------------|------------------|-------------------|------------------|------------------|
| | MARCH 31, 2007 | JUNE 30, 2007 | SEPT. 30, 2007 | DEC. 31, 2007 | DEC. 31, 2007 |
| Revenues: | | | | | |
| Earned Premiums | \$ 562.5 | \$ 570.2 | \$ 579.9 | \$ 574.3 | \$ 2,286.9 |
| Automobile Finance Revenues | 63.0 | 64.9 | 66.5 | 65.8 | 260.2 |
| Net Investment Income | 74.7 | 80.4 | 77.0 | 57.8 | 289.9 |
| Other Income | 1.0 | 1.2 | 0.5 | 0.8 | 3.5 |
| Net Realized Investment Gains | 22.5 | 17.0 | 12.5 | 10.5 | 62.5 |
| Total Revenues | 723.7 | 733.7 | 736.4 | 709.2 | 2,903.0 |
| Expenses: | | | | | |
| Policyholders Benefits and Incurred Losses and Loss Adjustment Expenses | 387.2 | 397.2 | 383.6 | 404.3 | 1,572.3 |
| Insurance Expenses | 171.6 | 174.2 | 179.6 | 180.4 | 705.8 |
| Automobile Finance Expenses | 42.1 | 43.7 | 61.5 | 125.2 | 272.5 |
| Interest Expense on Certificates of Deposit | 13.6 | 14.2 | 15.2 | 15.7 | 58.7 |
| Interest and Other Expenses | 16.1 | 20.0 | 16.1 | 14.7 | 66.9 |
| Total Expenses | 630.6 | 649.3 | 656.0 | 740.3 | 2,676.2 |
| Income (Loss) from Continuing Operations before Income Taxes and Equity in Net Income (Loss) of Investee | | | | | |
| Income Tax Benefit (Expense) | (28.6) | (25.0) | (23.1) | 26.8 | (49.9) |
| Income (Loss) from Continuing Operations before Equity in Net Income (Loss) of Investee | | | | | |
| Equity in Net Income (Loss) of Investee | 0.4 | (0.6) | 0.9 | 0.5 | 1.2 |
| Income (Loss) from Continuing Operations | 64.9 | 58.8 | 58.2 | (3.8) | 178.1 |
| Discontinued Operations: | | | | | |
| Income from Discontinued Operations Before Income Taxes | 5.2 | 3.8 | 8.9 | 16.9 | 34.8 |
| Income Tax Benefit (Expense) | (0.6) | (0.2) | (2.1) | (4.6) | (7.5) |
| Income from Discontinued Operations | 4.6 | 3.6 | 6.8 | 12.3 | 27.3 |
| Net Income | \$ 69.5 | \$ 62.4 | \$ 65.0 | \$ 8.5 | \$ 205.4 |
| Income (Loss) Per Share from Continuing Operations (a) | | | | | |
| Income Per Share from Discontinued Operations (a) | 0.07 | 0.06 | 0.11 | 0.19 | 0.42 |
| Net Income Per Share (a) | \$ 1.04 | \$ 0.95 | \$ 1.00 | \$ 0.13 | \$ 3.13 |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | | | | | | | | |
|--|----|------|----|------|----|------|----|--------|----|------|
| Income (Loss) Per Share from Continuing Operations | | | | | | | | | | |
| Assuming Dilution (a) | \$ | 0.96 | \$ | 0.89 | \$ | 0.89 | \$ | (0.06) | \$ | 2.70 |
| Income Per Share from Discontinued Operations | | | | | | | | | | |
| Assuming Dilution | | 0.07 | | 0.05 | | 0.11 | | 0.19 | | 0.42 |
| Net Income Per Share Assuming Dilution (a) | \$ | 1.03 | \$ | 0.94 | \$ | 1.00 | \$ | 0.13 | \$ | 3.12 |

(a) *The sum of quarterly per share amounts does not equal per share amounts for the year due to differences in weighted-average shares and equivalent shares outstanding for each of the periods presented.*

Table of Contents

Report of Independent Registered Public Accounting Firm

TO THE SHAREHOLDERS AND BOARD OF DIRECTORS OF UNITRIN, INC.

We have audited the accompanying consolidated balance sheets of Unitrin, Inc. and subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations, shareholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2008. Our audits also included the financial statement schedules listed in Item 15. We also have audited the Company's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control. Our responsibility is to express an opinion on these financial statements and financial statement schedules and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Unitrin, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity

Table of Contents

with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth herein. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for certain investments reported under the equity method of accounting in 2008.

/s/ Deloitte & Touche LLP

Chicago, Illinois

February 4, 2009

Table of Contents

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Not Applicable

**Item 9A. Controls and Procedures.
Disclosure Controls and Procedures**

The Company's management, with participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified by the SEC's rules and forms, and accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management Report on Internal Control Over Financial Reporting

We, as management of the Company, are responsible for establishing and maintaining adequate internal control over financial reporting. Pursuant to the rules and regulations of the SEC, internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Management has evaluated the effectiveness of its internal control over financial reporting as of December 31, 2008, based on the control criteria established in a report entitled *Internal Control - Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on such evaluation, we have concluded that the Company's internal control over financial reporting is effective as of December 31, 2008.

Table of Contents

The independent registered public accounting firm of Deloitte & Touche LLP, as auditors of Unitrin's consolidated financial statements, has issued an attestation report on the effectiveness of management's internal control over financial reporting based on criteria established in *Internal Control - Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ DONALD G. SOUTHWELL
Donald G. Southwell
President and Chief Executive Officer
February 4, 2009

/s/ ERIC J. DRAUT
Eric J. Draut
Executive Vice President and Chief Financial Officer

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

The attestation report of the independent registered public accounting firm, Deloitte & Touche LLP, on the Company's internal control over financial reporting is included in Item 8 under the heading "Report of Independent Registered Public Accounting Firm," and is incorporated herein by reference.

Item 9B. Other Information.

None

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The information required by this Item is incorporated herein by reference to the sections captioned "Election of Directors," "Unitrin Executive Officers," "Ownership of Unitrin Common Stock" and "Corporate Governance" in the Proxy Statement for the 2009 Annual Meeting of Shareholders of Unitrin. Unitrin plans to file such proxy statement within 120 days after December 31, 2008, the end of Unitrin's fiscal year.

The Company's code of ethics applicable to its chief executive officer, chief financial officer and principal accounting officer ("Code of Ethics for Senior Financial Executives") is posted in the Governance section of the Company's website (unitrin.com). The Company also intends to disclose any future amendments to, and any waivers from (though none are anticipated), the Code of Ethics for Senior Financial Executives in the Governance section of its website.

Item 11. Executive Compensation.

The information required by this Item is incorporated herein by reference to the sections captioned "Executive Compensation," "Compensation Committee Interlocks and Insider Participation," and "Compensation Committee Report" in the Proxy Statement for the 2009 Annual Meeting of Shareholders of Unitrin. The Compensation Committee Report to be included in such Proxy Statement shall be deemed to be furnished in this report and shall not be incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act as a result of such furnishing in this Item 11.

Table of Contents**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information required by this Item is set forth in the table below and incorporated herein by reference to the section captioned "Ownership of Unitrin Common Stock" in the Proxy Statement for the 2009 Annual Meeting of Shareholders of Unitrin.

Equity Compensation Plan Information

| Plan Category | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans or Programs (1) |
|--|--|--|---|
| Equity Compensation Plans Approved by Security Holders | 5,125,249 | 46.17 | 1,475,468 |
| Equity Compensation Plans Not Approved by Security Holders | | | |
| Total | 5,125,249 | 46.17 | 1,475,468 |

- (1) In addition to shares available for issuance under the Company's four stock option plans, this number includes 730,139 shares of restricted stock available for issuance under the Company's 2005 Restricted Stock and Restricted Stock Unit Plan.

Item 13. Certain Relationships and Related Transactions and Director Independence.

The information required by this Item is incorporated herein by reference to the sections captioned "Related Person Transactions" and "Director Independence" in the Proxy Statement for the 2009 Annual Meeting of Shareholders of Unitrin.

Item 14. Principal Accounting Fees and Services.

The information required by this Item is incorporated by reference to the section captioned "Independent Registered Public Accountant" in the Proxy Statement for the 2009 Annual Meeting of Shareholders of Unitrin.

Table of Contents

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) Documents filed as part of this Report

1. Financial Statements. The consolidated balance sheets of Unitrin and subsidiaries as of December 31, 2008 and 2007, and the consolidated statements of operations, cash flows and shareholders' equity and comprehensive income (loss) for the years ended December 31, 2008, 2007 and 2006, together with the notes thereto and the report of Deloitte & Touche LLP thereon appearing in Item 8 are included in this 2008 Annual Report on Form 10-K.

2. Financial Statement Schedules. The following five financial statement schedules are included on the pages immediately following the signature pages hereof. Schedules not listed here have been omitted because they are not applicable or not material or the required information is included in the Consolidated Financial Statements.

Schedule I Investments Other Than Investments in Related Parties

Schedule II Parent Company Financial Statements

Schedule III Supplementary Insurance Information

Schedule IV Reinsurance Schedule

Schedule VI Supplemental Information Concerning Property-Casualty Insurance Operations

The Report of Independent Registered Public Accounting Firm, Deloitte & Touche LLP, with regards to the Financial Statement Schedules listed above, is incorporated by reference to the Report of Independent Registered Public Accountant included in Item 8.

3. Exhibits. The following exhibits are either filed as a part hereof or are incorporated by reference. Exhibit numbers correspond to the numbering system in Item 601 of Regulation S-K. Exhibits 10.1 through 10.17 relate to compensatory plans incorporated by reference as exhibits hereto pursuant to Item 15(b) of Form 10-K.

3.1 Certificate of Incorporation (Incorporated by reference to Exhibit 3.1 to the Company's 2007 Annual Report on Form 10-K filed February 4, 2008).

3.2 Amended and Restated Bylaws (Incorporated herein by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed February 4, 2008.)

4.1 Rights Agreement between Unitrin, Inc. and Computershare Trust Company, N.A. as successor Rights Agent, including the Form of Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock, the Form of Rights Certificate and the Summary of Rights to Purchase Preferred Stock, dated as of August 4, 2004 and amended May 4, 2006 and October 9, 2006 (Incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K dated August 6, 2004, Exhibits 4.1 and 4.2 to the Company's Registration Statement on Form 8-A/A dated May 4, 2006 and Exhibit 4.1 to the Company's Registration Statement on Form 8-A/A dated October 10, 2006.)

Edgar Filing: UNITRIN INC - Form 10-K

- 4.2 Indenture dated as of June 26, 2002, by and between Unitrin, Inc. and The Bank of New York Trust Company, N.A., as successor trustee to BNY Midwest Trust Company, as Trustee (Incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed May 14, 2007.)

- 4.3 Officer's Certificate, including form of Senior Note with respect to the Company's 6.00% Senior Notes due May 15, 2017 (Incorporated herein by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed May 14, 2007.)

Table of Contents

- 4.4 Officer's Certificate, including form of Senior Note with respect to the Company's 4.875% Senior Notes due November 1, 2010 (Incorporated herein by reference to Exhibit 4.4 to the Company's Quarterly Report on Form 10-Q filed November 3, 2008.)

- 10.1 Unitrin, Inc. 1990 Stock Option Plan, as amended and restated effective May 3, 2000 (Incorporated herein by reference to Exhibit 10.1 to the Company's 2006 Annual Report on Form 10-K filed February 2, 2007.)

- 10.2 Unitrin, Inc. 1995 Non-Employee Director Stock Option Plan, as amended and restated effective February 3, 2009.

- 10.3 Unitrin, Inc. 1997 Stock Option Plan, as amended and restated effective February 6, 2006 (Incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed February 6, 2006.)

- 10.4 Unitrin, Inc. 2002 Stock Option Plan, as amended and restated effective February 3, 2009.

- 10.5 2005 Restricted Stock and Restricted Stock Unit Plan, as amended and restated effective February 3, 2009.

- 10.6 Form of Stock Option Agreement under the Unitrin, Inc. 1995 Non-Employee Director Stock Option Plan, as of February 1, 2006 (Incorporated herein by reference to Exhibit 10.6 to the Company's Current Report on Form 8-K filed February 6, 2006.)

- 10.7 Form of Stock Option Agreement under the Unitrin, Inc. 1995 Non-Employee Director Stock Option Plan, as of February 3, 2009.

- 10.8 Form of Stock Option Agreement (including stock appreciation rights) under the Unitrin, Inc. 1997 Stock Option Plan, as of February 1, 2006 (Incorporated herein by reference to Exhibit 10.7 to the Company's Current Report on Form 8-K filed February 6, 2006.)

- 10.9 Form of Stock Option Agreement (including stock appreciation rights) under the Unitrin, Inc. 2002 Stock Option Plan, as of February 1, 2006 (Incorporated herein by reference to Exhibit 10.8 to the Company's Current Report on Form 8-K filed February 6, 2006.)

- 10.10 Form of Stock Option Agreement under the Unitrin, Inc. 2002 Stock Option Plan, as of February 3, 2009.

- 10.11 Form of Time-Vested Restricted Stock Agreement under the 2005 Restricted Stock and Restricted Stock Unit Plan, as of February 3, 2009.

- 10.12 Unitrin, Inc. Pension Equalization Plan, as amended and restated effective January 1, 2009.

- 10.13 Unitrin, Inc. Defined Contribution Supplemental Retirement Plan, effective January 1, 2008.

- 10.14 Unitrin, Inc. Non-Qualified Deferred Compensation Plan, as amended and restated effective January 1, 2009.

Edgar Filing: UNITRIN INC - Form 10-K

10.15 Unitrin is a party to individual severance agreements (the form of which is incorporated herein by reference to Exhibit 10.11 to the Company's Current Report on Form 8-K filed December 31, 2008), with the following executive officers:
Richard C. Vie (Chairman)

Donald G. Southwell (President and Chief Executive Officer)

David F. Bengston (Vice President)

John M. Boschelli (Vice President and Treasurer)

Eric J. Draut (Executive Vice President and Chief Financial Officer)

Table of Contents

Edward J. Konar (Vice President)

Scott Renwick (Senior Vice President, General Counsel and Secretary)

Richard Roeske (Vice President and Chief Accounting Officer)

Each of the foregoing agreements is identical except that the severance compensation multiple is 3.0 for Messrs. Vie and Southwell and 2.0 for the other executive officers.

- 10.16 Unitrin, Inc. Severance Plan, as amended and restated effective January 1, 2009.
- 10.17 Unitrin, Inc. Incentive Bonus Plan, dated February 3, 2004 (Incorporated herein by reference to Appendix A to the Company's Proxy Statement, dated March 29, 2004, in connection with the Company's 2004 Annual Meeting of Shareholders.)
- 10.18 Credit Agreement, dated as of June 24, 2005, by and among Unitrin, Inc., the lenders party thereto, JPMorgan Chase Bank, N.A., individually and as administrative agent, letter of credit issuer and swing line lender, Wells Fargo Bank, National Association, individually and as syndication agent, and Wachovia Bank, N.A., individually and as documentation agent (Incorporated herein by reference to Exhibit 10.1 to Unitrin's Current Report on Form 8-K filed June 27, 2005.)
- 12 Ratios of Earnings to Fixed Charges
- 13 Shareholders' Letter (forms a part of MD&A)
- 21 Subsidiaries of Unitrin, Inc.
- 23 Consent of Deloitte & Touche LLP
- 24 Power of Attorney (included on the signature page hereof)
- 31.1 Certification of Chief Executive Officer Pursuant to SEC Rule 13a-14(a).
- 31.2 Certification of Chief Financial Officer Pursuant to SEC Rule 13a-14(a).
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished pursuant to Item 601(b)(32) of Regulation S-K.)
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished pursuant to Item 601(b)(32) of Regulation S-K.)

(b) *Exhibits. Included in Item 15(a)3 above*

(c) *Financial Statement Schedules. Included in Item 15(a)2 above*

Table of Contents

POWER OF ATTORNEY

Each person whose signature appears below hereby appoints each of Donald G. Southwell, President and Chief Executive Officer, Eric J. Draut, Executive Vice President and Chief Financial Officer, and Scott Renwick, Senior Vice President, General Counsel and Secretary, his true and lawful attorney-in-fact with authority together or individually to execute in the name of each such signatory, and with authority to file with the SEC, any and all amendments to this 2008 Annual Report on Form 10-K of Unitrin, Inc., together with any and all exhibits thereto and other documents therewith, necessary or advisable to enable Unitrin, Inc. to comply with the Securities Exchange Act of 1934, as amended, and any rules, regulations, and requirements of the SEC in respect thereof, which amendments may make such other changes in the 2008 Annual Report on Form 10-K as the aforesaid attorney-in-fact executing the same deems appropriate.

SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, Unitrin, Inc. has duly caused this 2008 Annual Report on Form 10-K for the fiscal year ended December 31, 2008 to be signed on its behalf by the undersigned, thereunto duly authorized, on February 4, 2009.

UNITRIN, INC.

(Registrant)

By: /s/ DONALD G. SOUTHWELL
Donald G. Southwell
President, Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Unitrin, Inc. in the capacities indicated on February 4, 2009.

| Signature | Title |
|---|--|
| /s/ RICHARD C. VIE Richard C. Vie | Chairman and Director |
| /s/ DONALD G. SOUTHWELL Donald G. Southwell | President, Chief Executive Officer and Director |
| /s/ ERIC J. DRAUT Eric J. Draut | Executive Vice President, Chief Financial Officer and Director (principal financial officer) |
| /s/ RICHARD ROESKE Richard Roeske | Vice President and Chief Accounting Officer (principal accounting officer) |
| /s/ JAMES E. ANNABLE James E. Annable | Director |
| /s/ DONALD V. FITES Donald V. Fites | Director |

Edgar Filing: UNITRIN INC - Form 10-K

/s/ DOUGLAS G. GEOGA

Director

Douglas G. Geoga

146

Table of Contents

| Signature | Title |
|---|--------------|
| /s/ REUBEN L. HEDLUND Reuben L. Hedlund | Director |
| /s/ JERROLD V. JEROME Jerrold V. Jerome | Director |
| /s/ WILLIAM E. JOHNSTON, JR. William E. Johnston, Jr. | Director |
| /s/ WAYNE KAUTH Wayne Kauth | Director |
| /s/ FAYEZ S. SAROFIM Fayez S. Sarofim | Director |
| /s/ ANN E. ZIEGLER Ann E. Ziegler | Director |

Table of Contents

SCHEDULE I

UNITRIN, INC. AND SUBSIDIARIES

INVESTMENTS OTHER THAN INVESTMENTS IN RELATED PARTIES

DECEMBER 31, 2008

(Dollars in Millions)

| | Amortized Cost | Fair Value | Amount Carried in Balance Sheet |
|--|-------------------|----------------|---------------------------------------|
| Fixed Maturities: | | | |
| Bonds and Notes: | | | |
| United States Government and Government Agencies and Authorities | \$ 934.6 | \$ 979.1 | \$ 979.1 |
| States, Municipalities and Political Subdivisions | 1,295.6 | 1,308.5 | 1,308.5 |
| Corporate Securities: | | | |
| Other Bonds and Notes | 1,765.0 | 1,682.5 | 1,682.5 |
| Redeemable Preferred Stocks | 179.2 | 165.8 | 165.8 |
| Total Investments in Fixed Maturities | 4,174.4 | 4,135.9 | 4,135.9 |
| Northrop Common Stock | 38.6 | 40.3 | 40.3 |
| Other Equity Securities: | | | |
| Preferred Stocks | 150.1 | 119.9 | 119.9 |
| Common Stocks | 15.8 | 17.5 | 17.5 |
| Other Equity Interests | 50.9 | 44.1 | 44.1 |
| Total Investments in Other Equity Securities | 216.8 | 181.5 | 181.5 |
| Investee (A): | | | |
| Intermec | 102.2 | 168.1 | 102.2 |
| Loans, Real Estate and Other Investments | 714.9 | XXX.X | 714.9 |
| Short-term Investments | 548.6 | XXX.X | 548.6 |
| Total Investments | \$ 5,795.5 | | \$ 5,723.4 |

(A) Amortized Cost = Cost Plus Cumulative Undistributed Earnings.

See Accompanying Report of Independent Registered Public Accounting Firm.

SCHI-1

Table of Contents

SCHEDULE II

UNITRIN, INC.

PARENT COMPANY BALANCE SHEETS

December 31, 2008 and 2007

(Dollars in Millions)

| | December 31, 2008 | December 31, 2007 |
|--|----------------------|----------------------|
| ASSETS | | |
| Investments in Subsidiaries | \$ 2,382.4 | \$ 2,633.0 |
| Northrop Preferred Stock at Fair Value (Cost: 2007 \$186.9) | | 258.5 |
| Northrop Common Stock at Fair Value (Cost: 2007 \$69.3) | | 83.3 |
| Notes Receivable from Subsidiary, 10.00% Due 2010 | 20.0 | 20.0 |
| Other Equity Securities at Fair Value (Cost: 2008 \$4.0; 2007 \$5.9) | 4.2 | 6.7 |
| Short-term Investments | 9.9 | 65.9 |
| Cash | 9.2 | 1.7 |
| Other Receivables | 3.1 | 8.4 |
| Deferred Income Taxes | 58.0 | |
| Other Assets | 0.1 | 0.5 |
| Total Assets | \$ 2,486.9 | \$ 3,078.0 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Senior Notes Payable, 6.00% due 2017 (Fair Value: 2008 \$250.8 ;2007 \$344.3) | \$ 355.5 | \$ 355.0 |
| Senior Notes Payable, 4.875% due 2010 (Fair Value: 2008 \$177.2; 2007 \$200.0) | 199.4 | 199.1 |
| Liabilities for Income Taxes | 143.0 | 174.2 |
| Liabilities for Benefit Plans | 135.9 | 53.8 |
| Accrued Expenses and Other Liabilities | 4.5 | 4.9 |
| Total Liabilities | 838.3 | 787.0 |
| Shareholders' Equity: | | |
| Common Stock | 6.2 | 6.4 |
| Additional Paid-in Capital | 764.7 | 781.3 |
| Retained Earnings | 985.8 | 1,178.5 |
| Accumulated Other Comprehensive Income (Loss) | (108.1) | 324.8 |
| Total Shareholders' Equity | 1,648.6 | 2,291.0 |
| Total Liabilities and Shareholders' Equity | \$ 2,486.9 | \$ 3,078.0 |

See Accompanying Report of Independent Registered Public Accounting Firm.

SCHII-1

Table of Contents

SCHEDULE II

UNITRIN, INC.

PARENT COMPANY STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

(Dollars in Millions)

| | Years Ended December 31, | | |
|---|--------------------------|----------|----------|
| | 2008 | 2007 | 2006 |
| Net Investment Income | \$ 8.0 | \$ 26.1 | \$ 14.6 |
| Net Realized Investment Gains (Losses) | (12.9) | 22.6 | 2.2 |
| Total Revenues | (4.9) | 48.7 | 16.8 |
| Interest Expense | 33.5 | 33.5 | 28.5 |
| Other Operating (Income) Expenses | (4.8) | (1.9) | 0.4 |
| Total Operating Expenses | 28.7 | 31.6 | 28.9 |
| Income (Loss) before Income Taxes and Equity in Net Income (Loss) of Subsidiaries | (33.6) | 17.1 | (12.1) |
| Income Tax Benefit (Expense) | 13.0 | (0.3) | 7.0 |
| Income (Loss) before Equity in Net Income (Loss) of Subsidiaries | (20.6) | 16.8 | (5.1) |
| Equity in Net Income (Loss) of Subsidiaries | (9.0) | 188.6 | 292.1 |
| Net Income (Loss) | \$ (29.6) | \$ 205.4 | \$ 287.0 |

See Accompanying Report of Independent Registered Public Accounting Firm.

SCHII-2

Table of Contents

SCHEDULE II

UNITRIN, INC.

PARENT COMPANY STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

(Dollars in Millions)

| | Years Ended December 31, | | |
|--|--------------------------|----------------|----------------|
| | 2008 | 2007 | 2006 |
| Operating Activities: | | | |
| Net Income (Loss) | \$ (29.6) | \$ 205.4 | \$ 287.0 |
| Adjustment Required to Reconcile Net Income to Net Cash Provided by Operations: | | | |
| Equity in Net (Income) Loss of Subsidiaries | 9.0 | (188.6) | (292.1) |
| Cash Dividends from Subsidiaries | 84.2 | 157.6 | 221.8 |
| Net Realized Investment (Gains) Losses | 12.9 | (22.6) | (2.2) |
| Other, Net | (15.4) | 15.6 | 13.0 |
| Net Cash Provided by Operating Activities | 61.1 | 167.4 | 227.5 |
| Investing Activities: | | | |
| Capital Contributed to Subsidiaries | (125.0) | (52.0) | |
| Sale of Subsidiary | | 4.0 | |
| Acquisition of Business, Net of Cash Acquired | (95.4) | | |
| Sales of Common Stocks to Unaffiliates | 296.4 | 105.6 | 12.7 |
| Change in Short-term Investments | 56.0 | (25.9) | (39.0) |
| Net Cash Provided (Used) by Investing Activities | 132.0 | 31.7 | (26.3) |
| Financing Activities: | | | |
| Notes Payable Proceeds: | | | |
| Senior Notes Payable Issued | | 354.8 | |
| Revolving Credit Agreement | 232.0 | | 40.0 |
| Notes Payable Payments: | | | |
| Senior Notes Payable Repaid | | (300.0) | |
| Revolving Credit Agreement | (232.0) | | (40.0) |
| Cash Dividends Paid | (118.4) | (119.9) | (119.8) |
| Common Stock Repurchases | (69.0) | (139.5) | (89.9) |
| Exercise of Stock Options | 1.6 | 5.1 | 6.8 |
| Excess Tax Benefits on Share Based Awards | 0.2 | 1.3 | 2.3 |
| Net Cash Used by Financing Activities | (185.6) | (198.2) | (200.6) |
| Increase in Cash | 7.5 | 0.9 | 0.6 |
| Cash, Beginning of Year | 1.7 | 0.8 | 0.2 |
| Cash, End of Year | \$ 9.2 | \$ 1.7 | \$ 0.8 |

See Accompanying Report of Independent Registered Public Accounting Firm.

Table of Contents

SCHEDULE II

UNITRIN, INC.

PARENT COMPANY STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

(Dollars in Millions)

| | Years Ended December 31, | | |
|---|--------------------------|----------|----------|
| | 2008 | 2007 | 2006 |
| Net Income (Loss) | \$ (29.6) | \$ 205.4 | \$ 287.0 |
| Other Comprehensive Income (Loss): | | | |
| Unrealized Holding Gains (Losses) Arising During the Year: | | | |
| Securities Held by Subsidiaries | (584.9) | 85.9 | 72.3 |
| Securities Held by Parent | (97.1) | 35.5 | 21.5 |
| Reclassification Adjustment for Amounts Included in Net Income: | | | |
| Securities Held by Subsidiaries | 77.6 | (34.1) | (23.7) |
| Securities Held by Parent | 10.8 | (18.1) | (1.8) |
| Unrealized Holding Gains (Losses) | (593.6) | 69.2 | 68.3 |
| Unrecognized Postretirement Benefit Costs Arising During the Year | (73.4) | (5.0) | |
| Amortization of Unrecognized Postretirement Benefit Costs | (2.3) | (2.0) | |
| Net Unrecognized Postretirement Benefit Costs | (75.7) | (7.0) | |
| Foreign Currency Translation Adjustments | (2.0) | | |
| Equity in Other Comprehensive Income (Loss) of Subsidiary | 2.5 | 1.2 | (2.1) |
| Other Comprehensive Income (Loss) before Income Taxes | (668.8) | 63.4 | 66.2 |
| Income Tax Benefit (Expense): | | | |
| Unrealized Holding Gains (Losses) Arising During the Year: | | | |
| Securities Held by Subsidiaries | 205.9 | (30.8) | (25.4) |
| Securities Held by Parent | 34.0 | (12.4) | (7.5) |
| Reclassification Adjustment for Amounts Included in Net Income: | | | |
| Securities Held by Subsidiaries | (27.1) | 12.0 | 8.5 |
| Securities Held by Parent | (3.8) | 6.3 | 0.6 |
| Unrealized Holding Gains (Losses) | 209.0 | (24.9) | (23.8) |
| Unrecognized Postretirement Benefit Costs Arising During the Year | 26.5 | 1.4 | |
| Amortization of Unrecognized Postretirement Benefit Costs | 0.6 | 0.6 | |
| Net Unrecognized Postretirement Benefit Costs | 27.1 | 2.0 | |
| Foreign Currency Translation Adjustments | 0.7 | | |
| Equity in Other Comprehensive Income (Loss) of Subsidiary | (0.9) | (0.4) | 0.7 |
| Income Tax Benefit (Expense) | 235.9 | (23.3) | (23.1) |

Edgar Filing: UNITRIN INC - Form 10-K

| | | | |
|-----------------------------------|------------|----------|----------|
| Other Comprehensive Income (Loss) | (432.9) | 40.1 | 43.1 |
| Total Comprehensive Income (Loss) | \$ (462.5) | \$ 245.5 | \$ 330.1 |

See Accompanying Report of Independent Registered Public Accounting Firm.

SCHII-4

Table of Contents

SCHEDULE III

UNITRIN, INC. AND SUBSIDIARIES

SUPPLEMENTARY INSURANCE INFORMATION

(Dollars in Millions)

| | Year Ended December 31, | | | | | | | December 31, | | |
|---------------------|-------------------------|------------------|----------------|-----------------------|--|---|--------------------------|-----------------------------------|--------------------|-------------------|
| | Premiums | Premiums Written | Other Income | Net Investment Income | Insurance Claims and Policy-holders Benefits | Amortization Of Deferred Policy Acquisition Costs | Other Insurance Expenses | Deferred Policy Acquisition Costs | Insurance Reserves | Unearned Premiums |
| 2008 | | | | | | | | | | |
| Kemper | \$ 930.7 | \$ 946.8 | \$ 0.5 | \$ 19.1 | \$ 673.8 | \$ 166.7 | \$ 102.2 | \$ 79.5 | \$ 476.1 | \$ 455.8 |
| Unitrin Specialty | 494.0 | 523.4 | 0.2 | 8.6 | 397.0 | 65.1 | 30.5 | 24.6 | 293.1 | 174.1 |
| Unitrin Direct | 290.5 | 286.7 | 0.4 | 4.6 | 246.7 | 7.5 | 93.8 | 15.6 | 163.1 | 70.1 |
| Life and Health (1) | 661.4 | N/A | 1.1 | 162.1 | 447.7 | 72.2 | 225.4 | 369.5 | 2,995.7 | 29.9 |
| Other | | N/A | 1.9 | 18.5 | | | (26.9) | | 313.3 | 3.6 |
| Total | \$ 2,376.6 | \$ N/A | \$ 4.1 | \$ 212.9 | \$ 1,765.2 | \$ 311.5 | \$ 425.0 | \$ 489.2 | \$ 4,241.3 | \$ 733.5 |
| 2007 | | | | | | | | | | |
| Kemper | \$ 926.3 | \$ 935.0 | \$ 0.5 | \$ 44.0 | \$ 618.1 | \$ 163.5 | \$ 101.0 | \$ 76.6 | \$ 502.4 | \$ 439.7 |
| Unitrin Specialty | 449.3 | 445.4 | 0.1 | 19.2 | 340.9 | 56.6 | 35.8 | 18.5 | 278.6 | 144.7 |
| Unitrin Direct | 257.6 | 247.6 | 0.4 | 8.9 | 219.3 | 11.0 | 77.8 | 16.3 | 142.6 | 74.1 |
| Life and Health (1) | 653.7 | N/A | 1.2 | 181.0 | 394.0 | 69.3 | 222.1 | 326.0 | 2,544.3 | 29.4 |
| Other | | N/A | 1.3 | 36.8 | | | (31.3) | | 388.0 | 34.3 |
| Total | \$ 2,286.9 | \$ N/A | \$ 3.5 | \$ 289.9 | \$ 1,572.3 | \$ 300.4 | \$ 405.4 | \$ 437.4 | \$ 3,855.9 | \$ 722.2 |
| 2006 | | | | | | | | | | |
| Kemper | \$ 944.6 | \$ 955.0 | \$ 0.4 | \$ 50.4 | \$ 586.2 | \$ 165.4 | \$ 110.4 | | | |
| Unitrin Specialty | 444.4 | 444.3 | | 22.4 | 335.6 | 60.9 | 31.1 | | | |
| Unitrin Direct | 225.9 | 182.5 | 0.4 | 9.3 | 182.3 | 10.4 | 52.7 | | | |
| Life and Health (1) | 675.6 | N/A | 11.2 | 181.3 | 404.6 | 71.5 | 236.7 | | | |
| Other | | N/A | 2.4 | 22.6 | | | (27.1) | | | |
| Total | \$ 2,290.5 | \$ N/A | \$ 14.4 | \$ 286.0 | \$ 1,508.7 | \$ 308.2 | \$ 403.8 | | | |

(1) The Company's Life and Health Insurance employee-agents also market certain property and casualty insurance products under common management. Accordingly, the Company includes the results of these property and casualty insurance products in its Life and Health Insurance segment.

See Accompanying Report of Independent Registered Public Accounting Firm.

Table of Contents

SCHEDULE IV

UNITRIN, INC.

REINSURANCE SCHEDULE

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 and 2006

(Dollars in Millions)

| | Gross Amount | Ceded to Other Companies | Assumed from Other Companies | Net Amount | Percentage of Amount Assumed to Net |
|--------------------------------------|-------------------|--------------------------------|------------------------------------|-------------------|--|
| Year Ended December 31, 2008: | | | | | |
| Life Insurance in Force | \$ 21,908.7 | \$ 847.4 | \$ 310.4 | \$ 21,371.7 | 1.5% |
| Premiums | | | | | |
| Life Insurance | \$ 398.3 | \$ 2.5 | \$ 2.7 | \$ 398.5 | 0.7% |
| Accident and Health Insurance | 160.0 | | 0.1 | 160.1 | |
| Property and Liability Insurance | 1,800.6 | 46.6 | 64.0 | 1,818.0 | 3.5% |
| Total Premiums | \$ 2,358.9 | \$ 49.1 | 66.8 | \$ 2,376.6 | 2.8% |
| Year Ended December 31, 2007: | | | | | |
| Life Insurance in Force | \$ 20,177.0 | \$ 642.7 | \$ | \$ 19,534.3 | |
| Premiums | | | | | |
| Life Insurance | \$ 388.6 | \$ 0.8 | \$ | \$ 387.8 | |
| Accident and Health Insurance | 157.6 | (0.3) | | 157.9 | |
| Property and Liability Insurance | 1,716.2 | 42.2 | 67.2 | 1,741.2 | 3.9% |
| Total Premiums | \$ 2,262.4 | \$ 42.7 | 67.2 | \$ 2,286.9 | 2.9% |
| Year Ended December 31, 2006: | | | | | |
| Life Insurance in Force | \$ 20,767.3 | \$ 687.4 | \$ | \$ 20,079.9 | |
| Premiums | | | | | |
| Life Insurance | \$ 401.6 | \$ 0.9 | \$ | \$ 400.7 | |
| Accident and Health Insurance | 158.3 | | | 158.3 | |
| Property and Liability Insurance | 1,692.7 | 34.1 | 72.9 | 1,731.5 | 4.2% |
| Total Premiums | \$ 2,252.6 | \$ 35.0 | \$ 72.9 | \$ 2,290.5 | 3.2% |

See Accompanying Report of Independent Registered Public Accounting Firm.

SCHIV-1

Table of Contents

SCHEDULE VI

UNITRIN, INC. AND SUBSIDIARIES

SUPPLEMENTAL INFORMATION CONCERNING PROPERTY-CASUALTY INSURANCE OPERATIONS

(Dollars in Millions)

| Affiliation | Deferred Policy Acquisition Costs | Reserves for Unpaid Claims and Claim | | Unearned Premiums | Earned Premiums | Net Investment Income | Claim and Claim Adjustment Expenses Incurred Related to | | Amortization of Deferred Policy Acquisition Costs | Paid Claims and Claim Adjustment Expenses | Premiums Written | |
|---|--|--|----------|----------------------|--------------------|-----------------------------|---|----------------|---|--|---------------------|------------|
| | | Adjustment Expenses | Discount | | | | Current Year | Prior Years | | | | |
| Year Ended December 31, 2008: | | | | | | | | | | | | |
| (a) Consolidated property casualty entities | \$ 122.2 | \$ 1,268.7 | \$ | \$ 707.1 | \$ 1,818.1 | \$ 33.7 | \$ 1,456.0 | \$ (49.6) | \$ | \$ 248.7 | \$ 1,382.5 | \$ 1,859.7 |
| (b) Unconsolidated property casualty entities | \$ | \$ | \$ | \$ | \$ 70.8 | \$ 6.7 | \$ 62.0 | \$ (29.7) | \$ | \$ 13.1 | \$ 110.5 | \$ (12.3) |
| Year Ended December 31, 2007: | | | | | | | | | | | | |
| (a) Consolidated property casualty entities | \$ 112.1 | \$ 1,322.9 | \$ | \$ 696.2 | \$ 1,741.2 | \$ 72.8 | \$ 1,290.6 | \$ (55.4) | \$ | \$ 240.7 | \$ 1,264.9 | \$ 1,735.6 |
| (b) Unconsolidated property casualty entities | \$ 15.0 | \$ | \$ | \$ 50.8 | \$ 171.5 | \$ 23.0 | \$ 117.3 | \$ (45.7) | \$ | \$ 29.9 | \$ 123.2 | \$ 161.5 |
| Year Ended December 31, 2006: | | | | | | | | | | | | |
| (a) Consolidated property casualty entities | | | | | \$ 1,731.5 | \$ 82.7 | \$ 1,221.3 | \$ (65.8) | \$ | \$ 249.0 | \$ 1,161.5 | \$ 1,698.2 |
| (b) Unconsolidated property casualty entities | | | | | \$ 188.2 | \$ 28.9 | \$ 134.6 | \$ (25.8) | \$ | \$ 34.4 | \$ 130.7 | \$ 189.6 |

Amounts reported in (b) above represent amounts for Unitrin Business Insurance which is reported as a discontinued operation in the Company's financial statements. The Company has no 50%-or-less-owned property and casualty equity investees. Accordingly, amounts for category (c) are omitted from the table.

See Accompanying Report of Independent Registered Public Accounting Firm.

