

CITIZENS INC
Form 10-K
March 12, 2012

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

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

Commission File Number: 000-16509

CITIZENS, INC.
(Exact name of registrant as specified in its charter)

Colorado
(State of Incorporation)

84-0755371
(I.R.S. Employer Identification No.)

400 East Anderson Lane, Austin, TX
(Address of principal executive offices)

78752
(Zip Code)

(512) 837-7100

(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
Class A Common Stock	New York Stock Exchange

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

None

(Title of class)

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 403 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 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 requirement for the past 90 days. Yes No

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

Edgar Filing: CITIZENS INC - Form 10-K

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 or 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 file, an accelerated filer, a non-accelerated filer or a smaller reporting company.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of June 30, 2011, the aggregate market value of the Class A voting stock held by non-affiliates of the registrant was approximately \$305,863,400.

Number of shares of common stock outstanding as of March 5, 2012.

Class A: 48,962,938

Class B: 1,001,714

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Report incorporates certain portions of the definitive proxy materials of the registrant in respect to its 2012 Annual Meeting of Shareholders.

THIS PAGE INTENTIONALLY LEFT BLANK

TABLE OF CONTENTS

	Page
PART I	
Item 1. <u>Business</u>	2
Item 1A. <u>Risk Factors</u>	7
Item 1B. <u>Unresolved Staff Comments</u>	18
Item 2. <u>Properties</u>	18
Item 3. <u>Legal Proceedings</u>	18
Item 4. <u>Mine Safety Disclosures</u>	18
PART II	
Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	19
Item 6. <u>Selected Financial Data</u>	21
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
Item 7A. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	46
Item 8. <u>Financial Statements and Supplementary Data</u>	48
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	48
Item 9A. <u>Controls and Procedures</u>	48
Item 9B. <u>Other Information</u>	50
PART III	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	50
Item 11. <u>Executive Compensation</u>	50
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	50
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	50
Item 14. <u>Principal Accounting Fees and Services</u>	50
PART IV	
Item 15. <u>Exhibits, Financial Statement Schedules</u>	50
<u>Signatures</u>	102

Table of Contents

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report on Form 10-K are not statements of historical fact and constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act (the "Act"), including, without limitation, statements specifically identified as forward-looking statements within this document. Many of these statements contain risk factors as well. In addition, certain statements in future filings by the Company with the Securities and Exchange Commission, in press releases, and in oral and written statements made by us or with the approval of the Company, which are not statements of historical fact, constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, income or loss, earnings or loss per share, the payment or non-payment of dividends, capital structure, and other financial items, (ii) statements of our plans and objectives by our management or Board of Directors, including those relating to products or services, (iii) statements of future economic performance and (iv) statements of assumptions underlying such statements. Words such as "believes," "anticipates," "assumes," "estimates," "plans," "projects," "could," "expects," "intends," "targeted," "may," "will" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements.

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

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

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

We make available, free of charge, through our Internet website (<http://www.citizensinc.com>), our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Section 16 Reports filed by officers and directors, news releases, and, if applicable, amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after we electronically file such

reports with, or furnish such reports to, the Securities and Exchange Commission. We are not including any of the information contained on our website as part of, or incorporating it by reference into, this Annual Report on Form 10-K.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

PART I

Item 1. BUSINESS

Overview

Citizens, Inc. ("Citizens") is an insurance holding company serving the life insurance needs of individuals in the United States since 1969 and internationally since 1975. Through our insurance subsidiaries, we pursue a strategy of offering traditional insurance products in niche markets where we believe we are able to achieve competitive advantages. We had approximately \$1.1 billion of assets at December 31, 2011 and approximately \$5.2 billion of insurance in force. Our core insurance operations include issuing and servicing:

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

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

Our business has grown, both internationally and domestically, in recent years. Revenues rose from \$169.6 million in 2007 to \$195.0 million in 2011. During the five years ended December 31, 2011, our assets grew from \$787.9 million to \$1.1 billion. Total stockholders' equity increased from \$176.2 million at December 31, 2007 to \$255.7 million at December 31, 2011. See Item 6. "Selected Financial Data" in this Report.

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

Life Insurance

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

International Sales

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

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

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

We have implemented several policies and procedures to reduce the risks of asset and premium loss relating to our international business. Approvals for policy issuance are made in our Austin, Texas office and policies are issued and delivered to our independent consultants, who deliver the policies to the insureds. We have no offices, employees or assets outside of the United States. Insurance policy applications and premium payments are submitted by the independent consultants or customers to us and we review the applications in our home offices in Austin, Texas. Premiums are paid in U.S. Dollars through a U.S. financial institution by check, wire or credit card. The policies we issue contain limitations on benefits for certain causes of death, such as homicide and careless driving. We have also developed disciplined underwriting criteria, which includes medical reviews of applicants as well as background and reference checks. In addition, we have a claims policy that requires investigation of substantially all death claims. Furthermore, we perform background reviews and reference checks of prospective marketing firms and consultants.

Independent marketing firms and consultants specialize in marketing life insurance products and generally have several years of insurance marketing experience. We maintain standard contracts with the independent marketing firms pursuant to which they provide recruitment, training and supervision of their managers and associates in the service and placement of our products; however, all associates of these firms also contract directly with us as independent contractors and receive their compensation directly from us. Accordingly, should an arrangement between any independent marketing firm and us be terminated for any reason, we believe we would continue with the existing marketing arrangements with the associates of these firms without a material loss of sales. Our standard agreement with independent marketing firms and consultants provides they are independent contractors responsible for their own operation expenses, and that they are the representative of the prospective insured. In addition, the marketing firms guarantee any debts of their associates to us. The marketing firms receive commissions on all new and renewal policies serviced or placed by them or their associates. All of these contracts provide that the independent marketing firms and consultants are aware of and responsible for compliance with local laws.

International Products

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

- U.S. Dollar-denominated cash values that accumulate, beginning in the first policy year, to a policyholder during his or her lifetime;
 - premium rates that are competitive with or better than most foreign local companies;
 - a hedge against local currency inflation;
 - protection against devaluation of foreign currency;
 - capital investment in a more secure economic environment (i.e., the United States); and
 - lifetime income guarantees for an insured or for surviving beneficiaries.

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

International Competition

The life insurance business is highly competitive. We compete with a large number of stock and mutual life companies internationally and domestically, as well as with financial institutions that offer insurance products. There are more than 1,000 life insurance companies in the United States, some of which also provide insurance to foreign residents.

Given the variety of foreign markets in which we provide ordinary whole life insurance, it is not possible to ascertain our competitive position. We face competition primarily from companies formed and operated in the country in which the insureds reside, from companies that operate in the same manner as we do and from companies that are foreign to the countries in which policies are sold, but issue insurance policies denominated in the local currency of those countries. A substantial number of companies may be deemed to have a competitive advantage over us due to their significantly greater financial resources, histories of successful operations and larger marketing forces. However, we believe that our experience, combined with the special features of our policies, allow us to compete effectively in pursuing new business.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Because premiums on our international policies are paid in U.S. Dollars drawn on U.S. financial institutions, and we pay claims in U.S. Dollars, we provide a product that is different from the products provided by foreign-domiciled companies. Our international policies are usually acquired by individuals with significant net worth and earnings that place them in the top income brackets of their respective countries. The policies sold by our foreign competitors are generally offered broadly and are priced using the mortality of the entire population of the geographic region. Our mortality charges are therefore typically lower, which provides a competitive advantage. Additionally, the assets backing the reserves for our foreign competitors' policies must be substantially invested in their respective countries and, therefore, are exposed to the inflationary risks and social or economic crises that have been more common in these foreign countries.

Domestic Sales

The majority of our inforce business results from blocks of business of insurance companies we have acquired over the past 15 years. Our acquisition transition strategy focuses on the introduction of our cash accumulation ordinary whole life products to independent marketing consultants associated with companies we have acquired, while continuing to service the needs of acquired policyholders.

In the Midwest and the southern United States, we seek to serve middle income households through the sale of cash accumulation ordinary whole life insurance products. Our distribution strategy is through marketing consultants, comprised primarily of part-time, second-career sales associates (such as teachers, coaches, community leaders and others) in rural and urban areas. Over the past three years, new product sales have trended downward as we have tightened underwriting on business that did not meet our profitability objectives.

Domestic Products

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

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

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

Domestic Competition

The U.S. life insurance industry is a mature industry that, in recent years, has experienced little to no growth. Competition is intense because the life insurance industry is consolidating, with larger, more efficient and more effective organizations emerging from consolidation.

Many domestic life insurance companies have significantly greater financial, marketing forces and other resources, longer business histories and more diversified lines of insurance products than we do. We also face competition from companies marketing in person as well as with direct mail and Internet sales campaigns. Although we may be at a competitive disadvantage to these entities, we believe that our premium rates and policy features are generally competitive with those of other life insurance companies selling similar types of ordinary whole life insurance.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Home Service Insurance

Our Home Service segment operates in this market through our subsidiaries Security Plan Life Insurance Company ("SPLIC") and Security Plan Fire Insurance Company ("SPFIC"), and focus on the life insurance needs of the middle and lower income markets, primarily in Louisiana, Mississippi and Arkansas. Our policies are sold and serviced through a home service marketing distribution system of approximately 300 employee-agents who work full time on a route system and through over 230 funeral homes and independent agents to sell policies, collect premiums and service policyholders. To a lesser extent, our Home Service segment sells limited-liability, named peril property policies covering dwelling and contents.

Home Service Products and Competition

Our home service insurance products consist primarily of small face amount ordinary whole life and pre-need policies, which are designed to fund final expenses for the insured, primarily consisting of funeral and burial costs. The average life insurance policy face amount issued was approximately \$7,000 in 2011; therefore, the underwriting performed on these applications is limited. Our property coverages are limited to \$30,000 maximum coverage on any one dwelling and contents, while content-only coverage and dwelling-only coverage is limited to \$20,000. We face competition in Louisiana, Mississippi and Arkansas from other companies specializing in home service distribution of insurance. We seek to compete based upon our emphasis on personal service to our customers. We intend to continue premium growth within this segment via direct sales and acquisitions.

Other Non-Insurance Enterprises

Other Non-insurance Enterprises includes Computing Technology, Inc., which provides data processing services to the Company, and Insurance Investors, Inc., which provides aviation transportation to the Company. This segment also includes the results of Citizens, Inc., the parent Company.

Operations and Technology

Our administrative operations primarily serve our life insurance segment and are conducted primarily at our executive offices in Austin, Texas through approximately 116 administrative, operating and underwriting personnel. Our Home Service operations are conducted to a large degree from our district offices in Louisiana, Arkansas and Mississippi, as well as our support center in Donaldsonville, Louisiana through approximately 64 operations personnel. At our executive offices, we also perform policy design, marketing oversight, underwriting, accounting and reporting, customer service, administration and investing activities.

Our senior management has significant experience in insurance company application system design and implementation. Since the mid-1960's, our senior management has been leading development of evolving insurance applications. We have a single integrated system for our entire Company, which is a centrally-controlled, mainframe-based administrative system. Functions of our administrative system include policy set up, administration, billing and collections, commission calculation, valuation, automated internal audit functions, storage backup, image management and other related functions. Each company we acquire is ultimately converted onto our administrative system. This system has been in place for many years, and we believe it is a significant asset to us. We update our administrative system on an ongoing basis. This system is also capable of significant expansion without substantial capital outlay or increase in staff. Therefore, we believe we can achieve additional growth without costly administrative system expenditures, delays, failures or the addition of substantial staffing.

Regulation

Our U.S. insurance operations are subject to a wide variety of laws and regulations. State insurance laws establish supervisory agencies with broad regulatory authority to regulate most aspects of our U.S. insurance businesses, and our insurance subsidiaries are regulated by the insurance departments of each state in which they are licensed. In addition, U.S. laws, such as the USA Patriot Act of 2001, the Foreign Corrupt Practices Act (“FCPA”), the Gramm-Leach-Bliley Act of 1999, the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001, the Sarbanes-Oxley Act of 2002 and the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (“the Dodd-Frank Act”), are examples of U.S. regulation that affect our business. We are subject to comprehensive regulations under the USA Patriot Act with respect to money laundering, as well as federal regulations regarding privacy and confidentiality. Our insurance products and thus our businesses also are affected by U.S. federal, state and local tax laws. The Dodd-Frank Act focuses on financial reform and may result in significant changes to the regulation of institutions operating in the financial services industry, including the Company. Legislative or regulatory requirements imposed by or promulgated in connection with this Act may make it more expensive for the Company to conduct its business, may have a material adverse effect on the overall business climate and could materially affect the profitability of the results of operations and financial condition of financial institutions. The Company is uncertain as to all of the impacts this new legislation will have and cannot provide assurance it will not adversely affect its results of operations and financial condition. In general, government regulation at the federal level may increase and may result in unpredictable consequences for the Company. In addition, other federal laws and regulations apply to us in areas such as pension regulations, privacy, tort reform and taxation.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

The purpose of the laws and regulations that affect our insurance business is primarily to protect our insureds and not our stockholders. Many of the laws and regulations to which we are subject are regularly re-examined, and existing or future laws and regulations may become more restrictive or otherwise adversely affect our operations. In addition, insurance regulatory authorities (including state law enforcement agencies and attorneys general) periodically make inquiries and regularly conduct examinations regarding compliance by us and our subsidiaries with insurance, and other laws and regulations regarding the conduct of our insurance businesses. We cooperate with such inquiries and examinations and take corrective action when warranted.

Our insurance subsidiaries are collectively licensed to transact business in 32 states. We have insurance subsidiaries domiciled in the states of Colorado, Louisiana and Texas. Our U.S. insurance subsidiaries are licensed and regulated in all U.S. jurisdictions in which they conduct insurance business. The extent of this regulation varies, but most jurisdictions have laws and regulations based upon the National Association of Insurance Commissioners ("NAIC") model rules governing the financial condition of insurers, including standards of solvency, types and concentration of investments, establishment and maintenance of reserves, credit for reinsurance and requirements of capital adequacy, and the business conduct of insurers, including marketing and sales practices and claims handling. In addition, statutes and regulations usually require the licensing of insurers and their agents, the approval of policy forms and related materials and the approval of rates for certain types of insurance products.

All U.S. jurisdictions in which our U.S. insurance subsidiaries conduct insurance business have enacted legislation that requires each U.S. insurance company in a holding company system, except captive insurance companies, to register with the insurance regulatory authority of its jurisdiction of domicile and to furnish that regulatory authority financial and other information concerning the operations of, and the interrelationships and transactions among, companies within its holding company system that may materially affect the operations, management or financial condition of the insurers within the system. These laws and regulations also regulate transactions between insurance companies and their parents and affiliates. Generally, these laws and regulations require that all transactions within a holding company system between an insurer and its affiliates be fair and reasonable and that the insurer's statutory capital and surplus following any transaction with an affiliate be both reasonable in relation to its outstanding liabilities and adequate to its financial needs. Statutory surplus is the excess of admitted assets over the sum of statutory liabilities and capital. For certain types of agreements and transactions between an insurer and its affiliates, these laws and regulations require prior notification to, and non-disapproval or approval by, the insurance regulatory authority of the insurer's jurisdiction of domicile.

The payment of dividends or other distributions to us by our insurance subsidiaries is regulated by the insurance laws and regulations of their respective states of domicile. The laws and regulations of some of these jurisdictions also prohibit an insurer from declaring or paying a dividend except out of its earned surplus or require the insurer to obtain regulatory approval before it may do so. In addition, insurance regulators may prohibit the payment of ordinary dividends or other payments by our insurance subsidiaries to us (such as a payment under a tax sharing agreement or for employee or other services) if they determine such payment could be adverse to policyholders or insurance contract holders of the subsidiary.

The laws and regulations of the jurisdictions in which our U.S. insurance subsidiaries are domiciled require that a controlling party obtain the approval of the insurance commissioner of the insurance company's jurisdiction of domicile prior to acquiring control of the insurer and may delay, deter or prevent a transaction our shareholders might consider desirable.

Risk-based capital ("RBC") requirements are imposed on life and property and casualty insurance companies. The NAIC has established minimum capital requirements in the form of RBC. RBC factors the type of business written by

an insurance company, the quality of its assets, and various other aspects of an insurance company's business to develop a minimum level of capital called "authorized control level risk-based capital" and compares this level to adjusted statutory capital that includes capital and surplus as reported under statutory accounting principles, plus certain investment reserves. Should the ratio of adjusted statutory capital to control level risk-based capital fall below 200%, a series of actions by the affected company would begin.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Potential Changes in Regulation

Government actions in response to the recent financial crisis and market volatility could significantly impact our current regulations. As part of a comprehensive reform of financial services regulation known as the Dodd-Frank Act, Congress established an office within the federal government to collect information about the insurance industry, recommend standards, and represent the United States in dealing with foreign insurance regulators.

Item 1A. RISK FACTORS

Investing in our Company involves certain risks. Set forth below are certain risks with respect to our Company. Readers should carefully review these risks, together with the other information contained in this report. The risks and uncertainties we have described in this report are not the only ones we face. Additional risks and uncertainties not presently known to us, or that we currently deem not material, may also adversely affect our business. Any of the risks discussed in this report or that are presently unknown or not material, if they were to actually occur, could result in a significant adverse impact on our business, operating results, prospects or financial condition. References in the risk factors below to "we," "us," "our," "Citizens" and like terms relate to Citizens, Inc. and its subsidiaries on a U.S. GAAP consolidated financial statement basis, unless specifically identified otherwise. We operate our subsidiaries as separate and distinct entities with respect to corporate formalities.

Risks Relating to Our Business

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

A substantial part of our insurance policy sales are from foreign countries, primarily those in Latin America and the Pacific Rim. There is a risk that we may lose a significant portion of these sales should adverse events occur in these countries. We seek to address this risk by, among other things, not accepting insurance applications outside of the U.S., maintaining all of our assets in the U.S. and requiring that policy premiums be paid to us in U.S. Dollars drawn on U.S. financial institutions. Accordingly, we have never qualified to do business in any foreign country and have never submitted our insurance policies issued to foreign residents for approval by any foreign or domestic insurance regulatory agency. We sell our policies to foreign residents using foreign independent marketing firms and independent consultants, and we rely on those persons to comply with applicable laws in marketing our insurance products.

The government of a foreign country could determine that its residents may not buy life insurance from us unless we became qualified to do business in that country or unless our policies purchased by its residents receive prior approval from its insurance regulators. Also, new laws or regulations could be implemented or new applications of existing laws or regulations could occur, which could result in the cessation of marketing activities by our independent marketing firms and consultants. From time to time we have become aware of new foreign laws, regulations or new interpretations of foreign laws or regulations that may have an adverse effect on the marketing efforts of our foreign independent marketing firms and consultants. We cannot assure you that any of these laws, regulations, or application of them by foreign regulatory authorities will not have an adverse effect on the marketing efforts of our independent marketing firms and consultants and, in turn, on our revenues. Further, there is no assurance that we would be able to qualify to do business in any foreign country or that its insurance regulatory authorities would approve our policies if we decided to submit our insurance policies for approval. We could also face sanctions, including fines and penalties, if a country's authorities determined any failure to qualify or otherwise comply with its laws was willful or ongoing. Any of the foregoing could reduce our revenues and materially adversely affect our results of operations and

financial condition. Additionally, we do not determine whether our independent consultants are required to be licensed to sell insurance in the countries in which they market our policies. If our independent consultants were not in compliance with applicable laws, including licensing laws, they could be required to cease operations, which would reduce our revenues. We have not obtained any advice of counsel in any foreign jurisdictions with respect to these matters. We are unable to quantify the effect of foreign regulation on our business if regulation were to be imposed on us, but we believe we could expend substantial amounts of time and incur substantial expense in complying with any foreign regulation, and we may decide to withdraw from or avoid a market if foreign regulation were imposed.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Additionally, if economic or political crises were to occur in any of the countries where our foreign policyowners reside, our revenues could be adversely affected. Also, currency control laws, regulations and decrees in foreign countries, if implemented, could materially adversely affect our revenues by imposing restrictions on asset transfers outside of a country where our insureds reside.

While our management has more than 40 years of experience in writing life insurance policies for foreign residents without any significant legal prohibition, regulatory action, or any lengthy currency controls relating to our foreign resident insureds, there can be no assurance that such situations will not occur and that our revenues, results of operations and financial condition will not be materially, adversely affected if they do occur.

The majority of our foreign policyholders choose to invest their policy dividends or other cash benefits in our Class A common stock through the Citizens, Inc. Stock Investment Plan (the "Plan"). If a securities regulatory authority were to deem the Plan's operation contrary to applicable securities laws, we risk facing fines and penalties and cease and desist orders which would create a reduction in the amount of Class A common stock purchased on the open market through the Plan.

The offer and sale of our Class A common stock through the Plan is registered under the Securities Act of 1933, but not under the laws of any foreign jurisdiction. Most all of our foreign policyholders participate in the Plan and choose to invest dividends paid on their insurance policies in our Class A common stock pursuant to the Plan. We have not obtained any advice of counsel in any foreign jurisdiction as to whether such participation by foreign residents in the Plan is subject to foreign securities laws or regulations or whether our independent consultants in these jurisdictions are subject to licensing requirements in connection with foreign policyholder participation in the Plan. If a securities regulatory authority were to determine the offer and sale of our Class A common stock under the Plan were contrary to applicable laws and regulations of its jurisdiction, we could be faced with cease and desist orders, fines and penalties, or reduced participation in the Plan by our foreign policyholders. This also could materially reduce the amount of our Class A common stock purchased and sold in the open market under the Plan, as historically a significant volume of shares have been purchased under the Plan through issuance of policy cash dividends assigned to the Plan. We could also be faced with private disputes relating to the Plan, including the possibility of securities law claims within the United States. In the absence of countervailing considerations, we would expect to defend any such claims and we could incur significant defense costs, including not only attorneys' fees and other direct litigation costs, but also the expenditure of substantial amounts of management time that otherwise would be devoted to our business. This could materially adversely affect our results of operations and financial condition.

We face financial and capital market risks in our operations

As an insurance holding company with significant investment exposure, we face material financial and capital markets risk in our operations. Due to the low interest rate environment over the past three years, we experienced significant call activity on our fixed income portfolio which has decreased our investment yields compared to prior years. Also, we recorded other-than-temporary impairments ("OTTI") in the past several years due to credit related market declines. In addition, the significant increase in worldwide economic instability and unemployment rates could result in decreased persistency of our insurance policies in force, as well as reduced new insurance policy sales, which may materially adversely affect our results of operations and financial condition.

Economic uncertainty has recently been exacerbated by the increased potential for default by one or more European sovereign debt issuers, the potential partial or complete dissolution of the Eurozone and its common currency and the negative impact of such events on global financial institutions and capital markets generally. Actions or inactions of European governments may impact these actual or perceived risks. In the U.S. during 2011, one rating agency

downgraded the U.S.'s long-term debt credit rating from AAA. Future actions or inactions of the United States government, including a shutdown of the federal government, could increase the actual or perceived risk that the U.S. may not ultimately pay its obligations when due and may disrupt financial markets.

Changes in market interest rates may significantly affect our profitability.

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

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

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

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

In particular, at December 31, 2011, fixed maturities represented \$741.8 million or 88.4% of our total investments of \$839.2 million. The fair value of fixed maturities and the related investment income fluctuates depending on general economic and market conditions. The fair value of these investments generally increases or decreases in an inverse relationship with fluctuations in interest rates, while net investment income realized by us will generally increase or decrease in line with changes in market interest rates. In addition, actual net investment income and/or cash flows from investments that carry prepayment risk, such as mortgage-backed and other asset-backed securities, may differ from those anticipated at the time of investment as a result of interest rate fluctuations. An investment has prepayment risk when there is a risk that the timing of cash flows that result from the repayment of principal might occur earlier than anticipated because of declining interest rates or later than anticipated because of rising interest rates. We experienced significant prepayments of bonds in our investment portfolio over the past three years. The impact of value fluctuations affects our consolidated financial statements, as a large portion of our fixed maturities that are classified as available-for-sale, with changes in fair value reflected in our stockholders' equity (accumulated other comprehensive income or loss). No similar adjustment is made for liabilities to reflect a change in interest rates. Therefore, interest rate fluctuations and economic conditions could adversely affect our stockholders' equity, total comprehensive income and/or cash flows. For mortgage-backed securities, credit risk exists if mortgagees default on the underlying mortgages. Although at December 31, 2011, approximately 97.7% of our fixed maturities were investment grade with 71.4% rated AA or above, all of our fixed maturities are subject to credit risk. If any of the issuers of our fixed maturities suffer financial setbacks, the ratings on the fixed maturities could fall (with a concurrent fall in fair value) and, in a worst case scenario, the issuer could default on its financial obligations. If the issuer defaults, we could have realized losses associated with the impairment of the securities.

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

At December 31, 2011, we had investments with a carrying value of \$307.2 million (36.6% of our total invested assets) in U.S. Government sponsored corporations and agencies, including the Federal Home Loan Mortgage Corporation ("Freddie") and the Federal National Mortgage Association ("Fannie"). Both Freddie and Fannie are

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

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

Fixed maturity and equity securities classified as available-for-sale are reported at fair value. Unrealized gains and losses on available-for-sale securities are recognized as a component of other comprehensive income (loss) and are, therefore, excluded from our net income. Our total gross unrealized losses on our available-for-sale securities portfolio at December 31, 2011 were \$3.0 million. The accumulated change in estimated fair value of these securities is recognized in net income when the gain or loss is realized upon sale of the security or in the event that the decline in estimated fair value is determined to be other-than-temporary and an impairment charge to earnings is taken. Realized losses or impairments may have a material adverse effect on our net income in a particular quarterly or annual period.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

We maintain reserves to cover our estimated exposure for claims relating to our issued insurance policies. Reserves, whether calculated under U.S. generally accepted accounting principles ("U.S. GAAP") or statutory accounting practices prescribed by various state insurance regulators, do not represent an exact calculation of exposure, but instead represent our best estimates, generally involving actuarial projections, of what we expect claims will be based on mortality assumptions that are determined by various regulatory authorities. Many reserve assumptions are not directly quantifiable, particularly on a prospective basis. In addition, when we acquire other domestic life insurance companies, our assessment of the adequacy of acquired policy liabilities is subject to our estimates and assumptions. Reserve estimates are refined as experience develops, and adjustments to reserves are reflected in our statements of operations for the period in which such estimates are updated. Because establishing reserves is an inherently uncertain process involving estimates of future losses, future developments may require us to increase claims reserves, which may have a material adverse effect on our results of operations and financial condition in the periods in which such increases occur.

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

At December 31, 2011, we had \$136.3 million of deferred policy acquisition costs, or DAC. DAC represents costs that vary with and are primarily related to the sale and issuance of our insurance policies and are deferred and amortized over the estimated life of the related insurance policies. These costs include commissions in excess of ultimate renewal commissions, solicitation and printing costs, sales material costs and some support costs, such as underwriting and contract and policy issuance expenses. Under U.S. GAAP, DAC is amortized to income over the lives of the underlying policies, in relation to the anticipated recognition of premiums.

In addition, when we acquire a block of insurance policies, we assign a portion of the purchase price to the right to receive future net cash flows from existing insurance and investment contracts and policies. This intangible asset, called the cost of customer relationships acquired, or CCRA, represents the actuarially estimated present value of future cash flows from the acquired policies. At December 31, 2011, we had \$27.9 million of CCRA. We amortize the value of this intangible asset in a manner similar to the amortization of DAC.

Our amortization of DAC and CCRA generally depends upon anticipated profits from investments, surrender and other policy charges, mortality, morbidity, persistency and maintenance expense margins. For example, if our insurance policy lapse and surrender rates were to exceed the assumptions upon which we priced our insurance policies, or if actual persistency proves to be less than our persistency assumptions, especially in the early years of a policy, we would be required to accelerate the amortization of expenses we deferred in connection with the acquisition of the policy. We regularly review the quality of our DAC and CCRA to determine if they are recoverable from future income. If these costs are not recoverable, they are charged to expenses in the financial period in which we make this determination.

Unfavorable experience with regard to expected expenses, investment returns, surrender and other policy charges, mortality, morbidity, lapses or persistency may cause us to increase the amortization of DAC or CCRA, or both, or to record a current period expense to increase benefit reserves, any of which could have a material adverse effect on our results of operations and financial condition.

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

Goodwill represents the excess of the amount paid by us to acquire various life insurance companies over the fair value of their net assets at the date of the acquisition. Under U.S. GAAP, we test the carrying value of goodwill for impairment at least annually at the "reporting unit" level, which is either an operating segment or a business that is one level below the operating segment. Goodwill is impaired if its carrying value exceeds its implied fair value. This may occur for various reasons, including changes in actual or expected earnings or cash flows of a reporting unit, generation of earnings by a reporting unit at a lower rate than similar businesses or declines in market prices for publicly traded businesses similar to our reporting units. If any portion of our goodwill becomes impaired, we would be required to recognize the amount of the impairment as a current-period expense, which could have a material adverse effect on our results of operations and financial condition. Goodwill in our consolidated financial statements was \$17.2 million as of December 31, 2011.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

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

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

In the absence of countervailing considerations, we would expect to defend any such claims vigorously. However, in doing so, we could incur significant defense costs, including attorneys' fees, other direct litigation costs and the expenditure of substantial amounts of management time that otherwise would be devoted to our business. If we suffer an adverse judgment as a result of any claim, it could have a material adverse effect on our business, results of operations and financial condition. See Item 3, Legal Proceedings and Note 8 to the Company's Consolidated Financial Statements.

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

We reinsure certain risks underwritten by our various insurance subsidiaries. Market conditions beyond our control determine the availability and cost of the reinsurance protection we purchase. The high cost of reinsurance or lack of affordable coverage could adversely affect our results of operations and financial condition.

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

In 2011, we reinsured \$462 million of face amount of our life insurance policies. Amounts reinsured in 2011 represented 10.1% of the face amount of direct life insurance in force in that year. Although the cost of reinsurance is, in some cases, reflected in premium rates, under certain reinsurance agreements, the reinsurer may increase the rate it charges us for reinsurance. If our cost of reinsurance were to increase, we might not be able to recover these increased costs, and our results of operations and financial condition could be materially adversely affected. See Note 5 to the Company's Consolidated Financial Statements.

We may not be able to continue our past strategy of acquiring other U.S. life insurance companies, and we may not realize improvements to our financial results as a result of our past or any future acquisitions.

We have acquired 16 U.S. life insurance companies since 1987. Our objective in this strategy has been to increase our assets, revenues and capital, improve our competitive position and increase our earnings, in part by realizing certain operating efficiencies associated with economies of scale.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

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

Our international and domestic operations face significant competition.

Our international marketing plan focuses on making available U.S. Dollar-denominated life insurance products to high net worth, high income individuals residing in more than 30 countries. New competition could increase the supply of available insurance, which could affect our ability to price our products at attractive profitable rates to us, thereby adversely affecting our revenues, results of operations and financial condition. Although there are some impediments facing potential competitors that wish to enter the foreign markets we serve, the entry of new competitors into these markets may occur, affording our customers reason to change to other insurance providers. In connection with our business with foreign nationals, we experience competition primarily from the following sources, many of which have substantially greater financial, marketing and other resources than we have:

- Foreign operated companies with U.S. Dollar policies. We face direct competition from companies that operate in the same manner as we operate in our international markets.
- Companies foreign to the countries in which their policies are sold but that issue local currency policies. Another group of our competitors in the international marketplace consists of companies that are foreign to the countries in which their policies are sold but issue life insurance policies denominated in the local currencies of those countries. Local currency policies provide the benefit of assets located in the country of foreign residents, but entail risks of uncertainty due to local currency fluctuations, as well as the perceived instability and weakness of local currencies.
- Locally operated companies with local currency policies. We compete with companies formed and operated in the country in which our foreign insureds reside. Generally, these companies are subject to risks of currency fluctuations, and they primarily use mortality tables based on experience of the local population as a whole. These mortality tables are typically based on significantly shorter life spans than those we use. As a result, the cost of insurance from these companies tends to be higher than ours. Although these companies typically market their policies to a broader section of the population than do our independent marketing firms and independent consultants, there can be no assurance that these companies will not endeavor to place a greater emphasis on our target market and compete more directly with us.

In the United States, we compete with more than 1,000 other life insurance companies of various sizes. The life insurance business in the United States is highly competitive, in part because it is a mature industry that, in recent years, has experienced little to no growth in life insurance sales. Many domestic life insurance companies have substantially greater financial resources, longer business histories and more diversified lines of insurance coverage

than we do. These companies also have larger sales forces than we have. Competition in the United States has also increased recently because the life insurance industry is consolidating, with larger, more efficient organizations emerging from the consolidation.

In addition, from time to time, companies enter and exit the markets in which we operate, thereby increasing competition at times when there are new entrants. We may lose business to competitors offering competitive products at lower prices, or for other reasons.

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

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

We distribute our insurance products through several distribution channels, including independent marketing firms and independent consultants and our employee agents. These relationships are significant for both our revenues and our profits. In our life insurance segment, we depend almost exclusively on the services of independent marketing firms and independent consultants. In our home service insurance segment, we depend on employee agents whose role in our distribution process is integral to developing and maintaining relationships with policyholders. Significant competition exists among insurers in attracting and maintaining marketers of demonstrated ability. Some of our competitors may offer better compensation packages for marketing firms, independent consultants and agents and broader arrays of products and have a greater diversity of distribution resources, better brand recognition, more competitive pricing, lower cost structures and greater financial strength or claims paying ratings than we do. We compete with other insurers for marketing firms, independent consultants and employee agents primarily on the basis of our compensation and support services. Any reduction in our ability to attract and retain effective sales representatives could materially adversely affect our revenues, results of operations and financial condition.

Loss of the services of our senior management team would likely hinder development of our operating and marketing programs and our strategy for expanding our business.

We rely on the active participation of our Chairman of the Board and Chief Executive Officer, Harold E. Riley (age 83), and our Vice Chairman of the Board and President, Rick D. Riley (age 58), in connection with the development and execution of our operating and marketing plans and strategy for expanding our business. We anticipate that their expertise will continue to be of substantial value in connection with our operations. The loss of the services of either of these individuals could have a significant adverse effect on our business and prospects. We do not have an employment agreement with either of these persons nor do we carry a key-man insurance policy on either of their lives.

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

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

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

Most insurance regulatory authorities have broad discretion to grant, renew, suspend and revoke licenses and approvals, and could preclude or temporarily suspend us from carrying on some or all of our activities, including

acquisitions of other insurance companies, require us to add capital to our insurance company subsidiaries, or fine us. If we are unable to maintain all required licenses and approvals, or if our insurance business is determined not to comply fully with the wide variety of applicable laws and regulations and their interpretations, including the USA Patriot Act, our revenues, results of operations and financial condition could be materially adversely affected.

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

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

Currently, the U.S. Federal Government does not directly regulate the insurance business, although initiatives for Federal regulation of insurance are proposed by members of the U.S. Congress from time to time. However, Federal legislation and administrative policies in several other areas can materially and adversely affect insurance companies, including our business. These areas include the USA Patriot Act, financial services regulation, securities regulation, including the Sarbanes-Oxley Act of 2002, the Dodd-Frank Act, pension regulation, privacy, tort reform legislation and taxation. In addition, various forms of direct federal regulation of insurance have been proposed from time to time.

Our failure to maintain effective information systems could adversely affect our business.

We must maintain and enhance our existing information systems and develop new information systems in order to keep pace with continuing changes in information processing technology, evolving industry and regulatory standards and changing customer preferences. If we do not maintain adequate systems, we could experience adverse consequences, including products acquired through acquisition, inadequate information on which to base pricing, underwriting and reserve decisions, regulatory problems, failure to meet prompt payment obligations, increases in administrative expenses and loss of customers.

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

Our failure to maintain effective and efficient information systems, or our failure to efficiently and effectively consolidate our information systems to eliminate redundant or obsolete applications, could have a material adverse effect on our results of operations and financial condition.

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

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

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

We have a written information security program with appropriate administrative, technical and physical safeguards to protect such confidential information. If we do not comply with privacy regulations and protect confidential information, we could experience adverse consequences, including regulatory sanctions, loss of reputation and litigation, any of which could have a material adverse effect on our business, results of operations and financial condition.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

We interface with and distribute our products to individual consumers. There may be a perception that these purchasers may be unsophisticated and in need of consumer protection. Accordingly, from time to time, consumer advocate groups or the media may focus attention on our products, thereby subjecting the insurance industry to periodic negative publicity. We may also be negatively impacted if other insurance companies engage in practices resulting in increased public attention to our businesses. Negative publicity may result in lower sales of insurance, lower persistency of our insurance products, increased regulation and legislative scrutiny of industry practices as well as increased litigation, which may further increase our costs of doing business and impede our ability to market our products. As a result, our business, results of operations and financial condition could be materially adversely affected.

General economic, financial market and political conditions may materially adversely affect our results of operations and financial condition.

Our results of operations and financial condition may be materially adversely affected from time to time by general economic, financial market and political conditions, both in the United States and in the foreign countries where our policyowners reside. These conditions include economic cycles such as: levels of consumer spending; levels of inflation; movements of the financial markets; availability of credit; fluctuations in interest rates, monetary policy or demographics; and legislative and competitive changes.

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

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

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

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

Except to the extent that we are a creditor with recognized claims against our subsidiaries, claims of our subsidiaries' creditors, including policyholders, have priority with respect to the assets and earnings of the subsidiaries over the claims of our creditors and shareholders. If any of our subsidiaries becomes insolvent, liquidates or otherwise reorganizes, our creditors and shareholders will have no right to proceed in their own right against the assets of that subsidiary or to cause the liquidation, bankruptcy or winding-up of the subsidiary under applicable liquidation, bankruptcy or winding-up laws.

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

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

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

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

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

Risks Relating to Our Class A Common Stock

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

Most all of our international policyholders participate in the Plan and they invest their policy dividends and benefits in our Class A common stock pursuant to the Plan. Once a policyholder elects to participate in the Plan, his or her policy benefits are assigned to purchase Citizens Class A common stock under the Plan in the open market. There is a risk our Class A common stock price could be negatively impacted by a decrease in our policyholders' participation in the Plan. If fewer policyholders elect to participate in the Plan, or our international premium collections were to decrease as a result of regulatory, economic, or marketing impediments, the trading volume of our Class A stock may decline from its present levels and the demand for our Class A common stock could be negatively impacted.

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

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

structure, or corporate operating strategies as a result of different ownership of our Class B common stock.

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

There were 48,808,662 shares of our Class A common stock issued as of December 31, 2011. Our executive officers, directors and management owned approximately 4,084,000 shares of our Class A common stock as of December 31, 2011, representing approximately 8% of our then outstanding Class A common stock. Almost all of these shares have been registered for public resale and generally may be sold freely. In the event of a sale of some or all of these shares or the perceived sale of these shares, the market price of our Class A common stock could fall substantially.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

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

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

It is difficult for Class A common shareholders to elect any of our directors or otherwise exert any significant influence over our business. The sole holder of our outstanding Class B common stock is entitled to elect a simple majority of our board of directors and therefore controls us. All of our Class B common stock is currently owned by the Harold E. Riley Trust, of which Harold E. Riley, our founder, Chairman of the Board and Chief Executive Officer, is the sole trustee. Additionally, Harold E. Riley beneficially owns approximately 5% of the issued shares of our Class A common stock.

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

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

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

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

State insurance laws generally require prior approval of a change in control of an insurance company. Generally, such laws provide that control over an insurer is presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing 10% or more of the voting securities of the insurer. In considering an application to acquire control of an insurer, an insurance commissioner generally will consider such factors as the experience, competence and financial strength of the proposed acquirer, the integrity of the proposed acquirer's board of directors and executive officers, the proposed acquirer's plans for the management and operation of the insurer, and any anti-competitive results that may arise from the acquisition. In addition, a person seeking to acquire control of an insurance company is required in some states to make filings prior to completing an acquisition if the acquirer and the target insurance company and their affiliates have sufficiently large market shares in particular

lines of insurance in those states. These state insurance requirements may delay, deter or prevent our ability to complete an acquisition.

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

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

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

We own our principal office in Austin, Texas, consisting of an 80,000 square foot office building in addition to approximately one acre of land nearby that houses storage facilities. Approximately 50,000 square feet is occupied or reserved for our operations. We also own a training facility at Lake Buchanan, Texas. In addition, we own other properties in Texas, Arkansas and Louisiana that are incidental to our operations.

Item 3. LEGAL PROCEEDINGS

We are a defendant in a lawsuit filed on August 6, 1999, in the Texas District Court, Austin, Texas, now styled Delia Bolanos Andrade, et al., Plaintiffs, v. Citizens Insurance Company of America, et al., Defendants in which a class was originally certified by the trial court and reversed by the Texas Supreme Court in 2007 with an order to the trial court to conduct further proceedings consistent with its ruling. The underlying lawsuit alleged that certain life insurance policies CICA made available to non-U.S. residents, when combined with a policy feature that allowed certain cash benefits to be assigned to two non-U.S. trusts for the purpose of accumulating ownership of our Class A common stock, along with allowing the policyholders to make additional contributions to the trusts, were actually offers and sales of securities that occurred in Texas by unregistered dealers in violation of the Texas securities laws. The remedy sought was rescission and return of the insurance premium payments. On December 9, 2009, the trial court denied the recertification of the class after conducting additional proceedings in accordance with the Texas Supreme Court's ruling. The remaining plaintiffs must now proceed individually, and not as a class, if they intend to pursue their claims against us. Since the December 9, 2009 trial court ruling, no individual cases have been further pursued by the plaintiffs. The probability of the plaintiffs further pursuing their cases individually is unknown. An estimate of any possible loss or range of losses cannot be made at this time in regard to individuals pursuing claims. However, should the plaintiffs further pursue their claims individually, we intend to vigorously defend any proceedings.

SPFIC is a defendant in a putative class action lawsuit in Louisiana styled The State of Louisiana v. AAA Insurance (the "Road Home Litigation"), which was filed in the Civil District Court for the Parish of Orleans on August 23, 2007. The Louisiana Attorney General filed the Road Home Litigation as a putative class action lawsuit in state court against SPFIC and approximately 200 other insurers on behalf of the State of Louisiana, as assignee, and on behalf of a class of Road Home fund recipients alleging that SPFIC and the other insurers have failed to pay all damages owed under their policies. The insurers removed the matter to federal court. The defendants filed a motion to dismiss, and in March 2009, the district court granted part of the defendants' motion, dismissing all of the extra-contractual claims, including the bad faith and breach of fiduciary duty claims. As a result, the remaining claims are for breach of contract and declaratory relief on the alleged underpayment of claims by the insurers. The court did not dismiss the class action allegations. The defendants also had moved to dismiss the complaint on grounds that the State had no standing to bring the lawsuit as an assignee of insureds because of anti-assignment language in the insurers' policies. The court denied the defendants' motion for reconsideration on the assignment issue but found the matter was ripe for consideration by the federal appellate court. The defendants filed a petition for permission to appeal to the Fifth Circuit. The Fifth Circuit accepted review. On July 20, 2011, the Fifth Circuit ruled there was no public policy which precludes an anti-assignment clause from applying to post loss assignments, but the anti-assignment language must be evaluated on a policy by policy basis and unambiguously express that the non-assignment clause applies to post-loss assignments. In October 2011, the United States District Court for the Eastern District of Louisiana denied the State's motion to remand to state court. The Road Home Litigation remains pending in federal district court. The State has yet

to identify the specific claims it contends are at issue in the Road Home Litigation, or the alleged deficiencies in adjusting those claims. Each individual claim at issue will require an individual analysis. A number of the claims may be subject to individual defenses. To date, there has been no discovery in the Road Home Litigation. We anticipate the State will vigorously pursue the matter in the district court and are uncertain as to the impact a case by case analysis of claims will have on SPFIC. An estimate of possible loss or range of loss cannot be made at this time as a result of the Fifth Circuit or federal district court's rulings in the Road Home Litigation. SPFIC intends to vigorously defend any remaining proceedings.

SPFIC is vigorously defending a number of matters in various stages of development filed in the aftermath of Hurricane Katrina and Hurricane Rita in addition to the Road Home Litigation, including a number of individual lawsuits, which are immaterial to the Company's financial statements.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

PART II

Item MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS
5. AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our Class A common stock is traded on the New York Stock Exchange ("NYSE") under the symbol CIA.

Quarterly high and low closing prices per share of our Class A common stock as reported by the NYSE are shown below.

Quarter Ended	2011		2010	
	High	Low	High	Low
March 31	\$ 7.79	6.95	\$ 7.27	5.90
June 30	7.50	6.27	7.31	6.43
September 30	7.23	6.06	7.17	6.55
December 31	9.69	5.98	7.59	6.84

Equity Security Holders

The number of stockholders on record on March 5, 2012 was as follows:

- Class A Common Stock - 91,091
- Class B Common Stock - 1

We have never paid cash dividends on our Class A or B common stock and do not expect to pay cash dividends in the foreseeable future. For restrictions on our present and future ability to pay dividends, see Note 6 of the "Notes to Consolidated Financial Statements."

We did not purchase any of our equity securities during any quarter in 2009, 2010 or 2011.

Securities Authorized for Issuance Under Equity Compensation Plans

We do not maintain any equity compensation plans or arrangements. Thus, we do not have any securities authorized for issuance under these types of plans, nor have we issued any options, warrants or similar instruments to purchase any of our equity securities, except for warrants issued in conjunction with the convertible preferred stock issued in 2004 and 2005. See Note 7 of the "Notes to Consolidated Financial Statements."

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Performance Comparison

The following graph compares the change in the Company's cumulative total stockholder return on its common stock over a five-year period. The following graph assumes a \$100 investment on December 31, 2006, and reinvestment of all dividends in each of the Company's common shares, the New York Stock Exchange ("NYSE") Composite and the Hemscott Group Index, a peer group of major U.S.-based insurance companies.

	2006	2007	2008	2009	2010	2011
Citizens, Inc.	100.00	83.79	146.97	98.94	112.88	146.82
NYSE Composite	100.00	108.87	66.13	84.83	96.19	92.50
Peer Group	100.00	119.91	70.83	141.71	189.36	205.29

The peer group index weights individual company returns for stock market capitalization. The companies included in the peer group index are shown in the following table.

Aegon NV	Great Eastern Holdings Limited	Phoenix Companies, Inc.
Allianz SE	Imperial Holdings, Inc.	Presidential Life Corp.
American Equity Investment Life Holding	Independence Holding Co.	Protective Life Corp.
American National Ins. Co.	ING Groep NV	Prudential Financial, Inc.
Atlantic American Corp.	Investors Heritage Capital Corp.	Prudential PLC
Aviva PLC	Kansas City Life Ins. Co.	Reins Group of America, Inc.
AXA	Legal & General Group PLC	Standard Life PLC
China Life Ins Co. Limited	Life Partners Holdings, Inc.	Sun Life Financial, Inc.
Citizens, Inc.	Lincoln National Corp.	Symetra Financial Corp.
Delphi Financial Group, Inc.	Manulife Financial Corp.	Torchmark Corp.
FBL Financial Group, Inc.	Metlife, Inc.	UTG, Inc.
Genworth Financial, Inc.	National Western Life Ins. Co.	

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Item 6. SELECTED FINANCIAL DATA

The following table presents selected financial data of the Company. This should be read in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8. "Financial Statements and Supplementary Data" of this Form 10-K.

	2011	Years ended December 31,			2007
		2010	2009	2008	
		(In thousands, except per share data)			
Operating items					
Insurance premiums	\$ 161,395	152,052	147,280	141,297	136,748
Net investment income	30,956	30,077	29,602	30,478	30,743
Realized investment gains (losses)	765	8,012	8,040	(23,812)	(94)
Change in fair value of warrants	1,136	232	3,154	(2,662)	828
Total revenues	195,013	191,181	188,980	146,673	169,637
Net income (loss)	8,375	15,511	17,340	(15,707)	16,557
Balance sheet data					
Total assets	1,091,270	986,506	927,326	832,276	787,909
Total liabilities	835,585	758,872	711,251	653,022	597,532
Total stockholders' equity	255,685	227,634	216,075	171,541	176,157
Life insurance in force	5,244,200	5,115,662	4,997,043	4,666,848	4,538,202
Per share data					
Book value per share	5.12	4.58	4.35	3.68	4.00
Basic and diluted earnings (loss) per Class A share	0.17	0.32	0.31	(0.42)	0.35

See Item 1. "Business" and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations," for information that may affect the comparability of the financial data contained in the above table.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is management's discussion and analysis of the consolidated financial condition and consolidated results of operations of the Company. It is intended to be a discussion of certain key financial information regarding the Company and should be read in conjunction with the Consolidated Financial Statements and related Notes to this report on Form 10-K.

Overview

We conduct operations as an insurance holding company emphasizing ordinary life insurance products in niche markets where we believe we can achieve competitive advantages. As an insurance provider, we collect premiums on an ongoing basis to pay future benefits to our policy and contract holders. Our core operations include issuing:

- whole life insurance;
- endowments;
- credit insurance;

- final expense; and
- limited liability property policies.

The Company derives its revenues principally from 1) premiums earned for insurance coverages provided to insureds; 2) net investment income; and 3) net realized capital gains and losses.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Profitability of our insurance operations depends heavily upon the Company's underwriting discipline, as we seek to manage exposure to loss through favorable risk selection and diversification, management of claims, use of reinsurance, the size of our in force block, actual mortality and morbidity experience, and our ability to manage our expense ratio, which we accomplish through economies of scale and management of acquisition costs and other underwriting expenses.

Pricing adequacy depends on a number of factors, including the ability to obtain regulatory approval for rate changes, proper evaluation of underwriting risks, the ability to project future losses based on historical loss experience adjusted for known trends, the Company's response to competitors, and expectations about regulatory and legal developments and expense levels. The Company seeks to price our insurance policies such that insurance premiums and future net investment income earned on premiums received will cover underwriting expenses and the ultimate cost of paying claims reported on the policies and provide for a profit margin. For many of our insurance products, the Company is required to obtain approval for the premium rates from state insurance departments. The profitability of fixed annuities, riders and other "spread-based" product features depends largely on the Company's ability to earn target spreads between earned investment rates on assets and interest credited to policyholders.

The investment return, or yield, on invested assets is an important element of the Company's earnings since insurance products are priced with the assumption that premiums received can be invested for a period of time before benefits are paid. The majority of the Company's invested assets have been held in available-for-sale and held-to-maturity securities, primarily in asset classes of corporate bonds, municipal bonds, and government obligation bonds.

The primary investment objective for the Company is to maximize economic value, consistent with acceptable risk parameters, including the management of credit risk and interest rate sensitivity of invested assets, while generating sufficient after-tax income to meet policyholder and corporate obligations. The Company maintains a conservative investment strategy that may vary based on a variety of factors including business needs, regulatory requirements and tax considerations.

Current Financial Highlights

Our assets grew from \$986.5 million as of December 31, 2010, to \$1.1 billion as of December 31, 2011. Total stockholders' equity increased from \$227.6 million at December 31, 2010, to \$255.7 million at December 31, 2011.

- Insurance premiums rose 6.1% and 3.2% in 2011 and 2010, primarily from sales in our life insurance segment, which increased \$8.2 million from amounts reported in 2010.
- Net investment income increased 2.9% for 2011 and was flat in 2010 and 2009. The average yield on the consolidated investment portfolio has declined significantly the last three years from a yield of 4.75% in 2009 down to 4.32% in 2010 and to 4.03% in 2011. The increase in the investment asset balances due to premium revenue growth was sufficient to offset the lower yield in the declining rate environment and resulted in an increase in net investment income.
- Realized net investment gains in the past three years resulted primarily from sales of securities that had been previously impaired due to declines in market values. These gains were partially offset by other-than-temporary impairments that were recorded in 2011, 2010 and 2009 of \$631,000, \$27,000 and \$296,000, respectively, reported as realized losses.

-

Claims and surrenders expense decreased 1.6% from the comparable period in 2010 as a result of favorable development.

Life Insurance. For over thirty years, CICA and its predecessors have accepted policy applications from foreign nationals for U.S. Dollar-denominated ordinary whole life insurance and endowment policies. We make our insurance products available using third-party marketing organizations and independent marketing consultants.

Endowment product sales have been on the rise and represented approximately 80% of new sales. The Company offers a ten, fifteen and twenty year endowment and our top selling endowment is a product that matures at age sixty-five. We also introduced a new product in the current year that is an endowment at age eighteen with a payout over four or five years. We have had limited sales to date, but we anticipate this product will be well received in our international markets.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

Home Service Insurance. We provide final expense ordinary life insurance to middle and lower income individuals in Louisiana, Mississippi and Arkansas. Our policies in this segment are sold and serviced through a home service marketing distribution system utilizing employee-agents who work on a route system to collect premiums and service policyholders, and through networks of funeral homes that collect premiums and provide personal policyholder service.

Economic and Insurance Industry Developments

Significant economic issues impacting our business and industry currently and into the future are discussed below.

- It is predicted that the interest rate environment will remain low for the foreseeable future, which translates into lower profit margins for insurers. We have been impacted by the historically low interest rate environment over the past several years as our fixed income investment portfolio, primarily invested in callable securities, has been reinvested at lower yields during this declining interest rate environment. The Company's conservative investment strategy has not changed, but it has been a challenging investment time, as large amounts of calls resulted in significant cash balances to be reinvested. The Company experienced some delays in reinvesting the funds as suitable bonds meeting our target characteristics of investment grade and yield parameters were identified. Our investment earnings also impact the reserve and Deferred Acquisition Costs ("DAC") balances, as assumptions are used in the development of the balances. Due to the recent decline in investment yields on our portfolio, our projection of long-term investment returns has declined. This has resulted in increasing the reserves on policies issued in the current year, as well as reducing the DAC asset.
- As an increasing percentage of the world population reaches retirement age, we believe we will benefit from increased demand for living products rather than death products, as aging baby boomers will require cash accumulation to pay expenses to meet their lifetime needs. Our ordinary life products are designed to accumulate cash values to provide for living expenses in a policy owner's later years, while continuously providing a death benefit.
- We believe there is a trend toward consolidation of domestic life insurance companies, due to significant losses incurred by the life insurance industry as a result of the credit crisis and recent economic pressures, as well as increasing costs of regulatory compliance for domestic life insurance companies. We believe this trend should be a benefit to our acquisition strategy as more complementary acquisition candidates may become available for us to consider.
- Many of the events and trends affecting the life insurance industry have had an impact on the life reinsurance industry. These events have led to a decline in the availability of reinsurance. While we currently cede a limited amount of our primary insurance business to reinsurers, we may find it difficult to obtain reinsurance in the future, forcing us to seek reinsurers who are more expensive to us. If we cannot obtain affordable reinsurance coverage, either our net exposures will increase or we will have to reduce our underwriting commitments.
- While our management has more than 40 years of experience in writing life insurance policies for foreign residents, changes related to foreign government laws and regulations and application of them, along with currency controls

affecting our foreign resident insureds could adversely impact our revenues, results of operations and financial condition.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Recent Acquisitions

In 2008, the Company acquired Ozark National Life Insurance Company (“ONLIC”), an Arkansas domiciled life company. This entity provided an Arkansas field force of home service agents and funeral homes selling pre-need and final expense policies and was merged into SPLIC as of October 1, 2009, and is included in the Home Service segment. In the first quarter of 2009, the Company completed its acquisition of Integrity Capital Corporation (“ICC”). ICC is the parent of Integrity Capital Insurance Company (“ICIC”), an Indiana life insurance company. Both ICC and ICIC were merged into CICA effective April 1, 2011.

On August 1, 2011, SPLIC entered into assumption reinsurance agreements with Escude Life Insurance Company in Rehabilitation, and Benton Life Insurance Company in Rehabilitation. At the time the agreements were executed, both companies were under receivership with the Louisiana Department of Insurance. In total, SPLIC assumed approximately \$4.5 million in reserve liabilities and received approximately \$4.6 million in cash, with a minimal reinsurance ceding commission being paid. These transactions are accounted for under business combination accounting and are not deemed material.

Consolidated Results of Operations

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

Revenues

Insurance revenues are primarily generated from premium revenues and investment income. In addition, realized gains and losses on investment holdings can significantly impact revenues from year to year.

	Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
Revenues:			
Premiums:			
Life insurance	\$ 154,778	145,665	141,001
Accident and health insurance	1,561	1,577	1,531
Property insurance	5,056	4,810	4,748
Net investment income	30,956	30,077	29,602
Realized investment gains, net	765	8,012	8,040
Decrease in fair value of warrants	1,136	232	3,154
Other income	761	808	904
Total revenues	195,013	191,181	188,980
Exclude decrease in fair value of warrants	(1,136)	(232)	(3,154)
Total revenues excluding fair value adjustments of warrants outstanding	\$ 193,877	190,949	185,826

Premium Income. Premium income derived from life, accident and health, and property insurance sales, increased 6.1% during 2011. The increase resulted primarily from renewal premiums, which totaled \$135.1 million, \$127.1 million and \$123.2 million in 2011, 2010 and 2009, respectively. Endowment sales represent a significant portion of new business sales internationally, as these products have gained in popularity over the past several years. In addition,

most of our life insurance policies contain a policy loan provision, which allows the policyholder to use cash value of a policy to pay premiums. The policy loan asset balance increased 9.8% year over year.

Net Investment Income. Net investment income increased to \$31.0 million in 2011 compared to \$30.1 million in 2010, despite a decline in the yield on investments as we experienced higher average invested assets as a result of investment of new premium revenue.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Net investment income performance is summarized as follows.

	Years Ended December 31,		
	2011	2010	2009
	(In thousands, except for %)		
Net investment income	\$30,956	30,077	29,602
Average invested assets, at amortized cost	767,359	696,134	622,699
Yield on average invested assets	4.03 %	4.32 %	4.75 %

Yields on invested assets vary between segment operations due to different portfolio mixes in the segments. The life segment invests more in U.S. government securities while the home service segment has a larger concentration in the corporate and municipal sectors.

We have traditionally invested in fixed maturity securities with a large percent held in callable issues. Over the past three years, we have experienced significant call activity related to fixed maturity security holdings due to the historically low interest rate environment. As these call proceeds were invested into lower yielding securities, the yield on the portfolio has declined. The recent declines in yield rates appear to be leveling off as the reinvestment of calls is resulting in a lesser impact relative to yield changes. If market interest rates begin to rise, our call risk would diminish and our portfolio yield will rise over time, as new money investments would be made at higher rates.

Investment income from fixed maturity securities accounted for approximately 84.2% of total investment income for the year ended December 31, 2011. We continue to hold investments in bonds of U.S. Government-sponsored enterprises, such as Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC"), which comprised 42.7% of the total fixed maturity portfolio based on amortized cost at December 31, 2011. We have increased our investment purchases of corporate and municipal securities over the past year, focusing on utility service sectors in these security categories. In addition, we have reinvested proceeds from bond calls totaling \$31.5 million into equity securities related to bond mutual funds during the year. These securities offer a competitive yield with a shorter duration.

	Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
Gross investment income:			
Fixed maturity securities	\$26,606	26,829	25,921
Equity securities	1,534	713	1,056
Mortgage loans	99	101	50
Policy loans	3,024	2,704	2,444
Long-term investments	225	246	465
Other	122	207	507
Total investment income	31,610	30,800	30,443
Less investment expenses	(654)	(723)	(841)
Net investment income	\$30,956	30,077	29,602

Lower investment income from fixed maturity investments for the year resulted from declining yields, as previously noted. The increase in earnings on asset balances of fixed maturity and equity securities from new money investments is offsetting the yield decline for the year. In addition, the increase in the policy loans asset balance, which represents

policyholders utilizing their accumulated policy cash value, contributed to the increase to investment income. Other investment income for the year ended December 31, 2009 included a legal settlement of \$0.2 million in connection with a defaulted bond investment.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Realized Gains (Losses) on Investments. In 2011, 2010 and 2009, the Company sold equity mutual funds, which were previously impaired, and realized gains of \$1.3 million, \$6.4 million and \$4.9 million, respectively.

Realized investment gains (losses) are as follows.

	2011	Years Ended December 31, 2010	2009
		(In thousands)	
Realized investment gains (losses):			
Sales, calls and maturities			
Fixed maturities	\$ 119	753	2,705
Equity securities	1,259	7,343	5,292
Property and equipment	2	(8)	323
Other long-term investments	16	(49)	16
Net realized investment gains	1,396	8,039	8,336
Other-than-temporary impairments ("OTTI"):			
Fixed maturities	(70)	(27)	(103)
Equity securities	-	-	(193)
Other long-term investments	(561)	-	-
Realized losses on OTTI	(631)	(27)	(296)
Net realized investment gains (losses)	\$ 765	8,012	8,040

Included in net realized investment gains and losses are OTTI on investments. We recorded an OTTI write-down in 2011 of \$70,000 related to one American Airlines ("AMR") debt security holding that had a maturity date in 2012. AMR declared bankruptcy in November of 2011. We also recorded an impairment in 2011 of \$0.6 million related to an investment property that was acquired as part of the ONLIC acquisition in 2008. A current appraisal reflected a declining value of this Arkansas office building from the fair value at acquisition. In 2010, one security that had been previously impaired was written down with a charge to income of \$27,000. In 2009, the Company recorded \$0.3 million in realized losses related to impairments due to market declines related to issuer credit deterioration.

Decrease in Fair Value of Warrants. The market value of our Class A common stock increased in 2011 and decreased during 2010 and 2009. We recognized a gain on the decrease in fair value of warrants of \$1.1 million, \$0.2 million and \$3.2 million in 2011, 2010 and 2009, respectively. The gains in 2010 and 2009 were directly related to the decrease in the price of our Class A common stock; however, the 2011 gain was the result of the significant decrease in the number of warrants outstanding due to expirations and exercises. The total number of warrants outstanding as of December 31, 2011 was 169,482 and was 1,201,440 in 2010 and 2009. The warrant liability is calculated using the Black-Scholes option pricing model, which projects the future value of the warrants when they expire. Current accounting standards require the change in the value of the warrant liability be recorded as a component of revenues. When the liability increases we incur a loss, and when the liability decreases we recognize income. The warrant liability is not anticipated to have an effect on the Company's cash flows, as the Company expects the warrants will either be exercised and converted into our Class A common stock in 2012, at the election of the warrant holders, or expire.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Benefits and Expenses

	Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
Benefits and expenses:			
Insurance benefits paid or provided:			
Claims and surrenders	\$60,056	61,038	59,988
Increase in future policy benefit reserves	58,264	46,420	40,790
Policyholders' dividends	8,072	7,485	6,680
Total insurance benefits paid or provided	126,392	114,943	107,458
Commissions	38,374	36,585	35,536
Other general expenses	26,897	27,085	28,403
Capitalization of deferred policy acquisition costs	(29,433)	(27,960)	(27,132)
Amortization of deferred policy acquisition costs	18,620	17,840	20,678
Amortization of cost of customer relationships acquired	2,998	3,058	3,431
Total benefits and expenses	\$183,848	171,551	168,374

Claims and Surrenders. As noted in the table below, claims and surrenders decreased from \$61.0 million in 2010 to \$60.1 million in 2011.

	Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
Death claims	\$20,996	22,670	22,494
Surrender expenses	19,978	19,727	19,666
Endowment benefits	14,537	14,499	14,079
Property claims	1,986	1,578	1,590
Accident and health benefits	449	608	437
Other policy benefits	2,110	1,956	1,722
Total claims and surrenders	\$60,056	61,038	59,988

- The Company monitors death claims based upon expectations. The claims experience was favorable in 2011, decreasing by 7.4% from 2010 recorded amounts and remained relatively consistent over the prior two years. Additionally, 2011 results include a \$0.8 million incurred but not reported release of liability related to our claim expense calculation. These values may routinely fluctuate from year to year.
- Policy surrenders increased in 2011 and 2010 compared to 2009, but remained at a level that represents approximately 0.5% of direct ordinary whole life insurance inforce. The increase in surrender expense is primarily related to our international business and is expected to increase over time due to the aging of this block of business. A significant portion of surrenders relates to policies that have been in force over fifteen years and no longer have a surrender charge associated with them. Total direct insurance inforce reported in 2011 was \$4.6 billion, and in 2010 was \$4.5 billion compared to \$4.4 billion in 2009.
- Endowment benefits increased in each of the last three years. We have a series of international policies that carry an immediate endowment benefit of an amount selected by the policy owner. These benefits have been popular in

the Pacific Rim and Latin America, where the Company has experienced increased interest in our guaranteed products in recent years. Like policy dividends, endowments are factored into the premium and, as such, the increase has no impact on profitability. The Company expects these benefits to continue to increase as this block of business increases and persists.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

- Property claims increased 26% to approximately \$2.0 million in 2011 compared with the amount reported for 2010 and 2009, as the prior two years reflected claims reported that were lower than historical experience.

Reserves. The change in future policy benefit reserves has increased over the past several years, primarily because of the sale of endowment products, which build reserves at a much higher rate. Endowment sales totaled approximately \$12.3 million, \$9.4 million and \$8.5 million in 2011, 2010 and 2009, respectively. In addition, the low interest rate environment is impacting assumptions used in the development of reserve balances on current year issued policies, which results in an increase of reserves.

Policyholder Dividends. Policyholder dividends have risen at a rate that corresponds with the growth rate in new international life insurance premiums. The Company issues long duration participating policies to foreign residents that are expected to pay dividends to policyholders based upon actual experience. Policyholder dividends are factored into the premiums and have no impact on profitability.

Commissions. Commission expense fluctuates in a direct relationship to new and renewal insurance premiums and has increased 4.9% in 2011 compared to 2010 as premium revenues have increased.

Other General Expenses. Total general expenses decreased over the past several years on a consolidated basis as management has created efficiencies and improved processes. The decrease year to year was primarily related to lower audit, legal and consulting fees, as well as employee benefit cost reductions. We moved to a self insurance health plan for our employees in 2010 and have successfully decreased our overall benefit expenses.

We perform an expense study on an annual basis, which reflects an enterprise-wide time study, and we adjust cost allocations among entities as needed based upon this review. In the current year, we increased expenses allocated to the Life Insurance segment and decreased expenses attributable to the Home Service segment by approximately \$1.5 million. The allocation changes are reflected in the segment operations, but do not impact total expenses.

Deferred Policy Acquisition Costs. Capitalized deferred policy acquisition costs ("DAC") were \$29.4 million, \$28.0 million and \$27.1 million in 2011, 2010 and 2009. These costs will vary based upon newly issued and renewal business. Significantly lower amounts are capitalized related to renewal business in correlation with the lower commissions paid on renewal business compared to first year. Amortization of deferred policy acquisition costs increased in 2011 compared to 2010 amortization, as policy persistency had improved in 2010 compared to 2009, but declined in the Home Service segment in 2011, resulting in higher amortization. In addition, the prolonged low interest rate environment impacted the assumptions used in the development of the DAC asset for new policies issued in 2011. This resulted in a lower DAC balance and increased amortization in the current year by approximately \$1.4 million.

Cost of Customer Relationships Acquired and Other Intangibles. The 2009 higher amortization compared to 2010 and 2011 was related primarily to the ICC acquisition and greater amortization due to the increase in lapses on this new block of business.

Federal Income Tax. Federal income tax expense was \$2.8 million, \$4.1 million and \$3.3 million in 2011, 2010 and 2009, respectively, resulting in effective tax rates of 25.0%, 21.0% and 15.8%, respectively. The Company established a tax valuation allowance related to other-than-temporary impairment ("OTTI") losses on its mutual funds of \$6.9 million in 2008. The establishment of the valuation allowance had the effect of increasing tax expense. In 2009, \$2.8 million of this allowance was released as a reduction of tax expense primarily due to the sale of approximately 42% of the mutual fund portfolio in 2009. The remaining \$2.5 million valuation allowance was

released in 2010, as the Company sold investments at a gain that enabled it to realize the tax basis losses, thereby making the valuation allowance no longer necessary. In addition, the fair value change related to outstanding warrants of \$1.1 million and \$0.2 million were reported as an increase in revenues in 2011 and 2010, respectively, and \$3.2 million in 2009, which was not taxable and also impacted the corporate tax rate.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Segment Operations

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

- Life Insurance
- Home Service Insurance
- Other Non-insurance Enterprises

Our insurance operations are the primary focus of the Company, as those segments generate the majority of our income. The amount of insurance, number of policies, and average face amounts of policies issued during the periods indicated are shown below.

	Years Ended December 31,					
	2011	2010			2009	
	Amount of Insurance Issued	Number of Policies Issued	Average Policy Face Amount Issued	Amount of Insurance Issued	Number of Policies Issued	Average Policy Face Amount Issued
Life	\$362,795,290	5,921	\$ 61,273	\$347,332,137	5,359	\$ 64,813
Home Service	194,870,735	27,289	7,141	195,013,695	26,497	7,124

These segments are reported in accordance with U.S. GAAP. The Company evaluates profit and loss performance based on net income before federal income taxes.

	Income (Loss) Before Federal Income Taxes		
	Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
Life Insurance	\$5,782	13,909	10,472
Home Service Insurance	5,704	6,723	9,245
Other Non-Insurance Enterprises	(321)	(1,002)	889
Total	\$11,165	19,630	20,606

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Life Insurance

Our Life Insurance segment primarily issues ordinary whole life insurance in U.S. Dollar-denominated amounts to foreign residents in approximately 30 countries through approximately 2,300 independent marketing consultants, and domestically through almost 300 independent marketing firms and consultants throughout the United States.

	Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
Revenue:			
Premiums	\$ 118,205	109,985	105,997
Net investment income	17,258	16,523	16,667
Realized investment gains, net	1,347	6,590	1,100
Other income	526	650	340
Total revenue	137,336	133,748	124,104
Benefits and expenses:			
Insurance benefits paid or provided:			
Claims and surrenders	40,525	41,040	41,277
Increase in future policy benefit reserves	54,310	42,619	36,043
Policyholders' dividends	8,004	7,414	6,594
Total insurance benefits paid or provided	102,839	91,073	83,914
Commissions	23,482	21,899	21,146
Other general expenses	11,847	10,975	10,195
Capitalization of deferred policy acquisition costs	(23,254)	(21,398)	(20,975)
Amortization of deferred policy acquisition costs	15,719	16,185	17,861
Amortization of cost of customer relationships acquired	921	1,105	1,491
Total benefits and expenses	131,554	119,839	113,632
Income before federal income tax expense	\$ 5,782	13,909	10,472

Premiums. Premium revenues increased for 2011 compared to 2010 and 2009, due to higher international renewal premiums, which have experienced strong persistency as this block of insurance ages. First year premiums increased in the current year, reflecting improved new business production with increased sales of our endowment and whole life policies. Sales from Colombia, Ecuador, Taiwan and Venezuela represented the majority of the first year premium increase.

Endowment sales represent a significant portion of new business sales internationally, as these products have gained in popularity over the past several years. In addition, most of our life insurance policies contain a policy loan provision, which allows the policyholder to use cash value of a policy to pay premiums. The policy loan asset balance increased 10.5% year over year.

Life Insurance premium breakout is detailed below.

	Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
Premiums:			
First year	\$ 17,735	16,630	16,294

Edgar Filing: CITIZENS INC - Form 10-K

Renewal	100,470	93,355	89,703
Total premium	\$ 118,205	109,985	105,997

30

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

Country	Years ended December 31,								
	2011			2010			2009		
	(In thousands)								
Colombia	\$20,684	19.5	%	\$20,555	20.9	%	\$22,214	23.8	%
Venezuela	20,237	19.1		16,042	16.3		13,287	14.2	
Taiwan	14,675	13.8		14,493	14.7		13,387	14.4	
Ecuador	12,782	12.1		11,813	12.0		10,214	11.0	
Argentina	8,860	8.4		8,776	8.9		8,107	8.7	
Other Non-U.S.	28,800	27.1		26,768	27.2		26,036	27.9	
Total	\$106,038	100.0	%	\$98,447	100.0	%	\$93,245	100.0	%

The following table sets forth our premiums by state from our domestic business for the periods indicated.

State	Years ended December 31,								
	2011			2010			2009		
	(In thousands)								
Texas	\$5,046	41.5	%	\$4,739	41.1	%	\$5,083	39.9	%
Indiana	1,618	13.3		1,552	13.5		1,713	13.4	
Mississippi	1,048	8.6		988	8.6		1,072	8.4	
Oklahoma	911	7.5		946	8.2		1,207	9.5	
Missouri	800	6.6		764	6.6		838	6.6	
Other States	2,744	22.5		2,549	22.0		2,839	22.2	
Total	\$12,167	100.0	%	\$11,538	100.0	%	\$12,752	100.0	%

A number of domestic life insurance companies we acquired had blocks of accident and health insurance policies, which we did not consider to be a core part of our business. We have ceded this business under a coinsurance agreement with an unaffiliated insurance company under which it assumes substantially all of our accident and health policies. The premium amounts ceded under the coinsurance agreement in the years ended December 31, 2011, 2010, and 2009 were \$4.5 million, \$5.3 million and \$6.3 million, respectively.

Net Investment Income. Net investment income has been negatively impacted by the low interest rate environment, which has resulted in declining portfolio yields, as discussed in the Consolidated Results of Operations above.

	For the Years Ended December 31,					
	2011		2010		2009	
	(In thousands, except for %)					
Net investment income	\$17,258		16,523		16,667	
Average invested assets, at amortized cost	443,707		396,360		339,199	
Annualized yield on average invested assets	3.89	%	4.17	%	4.91	%

Realized Investment Gains, Net. Realized gains of \$1.3 million and \$6.6 were recognized in 2011 and 2010, due primarily to disposals of previously impaired equity mutual funds. Realized gains totaled \$1.1 million in 2009

resulting from sales of available-for-sale fixed income securities, as discussed in the Consolidated Results of Operations above.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

A breakout of claims and surrender benefits is detailed below.

	For the Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
Death claims	\$6,775	7,278	7,986
Surrender expenses	17,244	17,354	17,672
Endowment benefits	14,524	14,473	14,051
Accident and health benefits	308	443	288
Other policy benefits	1,674	1,492	1,280
Total claims and surrenders	\$40,525	41,040	41,277

- Death claims expense was lower in 2011 due to fewer reported claims. In addition, 2011 results includes a release of incurred but not reported liability related to our claim experience calculation of \$0.2 million. Mortality experience is closely monitored by the Company as a key performance indicator and these amounts were within expected levels.
- The increase in surrender expense is primarily related to our international business and is expected to increase over time due to the aging of this block of business. The majority of policy surrender benefits paid is attributable to our international business and was related to policies that have been in force over fifteen years, where surrender charges are no longer applicable.
- Endowment benefit expense results from the election by policyholders of a product feature that provides an annual benefit. This is a fixed benefit over the life of the contract, and this expense will increase with new sales and improved persistency.
- Other policy benefits increased in the current year due primarily to interest paid on premium deposits and dividend accumulations, as these policyholder liability accounts have increased.

Increase in Future Policy Benefit Reserves. Policy benefit reserves in 2011 increased compared to the same periods in 2010, primarily due to increased sales of endowment products, which build up reserve balances more quickly compared to other life product sales. Endowment sales have become more popular relative to our international clientele in the past few years. Endowment sales totaled approximately \$12.3 million, \$9.4 million and \$8.5 million, representing approximately 69.4%, 56.5% and 52.2% of total new first year premium in 2011, 2010 and 2009, respectively.

Policyholder Dividends. Policyholder dividends have risen at a rate that corresponds with the growth rate in new international life insurance premiums. The Company issues long duration participating policies to foreign residents that are expected to pay dividends to policyholders based upon actual experience. Policyholder dividends are factored into the premiums and have no impact on profitability.

Capitalization and Amortization of Deferred Policy Acquisition Costs. Capitalized costs increased, as commission related costs have increased in the current year compared to 2010. Amortization of DAC decreased in the current year by 2.9% from 2010 as the Company experienced improved persistency in this segment.

Commissions. Commission expense increase is directly related to the increase in premiums as noted above. First year policy premiums pay a higher commission rate than renewal policy premiums.

Other General Expenses. Current year expenses reflect an increase that results from an annual time and expense study by segment that resulted in a cost increase of \$1.5 million relative to allocated expenses in the life segment. The operating expenses increased from 2009 to 2010 due to renegotiating our agreement with Puritan Life Insurance Company of America, formerly Texas International Life Insurance Company, whereby we paid \$0.2 million as well as an increase in credit card processing fees of approximately \$0.2 million, as an increased number of policyholders are using our credit card payment option.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Home Service Insurance

Our Home Service Insurance segment provides pre-need and final expense ordinary life insurance and annuities to middle and lower income individuals primarily in Louisiana, Mississippi and Arkansas. Our policies in this segment are sold and serviced through funeral homes and a home service marketing distribution system utilizing over 530 employees and independent agents.

	Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
Revenue:			
Premiums	\$43,190	42,067	41,283
Net investment income	12,861	13,008	12,680
Realized investment gains (losses), net	(601)	1,475	6,562
Other income	112	82	101
Total revenue	55,562	56,632	60,626
Benefits and expenses:			
Insurance benefits paid or provided:			
Claims and surrenders	19,531	19,998	18,711
Increase in future policy benefit reserves	3,954	3,801	4,747
Policyholders' dividends	68	71	86
Total insurance benefits paid or provided	23,553	23,870	23,544
Commissions	14,892	14,686	14,390
Other general expenses	12,614	14,307	14,847
Capitalization of deferred policy acquisition costs	(6,179)	(6,562)	(6,157)
Amortization of deferred policy acquisition costs	2,901	1,655	2,817
Amortization of cost of customer relationships acquired	2,077	1,953	1,940
Total benefits and expenses	49,858	49,909	51,381
Income before federal income tax expense	\$5,704	6,723	9,245

Premiums. The premium increases were due to enhanced marketing efforts to promote the Home Service segment, as well as a SPFIC rate increase of approximately 5.8% that became effective January 1, 2011.

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

State	Years ended December 31,							
	2011		2010		2009			
	(In thousands)							
Louisiana	\$39,972	92.5 %	\$38,817	92.2 %	\$37,716	91.4 %		
Arkansas	1,869	4.3	1,837	4.4	2,048	5.0		
Mississippi	370	0.9	334	0.8	329	0.8		
Other States	979	2.3	1,079	2.6	1,190	2.8		
Total	\$43,190	100.0 %	\$42,067	100.0 %	\$41,283	100.0 %		

Net Investment Income. Net investment income has been negatively impacted by the low interest rate environment, which has resulted in declining portfolio yields as discussed in the Consolidated Results of Operations above.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Net investment income for our home service insurance segment is summarized as follows:

	For the Years Ended December 31,					
	2011		2010		2009	
	(In thousands, except for %)					
Net investment income	\$12,861		13,008		12,680	
Average invested assets, at amortized cost	287,833		279,682		269,052	
Annualized yield on average invested assets	4.47	%	4.65	%	4.71	%

Realized Investment Gains (Losses), Net. Net realized losses of \$0.6 million in 2011 are due primarily from an OTTI on one American Airlines debt security that totaled \$70,000 due to the issuer filing bankruptcy, and a write-down of approximately \$0.5 million related to investment real estate for an office building in Arkansas. We obtained an appraisal in 2011 that reflected a loss in fair value. Gains of \$1.5 million in 2010 related primarily to sales of below investment grade securities that were added to the portfolio as part of an acquisition and had been previously impaired. Gains reported in 2009 totaled \$6.6 million, which related primarily to sales of equity mutual funds that had been previously impaired. Impairments of \$0.3 million were recorded in 2009 due to further declines in fair values relating to credit issues.

Claims and Surrenders. A breakout of claims and surrender benefits is detailed below.

	For the Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
Death claims	\$14,221	15,392	14,508
Surrender expenses	2,734	2,374	1,994
Endowment benefits	13	26	28
Property claims	1,986	1,578	1,590
Accident and health benefits	141	165	149
Other policy benefits	436	463	442
Total claims and surrenders	\$19,531	19,998	18,711

- Death claims expense was lower in 2011 due to fewer reported claims. In addition, 2011 results include a \$0.6 million incurred but not reported release of liability related to our claim experience calculation. Mortality experience is closely monitored by the Company as a key performance indicator and these amounts were within expected levels.
- Surrender benefits have increased in 2011 compared to 2010, as the Home Service block grows, and is consistent with expectations for the current economic conditions.
- Property claims increased in 2011 compared to 2010 and 2009, as previous years reported claims were lower than historical experience.

Increase in Future Policy Benefit Reserves. The reserves in 2009 included a decrease of \$0.4 million resulting from a correction related to Ozark National Life Insurance Company, which was acquired in 2008.

Other General Expenses. Other general expenses decreased in 2011 compared to 2010, due to an overall decrease in expenses and a reallocation of expenses that became effective January 1, 2011, which reduced the home service segment allocation by \$1.5 million and increased the life segment allocation in the current year.

Capitalization and Amortization of Deferred Policy Acquisition Costs ("DAC"). DAC capitalization is directly correlated to fluctuations in first year commissions. Amortization in 2011 increased compared to 2010 primarily because we experienced a higher lapse rate in the current year in this segment. We monitor lapse rates as a key component of our insurance operations. We are not aware of any information that would indicate this higher lapse rate will continue. Amortization in 2011 includes an adjustment that resulted in an increase of \$0.3 million due to a refinement in an estimate using system generated information related to SPLIC assumptions. Amortization reported in 2010 is impacted by an adjustment that decreased amortization by \$0.3 million in that reporting period.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Other Non-Insurance Enterprises

Overall, other non-insurance operations are relatively immaterial to the consolidated results, except for the fair value adjustment related to the Company's warrants to purchase Class A common stock. These amounts fluctuate due to the movement in our Class A common stock price and fair value calculation using the Black-Scholes valuation model.

Investments

Financial stability and the prevention of capital erosion are important investment considerations for the Company. A primary investment goal is the conservation of assets due to the long-term nature of a significant portion of our liabilities. The administration of our investment portfolios is handled internally, pursuant to board-approved investment guidelines, with all trading activity approved by a committee of each entity's respective board of directors of our insurance company subsidiaries. The guidelines used require that bonds, both government and corporate, are of high quality, investment grade and comprise a majority of the investment portfolio. State insurance statutes prescribe the quality and percentage of the various types of investments that may be made by insurance companies and generally permit investment in qualified state, municipal, federal and foreign government obligations, high quality corporate bonds, preferred and common stock, mortgage loans and real estate within certain specified percentages. The assets selected are intended to mature in accordance with the average maturity of the insurance products and to provide the cash flow for our insurance company subsidiaries to meet their respective policyholder obligations.

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

	December 31, 2011		December 31, 2010		
	Carrying Value	% of Total Carrying Value	Carrying Value	% of Total Carrying Value	
	(In thousands)		(In thousands)		
Fixed maturity securities:					
U.S. Treasury and U.S. Government-sponsored enterprises	\$321,186	36.8	% \$378,012	48.7	%
Corporate	195,374	22.4	161,298	20.8	
Municipal bonds (2)	216,202	24.8	101,719	13.1	
Mortgage-backed (1)	8,849	1.0	14,808	2.0	
Foreign governments	142	-	132	-	
Total fixed maturity securities	741,753	85.0	655,969	84.6	
Short-term investments	2,048	0.2	-	-	
Cash and cash equivalents	33,255	3.8	49,723	6.4	
Other investments:					
Policy loans	39,090	4.5	35,585	4.6	
Equity securities	46,137	5.3	23,304	3.0	
Mortgage loans	1,557	0.2	1,489	0.2	
Real estate and other long-term investments	8,644	1.0	9,348	1.2	
Total cash, cash equivalents and investments	\$872,484	100.0	% \$775,418	100.0	%

(1) Includes \$8.1 million and \$13.2 million of U.S. Government agencies and government-sponsored enterprise in 2011 and 2010, respectively.

(2) Includes \$123.5 million and \$54.0 million of securities guaranteed by third parties for the year ended December 31, 2011 and 2010, respectively.

The current year decline in U.S. government-sponsored securities is due to call activity from this sector and reinvestment into fixed maturity corporate and municipal bond categories. The Company has increased investments in municipals primarily related to Build America taxable bonds, essential services and corporate issuer holdings in the utility sector.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

At December 31, 2011, investments in fixed maturity and equity securities were 90.3% of our total cash, and cash equivalents and investments. All of our fixed maturities were classified as either available-for-sale or held-to-maturity securities at December 31, 2011 and 2010. We had no fixed maturity or equity securities that were classified as trading securities at December 31, 2011 or 2010.

As previously discussed, our investment portfolios have been impacted significantly by the low interest rate environment over the past several years. The following table shows investment yields by segment operations as of December 31 for each year presented.

	Business Segment		
	Life Insurance	Home Service	Consolidated
2011	3.89 %	4.47 %	4.03 %
2010	4.17 %	4.65 %	4.32 %
2009	4.91 %	4.71 %	4.75 %

Yields on investment assets vary between segment operations due to different portfolio mixes in the segments. The life segment invests more in U.S. Government securities while the home service segment has a larger concentration in the corporate and municipal sectors. The following table shows the breakdown between segments by investment bond category based on amortized cost.

Fixed Maturity Category	Year Ended December 31, 2011			
	Life Insurance	Home Service	Other Non- Insurance Enterprises	Consolidated
			(In thousands)	
U.S. Treasury and U.S. Government-sponsored	\$220,405	86,376	7,542	314,323
Corporate	81,982	89,416	10,893	182,291
Municipal bonds	99,422	91,089	16,807	207,318
Mortgage-backed	836	7,436	-	8,272
Foreign governments	105	-	-	105
Total fixed maturity securities	\$402,750	274,317	35,242	712,309

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

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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

	December 31, 2011		December 31, 2010	
	Carrying Value (In thousands)	% of Total Carrying Value	Carrying Value (In thousands)	% of Total Carrying Value
AAA	\$ 46,663	6.3 %	\$ 428,194	65.3 %
AA	482,869	65.1	59,454	9.1
A	99,266	13.4	73,341	11.2
BBB	95,558	12.9	84,489	12.9
BB and other	17,397	2.3	10,491	1.5
Totals	\$ 741,753	100.0 %	\$ 655,969	100.0 %

The significant change from fixed maturity securities held in AAA and AA ratings is due to the credit quality downgrade of the U.S. Government by Standard & Poor's during the third quarter of 2011. This resulted in 193 securities with a carrying value totaling approximately \$306.1 million as of December 31, 2011, moving from the AAA rating category into the AA category for the 2011 reporting period.

In addition, the Company made new investments in the AA credit category of taxable municipals and corporate bonds, primarily public utility issuers with an average maturity of seven years. The increase in non-investment grade securities was due to downgrades of issuers in the current period, as the Company does not purchase below investment grade securities.

As of December 31, 2011, the Company held municipal securities that include third party guarantees. Detailed below is a presentation by NRSRO rating of our municipal holdings by funding type.

Municipals shown including third party guarantees

	December 31, 2011						Total		% Based on Amortized Cost
	General Obligation		Special Revenue		Other				
	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	
	(In thousands, except percentages)								
AAA	\$ 19,477	17,890	9,294	8,855	-	-	28,771	26,745	12.9 %
AA	52,377	48,960	87,580	82,260	5,954	5,580	145,911	136,800	66.0
A	3,704	3,773	29,355	28,494	-	-	33,059	32,267	15.6
BBB	517	516	4,498	4,754	1,016	1,045	6,031	6,315	3.0
BB and other	-	-	4,287	5,191	-	-	4,287	5,191	2.5
Total	\$ 76,075	71,139	135,014	129,554	6,970	6,625	218,059	207,318	100.0 %

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Municipals shown excluding third party guarantees

	December 31, 2011		Special Revenue		Other		Total		% Based on Amortized Cost
	General Obligation Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	
	(In thousands, except percentages)								
AAA	\$ 3,269	3,231	7,704	7,347	-	-	10,973	10,578	5.1 %
AA	49,164	45,900	64,153	60,120	5,954	5,580	119,270	111,600	53.7
A	10,805	10,397	53,109	50,869	-	-	63,915	61,266	29.6
BBB	517	516	5,761	6,027	1,016	1,045	7,294	7,588	3.7
BB and other	12,320	11,095	4,287	5,191	-	-	16,607	16,286	7.9
Total	\$ 76,075	71,139	135,014	129,554	6,970	6,625	218,059	207,318	100.0 %

The Company held investments in special revenue bonds that had a greater than 10% exposure based upon activity as of December 31, 2011 as shown in the table below.

Bond Issue Activity	Fair Value	Amortized Cost	% of Total Fair Value
	(In thousands)		
Public improvements	\$ 24,331	23,312	11.2 %
Refunding bonds and notes	24,829	23,864	11.4 %

The tables below represent the Company's detailed exposure of municipal holdings in Louisiana and Texas, which exceed 10% of the total municipal portfolio as of December 31, 2011.

	General Obligation		Special Revenue		Other		Total	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost
	(In thousands)							
AA	\$ 11,891	11,215	18,008	17,228	-	-	29,899	28,443
A	782	774	13,712	13,225	-	-	14,494	13,999
BBB	517	516	4,498	4,754	1,016	1,045	6,031	6,315
BB and other	-	-	4,287	5,191	-	-	4,287	5,191
Total	\$ 13,190	12,505	40,505	40,398	1,016	1,045	54,711	53,948

Louisiana securities including third party guarantees

Louisiana
securities
excluding third
party
guarantees

AA	\$ 9,564	8,975	10,944	10,530	-	-	20,508	19,505
A	3,109	3,014	19,514	18,650	-	-	22,623	21,664
BBB	517	516	5,761	6,027	1,016	1,045	7,294	7,588
BB and other	-	-	4,286	5,191	-	-	4,286	5,191
Total	\$ 13,190	12,505	40,505	40,398	1,016	1,045	54,711	53,948

38

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

The Company invests in municipal securities of issuers in the state of Louisiana and receives a credit that reduces its premium tax liability in that state. At December 31, 2011, total holdings of municipal securities in Louisiana represented 25.1% of all municipal holdings based upon fair value. The Company also holds 21.3% of its municipal holdings in Texas issuers.

	General Obligation		Special Revenue		Total	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost
	(In thousands)					
Texas securities including third party guarantees						
AAA	\$ 19,478	17,890	4,921	4,611	24,399	22,501
AA	7,832	7,350	9,723	9,507	17,555	16,857
A	1,333	1,318	3,258	3,289	4,591	4,607
BBB	-	-	-	-	-	-
BB and other	-	-	-	-	-	-
Total						