

CITIZENS INC  
Form 10-Q  
May 04, 2018

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

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2018

OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from to  
COMMISSION FILE NUMBER: 000-16509

CITIZENS, INC.  
(Exact name of registrant as specified in its charter)  
Colorado 84-0755371  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

2900 Esperanza Crossing, 2nd Floor  
Austin, Texas 78758  
(Address of principal executive offices) (Zip Code)  
(Registrant's telephone number, including area code:) (512) 837-7100  
(Former name, former address and former fiscal year, if changed since last report:) N/A

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

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

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

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

Edgar Filing: CITIZENS INC - Form 10-Q

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

..

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

As of May 1, 2018, the Registrant had 49,080,114 shares of Class A common stock, no par value, outstanding and 1,001,714 shares of Class B common stock outstanding.

---

THIS PAGE INTENTIONALLY LEFT BLANK

---

## TABLE OF CONTENTS

	Page Number
Part I. Financial Information	
Item 1. <u>Financial Statements</u>	
<u>Consolidated Statements of Financial Position, March 31, 2018 and December 31, 2017 (Unaudited)</u>	<u>2</u>
<u>Consolidated Statements of Comprehensive Income, Three Months Ended March 31, 2018 and 2017 (Unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Stockholders' Equity, Three Months Ended March 31, 2018 and 2017 (Unaudited)</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows, Three Months Ended March 31, 2018 and 2017 (Unaudited)</u>	<u>6</u>
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	<u>8</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>26</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>48</u>
Item 4. <u>Controls and Procedures</u>	<u>49</u>
Part II. Other Information	
Item 1. <u>Legal Proceedings</u>	<u>50</u>
Item 1A. <u>Risk Factors</u>	<u>51</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>64</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>64</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>64</u>
Item 5. <u>Other Information</u>	<u>64</u>
Item 6. <u>Exhibits</u>	<u>65</u>

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Financial Position

(In thousands)

(Unaudited)

	March 31, 2018	December 31, 2017
Assets		
Investments:		
Fixed maturities available-for-sale, at fair value (cost: \$960,303 and \$935,977 in 2018 and 2017, respectively)	\$981,095	974,609
Fixed maturities held-to-maturity, at amortized cost (fair value: \$235,827 and \$241,377 in 2018 and 2017, respectively)	230,705	233,961
Equity securities, at fair value (cost: \$15,289 in 2017)	15,449	16,164
Mortgage loans on real estate	193	195
Policy loans	75,636	73,735
Real estate held for investment (less \$5,562 and \$5,479 accumulated depreciation in 2018 and 2017, respectively)	7,334	7,416
Other long-term investments	35	36
Total investments	1,310,447	1,306,116
Cash and cash equivalents	41,247	46,064
Accrued investment income	18,752	19,062
Reinsurance recoverable	3,780	3,715
Deferred policy acquisition costs	165,563	167,063
Cost of customer relationships acquired	16,925	17,499
Goodwill	12,624	12,624
Other intangible assets	960	961
Deferred tax asset	56,342	50,797
Property and equipment, net	6,330	6,624
Due premiums, net (less \$1,370 and \$1,611 allowance for doubtful accounts in 2018 and 2017, respectively)	10,895	12,765
Prepaid expenses	639	251
Other assets	955	912
Total assets	\$1,645,459	1,644,453

(Continued)

See accompanying notes to consolidated financial statements.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Financial Position

(In thousands, except share amounts)

(Unaudited)

	March 31, 2018	December 31, 2017
Liabilities and Stockholders' Equity		
Liabilities:		
Policy liabilities:		
Future policy benefit reserves:		
Life insurance	\$ 1,148,052	1,133,875
Annuities	74,806	73,688
Accident and health	937	990
Dividend accumulations	24,397	23,713
Premiums paid in advance	52,723	51,431
Policy claims payable	9,048	8,610
Other policyholders' funds	8,421	8,483
Total policy liabilities	1,318,384	1,300,790
Commissions payable	1,982	2,430
Federal income tax payable	97,716	93,365
Other liabilities	17,931	24,355
Total liabilities	1,436,013	1,420,940
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Class A, no par value, 100,000,000 shares authorized, 52,215,852 shares issued and outstanding in 2018 and 2017, including shares in treasury of 3,135,738 in 2018 and 2017	259,383	259,383
Class B, no par value, 2,000,000 shares authorized, 1,001,714 shares issued and outstanding in 2018 and 2017	3,184	3,184
Accumulated deficit	(58,500 )	(54,375 )
Accumulated other comprehensive income:		
Unrealized gains on securities, net of tax	16,390	26,332
Treasury stock, at cost	(11,011 )	(11,011 )
Total stockholders' equity	209,446	223,513
Total liabilities and stockholders' equity	\$ 1,645,459	1,644,453

See accompanying notes to consolidated financial statements.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Comprehensive Income

Three Months Ended March 31,

(In thousands, except per share amounts)

(Unaudited)

	2018	2017
Revenues:		
Premiums:		
Life insurance	\$42,529	43,804
Accident and health insurance	291	328
Property insurance	1,209	1,249
Net investment income	13,771	12,739
Realized investment gains (losses), net	(575 )	1,263
Other income	208	198
Total revenues	57,433	59,581
Benefits and expenses:		
Insurance benefits paid or provided:		
Claims and surrenders	21,151	21,724
Increase in future policy benefit reserves	14,608	14,536
Policyholders' dividends	1,307	1,304
Total insurance benefits paid or provided	37,066	37,564
Commissions	8,959	9,925
Other general expenses	6,507	10,156
Capitalization of deferred policy acquisition costs	(5,963 )	(6,901 )
Amortization of deferred policy acquisition costs	7,606	7,375
Amortization of cost of customer relationships acquired	679	519
Total benefits and expenses	54,854	58,638
Income before federal income tax	2,579	943
Federal income tax expense (benefit)	2,542	(1,113 )
Net income	37	2,056
Per Share Amounts:		
Basic and diluted earnings per share of Class A common stock	\$—	0.04
Basic and diluted earnings per share of Class B common stock	—	0.02
Other comprehensive income (loss):		
Unrealized gains (losses) on available-for-sale debt securities:		
Unrealized holding gains (losses) arising during period	(18,098 )	5,137
Reclassification adjustment for losses (gains) included in net income	259	(152 )
Unrealized gains (losses) on available-for-sale debt securities, net	(17,839 )	4,985
Income tax expense (benefit) on unrealized gains (losses) on available-for-sale debt securities	(3,735 )	1,745
Other comprehensive income (loss)	(14,104 )	3,240
Total comprehensive income (loss)	\$(14,067)	5,296

See accompanying notes to consolidated financial statements.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Stockholders' Equity

Three Months Ended March 31, 2018 and 2017

(In thousands)

(Unaudited)

	Common Stock		Accumulated	Accumulated	Treasury	Total
	Class A	Class B	deficit	other comprehensive income (loss)	stock	Stockholders' equity
Balance at December 31, 2016	\$259,383	3,184	(16,248 )	13,792	(11,011)	249,100
Comprehensive income:						
Net income	—	—	2,056	—	—	2,056
Unrealized investment gains, net	—	—	—	3,240	—	3,240
Total comprehensive income	—	—	2,056	3,240	—	5,296
Balance at March 31, 2017	\$259,383	3,184	(14,192 )	17,032	(11,011)	254,396
Balance at December 31, 2017	\$259,383	3,184	(54,375 )	26,332	(11,011)	223,513
Accounting standards adopted January 1, 2018	—	—	(4,162 )	4,162	—	—
Balance at January 1, 2018	259,383	3,184	(58,537 )	30,494	(11,011)	223,513
Comprehensive loss:						
Net income	—	—	37	—	—	37
Unrealized investment losses, net	—	—	—	(14,104 )	—	(14,104 )
Total comprehensive loss	—	—	37	(14,104 )	—	(14,067 )
Balance at March 31, 2018	\$259,383	3,184	(58,500 )	16,390	(11,011)	209,446

See accompanying notes to consolidated financial statements.



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Cash Flows

Three Months Ended March 31,

(In thousands)

(Unaudited)

	2018	2017
Cash flows from operating activities:		
Net income	\$ 37	2,056
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized (gains) losses on sale of investments and other assets	575	(1,263 )
Net deferred policy acquisition costs	1,643	474
Amortization of cost of customer relationships acquired	679	519
Depreciation	437	236
Amortization of premiums and discounts on investments	4,155	4,106
Deferred federal income tax benefit	(1,793)	(3,895 )
Change in:		
Accrued investment income	310	267
Reinsurance recoverable	(65 )	(47 )
Due premiums	1,870	1,589
Future policy benefit reserves	14,757	14,527
Other policyholders' liabilities	2,352	3,849
Federal income tax payable	4,335	6,155
Commissions payable and other liabilities	(6,872)	(5,785 )
Other, net	(429 )	(1,158 )
Net cash provided by operating activities	21,991	21,630
Cash flows from investing activities:		
Sale of fixed maturities, available-for-sale	—	508
Maturities and calls of fixed maturities, available-for-sale	16,501	18,111
Maturities and calls of fixed maturities, held-to-maturity	2,295	1,245
Purchase of fixed maturities, available-for-sale	(43,914)	(41,076)
Sale of equity securities, available-for-sale	—	1,940
Calls of equity securities, available-for-sale	—	300
Principal payments on mortgage loans	2	32
Increase in policy loans, net	(1,901)	(944 )
Sale of other long-term investments and real estate	1	3,039
Purchase of property and equipment	(61 )	(433 )
Net cash used in investing activities	(27,077)	(17,278)

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Cash Flows, Continued

Three Months Ended March 31,

(In thousands)

(Unaudited)

	2018	2017
Cash flows from financing activities:		
Annuity deposits	\$1,775	2,705
Annuity withdrawals	(1,506 )	(1,416 )
Net cash provided by financing activities	269	1,289
Net increase (decrease) in cash and cash equivalents	(4,817 )	5,641
Cash and cash equivalents at beginning of year	46,064	35,510
Cash and cash equivalents at end of period	\$41,247	41,151
Supplemental disclosures of operating activities:		
Cash paid (received) during the period for income taxes, net	\$—	(3,372 )

Supplemental disclosures of noncash activities:

None.

See accompanying notes to consolidated financial statements.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements

March 31, 2018

(Unaudited)

(1) Financial Statements

Basis of Presentation and Consolidation

The consolidated financial statements include the accounts and operations of Citizens, Inc. ("Citizens"), a Colorado corporation, and its wholly-owned subsidiaries, CICA Life Insurance Company of America ("CICA"), Security Plan Life Insurance Company ("SPLIC"), Security Plan Fire Insurance Company ("SPFIC"), Citizens National Life Insurance Company ("CNLIC"), Magnolia Guaranty Life Insurance Company ("MGLIC"), Computing Technology, Inc. ("CTI"), Insurance Investors, Inc. ("III") and CICA Life Ltd. Citizens and its wholly-owned subsidiaries are collectively referred to as "the Company," "we," "us" or "our."

The consolidated statements of financial position as of March 31, 2018, and the consolidated statements of comprehensive income for the three-months ended March 31, 2018 and March 31, 2017 and the consolidated statements of cash flows for the three-month periods ended March 31, 2018 and March 31, 2017, have been prepared by the Company without audit. In the opinion of management, all normal and recurring adjustments to present fairly the financial position, results of operations, and changes in cash flows at March 31, 2018 and for comparative periods have been made. The consolidated financial statements have been prepared in accordance with United States Generally Accepted Accounting Principles ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission ("SEC"). Accordingly, the financial statements do not include all of the information and footnotes required for complete financial statements and should be read in conjunction with the Company's consolidated financial statements, and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2017. Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

We provide primarily life insurance and a small amount of health insurance policies through our insurance subsidiaries: CICA, SPLIC, MGLIC and CNLIC. Until the end of 2016, CICA and CNLIC issued ordinary whole-life policies, credit life and disability, burial insurance, pre-need policies, and accident and health related policies, throughout the Midwest and southern United States. Beginning January 1, 2017, CICA and CNLIC ceased selling life products domestically. The Company is developing a new product strategy domestically and plans to re-enter the life market in 2019. CICA primarily issues ordinary whole-life and endowment policies to non-U.S. residents. SPLIC offers final expense and home service life insurance in Louisiana, Arkansas and Mississippi, and SPFIC, a wholly-owned subsidiary of SPLIC, writes a limited amount of property insurance in Louisiana. MGLIC provides industrial life policies through independent funeral homes in Mississippi.

CTI provides data processing systems and services, as well as furniture and equipment, to the Company. III is currently not active. We plan to dissolve III and merge it into Citizens. CICA Life Ltd. is a newly established Bermuda entity that plans to begin operations in mid-2018.

Use of Estimates

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

The most significant estimates include those used in the evaluation of other-than-temporary impairments on debt and equity securities, actuarially determined assets and liabilities and assumptions, tests of goodwill impairment, valuation allowance on deferred tax assets, valuation of uncertain tax positions and contingencies relating to litigation and regulatory matters. Certain of these estimates are particularly sensitive to market conditions, and deterioration and/or volatility in the worldwide debt or equity markets could have a material impact on the consolidated financial statements.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

Significant Accounting Policies

For a description of significant accounting policies, see Note 1 of the notes to consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017, which should be read in conjunction with these accompanying consolidated financial statements.

(2) Accounting Pronouncements

Accounting Standards Recently Adopted

On February 14, 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. It allows a reclassification from accumulated other comprehensive income ("AOCI") to retained earnings of the stranded tax effects that occurred due to the enactment of the Tax Cuts and Jobs Act of 2017 (the "New Tax Act"). The updated guidance is effective for reporting periods beginning after December 15, 2018 and is to be applied retrospectively to each period in which there are items impacted by the New Tax Act remaining in AOCI or at the beginning of the period of adoption. Early adoption is permitted. The Company adopted the updated guidance effective January 1, 2018 and elected to reclassify the income tax effects of the New Tax Act from AOCI to accumulated deficit as of January 1, 2018. This reclassification resulted in an increase in accumulated deficit of \$4.7 million as of January 1, 2018 and an increase in AOCI by the same amount.

In January 2016, the FASB released ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. The updated guidance requires equity investments, except those accounted for under the equity method of accounting, that have readily determinable fair value to be measured at fair value with any changes in fair value recognized in net income. Equity securities that do not have readily determinable fair values may be measured at estimated fair value or cost less impairment, if any, adjusted for subsequent observable price changes, with changes in the carrying value recognized in net income. A qualitative assessment for impairment is required for equity investments without readily determinable fair values. The updated guidance also eliminates the requirement to disclose the method and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost on the balance sheet. The updated guidance was effective for the quarter ended March 31, 2018. The adoption of this guidance resulted in the recognition of \$560,000 of net after-tax unrealized gains on equity investments as a cumulative effect adjustment that decreased retained deficit as of January 1, 2018 and decreased AOCI by the same amount. The Company elected to report changes in the fair value of equity investments in realized investment gains (losses), net. At December 31, 2017, equity investments were classified as available-for-sale on the Company's balance sheet. However, upon adoption, the updated guidance eliminated the available-for-sale balance sheet classification for equity investments.

Accounting Standards Not Yet Adopted

The FASB's new lease accounting standard ASU 2016-02, Leases (Topic 842), was issued on February 25, 2016. The ASU will require organizations that lease assets, referred to as "lessees", to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. The accounting by organizations that own the assets leased by the

lessee, also known as lessor accounting, will remain largely unchanged from current U.S. GAAP. However, the ASU contains some targeted improvements that are intended to align, where necessary, lessor accounting with the lessee accounting model and with the updated revenue recognition guidance issued in 2014. The ASU on leases will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is assessing the impact of this new standard.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (Topic 326), with the main objective to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendments in this ASU require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

present the net carrying value at the amount expected to be collected on the financial asset. The income statement reflects the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. Credit losses on available-for-sale debt securities should be measured in a manner similar to current U.S. GAAP; however, the credit losses are recorded through an allowance for credit losses rather than as a write-down. This approach is an improvement to current U.S. GAAP because an entity will be able to record reversals of credit losses (in situations in which the estimate of credit losses declines) in current period net income, which in turn should align the income statement recognition of credit losses with the reporting period in which changes occur. Current U.S. GAAP prohibits reflecting those improvements in current-period earnings. For public business entities, the amendments in this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is evaluating the impact this guidance will have on our consolidated financial statements, but it is not expected to have a significant impact on the Company's consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-08, Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20). The amendments in this ASU shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The Company has a large portfolio of callable debt securities purchased at a premium. As such, the Company had already been amortizing the premium to the earliest call date to reduce volatility in earnings by eliminating reporting large realized losses when debt securities are called. For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

No other new accounting pronouncement issued or effective during the fiscal year had, or is expected to have, a material impact on our consolidated financial statements.

(3) Segment Information

The Company has two reportable segments: Life Insurance and Home Service Insurance. The Life Insurance and Home Service portions of the Company constitute separate businesses. In addition to the Life Insurance and Home Service business, the Company also operates other non-insurance ("Other Non-Insurance") portions of the Company, which primarily include the Company's IT and Corporate-support functions, which are included in the tables presented below to properly reconcile the segment information with the consolidated financial statements of the Company.

The accounting policies of the segments and other non-insurance enterprises are in accordance with U.S. GAAP and are the same as those used in the preparation of the consolidated financial statements. The Company evaluates profit and loss performance based on U.S. GAAP income before federal income taxes for its two reportable segments.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

The Company's Other Non-Insurance enterprises are the only reportable difference between segments and consolidated operations.

	Three Months Ended			
	March 31, 2018			
	Life	Home	Other	Consolidated
	Insurance	Service	Non-Insurance	Enterprises
	(In thousands)			
Revenues:				
Premiums	\$32,360	11,669	—	44,029
Net investment income	10,130	3,302	339	13,771
Realized investment losses, net	(185 )	(352 )	(38 )	(575 )
Other income (loss)	209	(1 )	—	208
Total revenue	42,514	14,618	301	57,433
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	15,291	5,860	—	21,151
Increase in future policy benefit reserves	13,582	1,026	—	14,608
Policyholders' dividends	1,297	10	—	1,307
Total insurance benefits paid or provided	30,170	6,896	—	37,066
Commissions	5,228	3,731	—	8,959
Other general expenses <sup>(1)</sup>	(884 )	5,544	1,847	6,507
Capitalization of deferred policy acquisition costs	(4,640 )	(1,323 )	—	(5,963 )
Amortization of deferred policy acquisition costs	6,540	1,066	—	7,606
Amortization of cost of customer relationships acquired	152	527	—	679
Total benefits and expenses	36,566	16,441	1,847	54,854
Income (loss) before income tax expense	\$5,948	(1,823 )	(1,546 )	2,579

<sup>(1)</sup> During the three months ended March 31, 2018, the Company reduced its estimate of the liability accrued for policies that are not in compliance with Section 7702 of the Internal Revenue Code from \$12.3 million to \$5.1 million, as we continue to refine our estimates. The decrease is primarily related to the Life Insurance segment, which when offset by the impact of increased compliance costs, resulted in a negative amount reported for other general expenses for the Life Insurance segment for the three months ended March 31, 2018. For further information, refer to disclosures under the "Qualification of Life Products" heading within Note 8 in the Company's notes to consolidated financial statements.



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

	Three Months Ended March 31, 2017			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	\$33,563	11,818	—	45,381
Net investment income	9,131	3,259	349	12,739
Realized investment gains, net	77	1,186	—	1,263
Other income (loss)	118	(1	) 81	198
Total revenue	42,889	16,262	430	59,581
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	15,676	6,048	—	21,724
Increase in future policy benefit reserves	13,260	1,276	—	14,536
Policyholders' dividends	1,295	9	—	1,304
Total insurance benefits paid or provided	30,231	7,333	—	37,564
Commissions	6,007	3,918	—	9,925
Other general expenses	3,872	4,858	1,426	10,156
Capitalization of deferred policy acquisition costs	(5,378	) (1,523	) —	(6,901
Amortization of deferred policy acquisition costs	6,306	1,069	—	7,375
Amortization of cost of customer relationships acquired	172	347	—	519
Total benefits and expenses	41,210	16,002	1,426	58,638
Income (loss) before income tax expense	\$1,679	260	(996	) 943

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

## (4) Earnings Per Share

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

	Three Months Ended March 31, 2018 (In thousands, except per share amounts)
Basic and diluted earnings per share:	
Numerator:	
Net income	\$37,205
Net income allocated to Class A common stock	\$37,035
Net income allocated to Class B common stock	— 21
Net income	\$37,205
Denominator:	
Weighted average shares of Class A outstanding - basic and diluted	49,080
Weighted average shares of Class B outstanding - basic and diluted	1,002
Basic and diluted earnings per share of Class A common stock	\$— 0.04
Basic and diluted earnings per share of Class B common stock	— 0.02

## (5) Investments

The Company invests primarily in fixed maturity securities, which totaled 89.7% of total cash, cash equivalents and investments at March 31, 2018. The Company's cash, cash equivalents and investments are listed below.

	March 31, 2018		December 31, 2017	
	Carrying Value	% of Total Carrying Value	Carrying Value	% of Total Carrying Value
	(In thousands)		(In thousands)	
Fixed maturity securities	\$1,211,800	89.7	\$1,208,570	89.3
Equity securities	15,449	1.1	16,164	1.2
Mortgage loans	193	—	195	—
Policy loans	75,636	5.6	73,735	5.5
Real estate and other long-term investments	7,369	0.5	7,452	0.6
Cash and cash equivalents	41,247	3.1	46,064	3.4
Total cash, cash equivalents and investments	\$1,351,694	100.0	\$1,352,180	100.0

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

The following tables represent the cost, gross unrealized gains and losses and fair value for fixed maturities as of the periods indicated.

	March 31, 2018			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Fixed maturities:				
Available-for-sale:				
U.S. Treasury securities	\$9,842	1,651	—	11,493
U.S. Government-sponsored enterprises	3,565	807	—	4,372
States and political subdivisions	558,513	13,977	2,810	569,680
Foreign governments	103	18	—	121
Corporate	386,664	12,069	5,019	393,714
Residential mortgage-backed	1,616	102	3	1,715
Total available-for-sale securities	960,303	28,624	7,832	981,095
Held-to-maturity securities:				
States and political subdivisions	210,623	5,759	722	215,660
Corporate	20,082	680	595	20,167
Total held-to-maturity securities	230,705	6,439	1,317	235,827
Total fixed maturities	\$1,191,008	35,063	9,149	1,216,922

	December 31, 2017			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Fixed maturities:				
Available-for-sale securities:				
U.S. Treasury securities	\$9,860	1,948	—	11,808
U.S. Government-sponsored enterprises	3,570	926	—	4,496
States and political subdivisions	550,536	18,507	1,540	567,503
Foreign governments	103	18	—	121
Corporate	370,043	20,212	1,552	388,703
Residential mortgage-backed	1,865	118	5	1,978
Total available-for-sale securities	935,977	41,729	3,097	974,609
Held-to-maturity securities:				
States and political subdivisions	213,054	7,585	629	220,010
Corporate	20,907	1,118	658	21,367
Total held-to-maturity securities	233,961	8,703	1,287	241,377
Total fixed maturity securities	\$1,169,938	50,432	4,384	1,215,986



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

The majority of the Company's equity securities are diversified stock and bond mutual funds.

	March 31, 2018 Fair Value (In thousands)	December 31, 2017 Fair Value
Equity securities:		
Stock mutual funds	\$3,117	3,217
Bond mutual funds	12,167	12,367
Common stock	21	24
Preferred stock	144	556
Total equity securities	\$15,449	16,164

The Company recognized \$302,000 of net realized losses on equity securities still held as of March 31, 2018.

## Valuation of Investments in Fixed Maturity and Equity Securities

Held-to-maturity securities are reported in the financial statements at amortized cost and available-for-sale securities are reported at fair value. Equity securities are measured at fair value with the change in fair value recorded through net income pursuant to the adoption of ASU 2016-01 as described in Note 2.

The Company monitors all debt securities on an on-going basis relative to changes in credit ratings, market prices, earnings trends and financial performance, in addition to specific region or industry reviews. The assessment of whether other-than-temporary impairments ("OTTI") have occurred is based on a case-by-case evaluation of underlying reasons for the decline in fair value. The Company determines other-than-temporary impairment by reviewing relevant evidence related to the specific security issuer as well as the Company's intent to sell the security, or if it is more likely than not that the Company would be required to sell a security before recovery of its amortized cost.

When an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the investment's cost and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is separated into the following: (a) the amount representing the credit loss; and (b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings becomes the new amortized cost basis of the investment. The new amortized cost basis is not adjusted for subsequent recoveries in fair value.

The Company evaluates whether a credit impairment exists for fixed maturity securities by considering primarily the following factors: (a) changes in the financial condition of the security's underlying collateral; (b) whether the issuer is current on contractually obligated interest and principal payments; (c) changes in the financial condition, credit rating and near-term prospects of the issuer; (d) the length of time to which the fair value has been less than the amortized cost of the security; and (e) the payment structure of the security. The Company's best estimate of expected future cash flows used to determine the credit loss amount is a quantitative and qualitative process. Quantitative review includes information received from third party sources such as financial statements, pricing and rating changes, liquidity and other statistical information. Qualitative factors include judgments related to business strategies, economic impacts on the issuer and overall judgment related to estimates and industry factors. The Company's best estimate of future cash flows involves assumptions including, but not limited to, various performance indicators, such as historical

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

and projected default and recovery rates, credit ratings, and current delinquency rates. These assumptions require the use of significant management judgment and include the probability of issuer default and estimates regarding timing and amount of expected recoveries, which may include estimating the underlying collateral value. In addition, projections of expected future debt security cash flows may change based upon new information regarding the performance of the issuer.

Other-than-temporary impairment of \$225,000 was recognized on one bond issuer and on one equity security totaling \$17,000 during the three months ended March 31, 2018 and 2017, respectively.

The following tables present the fair values and gross unrealized losses of fixed maturity securities that have remained in a continuous unrealized loss position for the periods indicated.

	March 31, 2018									
	Less than 12 months			Greater than 12 months			Total			
	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	
(In thousands, except for # of securities)										
Fixed maturities:										
Available-for-sale securities:										
States and political subdivisions	\$152,198	1,298	140	44,902	1,512	41	197,100	2,810	181	
Corporate	170,388	4,160	115	7,340	859	7	177,728	5,019	122	
Residential mortgage-backed	—	—	2	154	3	4	154	3	6	
Total available-for-sale securities	322,586	5,458	257	52,396	2,374	52	374,982	7,832	309	
Held-to-maturity securities:										
States and political subdivisions	23,109	153	24	8,905	569	16	32,014	722	40	
Corporate	—	—	—	2,225	595	2	2,225	595	2	
Total held-to-maturity securities	23,109	153	24	11,130	1,164	18	34,239	1,317	42	
Total fixed maturities	\$345,695	5,611	281	63,526	3,538	70	409,221	9,149	351	

As of March 31, 2018, the Company had 52 available-for-sale fixed maturity securities and 18 held-to-maturity fixed maturity securities that were in an unrealized loss position for greater than 12 months.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

	December 31, 2017								
	Less than 12 months		# of Securities	Greater than 12 months		# of Securities	Total		# of Securities
	Fair Value	Unrealized Losses		Fair Value	Unrealized Losses		Fair Value	Unrealized Losses	
(In thousands, except for # of securities)									
Fixed maturities:									
Available-for-sale securities:									
States and political subdivisions	\$49,408	312	46	47,233	1,228	46	96,641	1,540	92
Corporate	61,071	732	39	7,651	820	10	68,722	1,552	49
Residential mortgage-backed	132	3	4	157	2	4	289	5	8
Total available-for-sale securities	110,611	1,047	89	55,041	2,050	60	165,652	3,097	149
Held-to-maturity securities:									
States and political subdivisions	14,178	45	15	7,460	584	14	21,638	629	29
Corporate	—	—	—	2,169	658	2	2,169	658	2
Total held-to-maturity securities	14,178	45	15	9,629	1,242	16	23,807	1,287	31
Total fixed maturities	\$124,789	1,092	104	64,670	3,292	76	189,459	4,384	180
Equity securities:									
Common stock	95	6	1	—	—	—	95	6	1
Total equity securities	\$95	6	1	—	—	—	95	6	1

We have reviewed these securities in an unrealized loss position for the periods ended March 31, 2018 and December 31, 2017 and determined that no other-than-temporary impairment exists that have not been recognized based on our evaluation of the credit worthiness of the issuers and the fact that we do not intend to sell the investments nor is it likely that we will be required to sell the securities before recovery of their amortized cost bases which may be maturity. We continue to monitor all securities on an on-going basis and future information may become available which could result in other-than-temporary impairments being recorded.



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

The amortized cost and fair value of fixed maturity securities at March 31, 2018 by contractual maturity are shown in the table below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date have been reflected based upon final stated maturity.

	March 31, 2018	
	Amortized Cost	Fair Value
	(In thousands)	
Available-for-sale securities:		
Due in one year or less	\$40,387	40,592
Due after one year through five years	111,478	114,927
Due after five years through ten years	146,207	150,234
Due after ten years	662,231	675,342
Total available-for-sale securities	960,303	981,095
Held-to-maturity securities:		
Due in one year or less	20,392	20,437
Due after one year through five years	43,646	44,545
Due after five years through ten years	49,116	49,935
Due after ten years	117,551	120,910
Total held-to-maturity securities	230,705	235,827
Total fixed maturities	\$1,191,008	1,216,922

The Company uses the specific identification method of the individual security to determine the cost basis used in the calculation of realized gains and losses related to security sales.

	Fixed Maturities	Equity Securities
	Available-for-Sale	Available-for-Sale
	Three Months Ended March 31, 2017	Three Months Ended March 31, 2017
	(In thousands)	
Proceeds	\$ -508	-1,940
Gross realized gains	\$ -6	—
Gross realized losses	\$ —	-30

There were no sales of available-for-sale securities or equity securities for the three month period ended March 31, 2018. One available-for-sale fixed maturity security and one equity security were sold during the three month period ended March 31, 2017. There were no securities sold from the held-to-maturity portfolio for the three months ended March 31, 2018 or 2017.



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

(6) Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We hold available-for-sale fixed maturity securities, which are carried at fair value. We also report our equity securities at fair value with changes in fair value reported through the consolidated statements of comprehensive income.

Fair value measurements are generally based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our view of market assumptions in the absence of observable market information. We utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. All assets and liabilities carried at fair value are required to be classified and disclosed in one of the following three categories:

Level 1 - Quoted prices for identical instruments in active markets.

Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs or whose significant value drivers are observable.

Level 3 - Instruments whose significant value drivers are unobservable.

Level 1 primarily consists of financial instruments whose value is based on quoted market prices such as U.S. Treasury securities and actively traded mutual fund and stock investments.

Level 2 includes those financial instruments that are valued by independent pricing services or broker quotes. These models are primarily industry-standard models that consider various inputs, such as interest rates, credit spreads and foreign exchange rates for the underlying financial instruments. All significant inputs are observable, or derived from observable information in the marketplace or are supported by observable levels at which transactions are executed in the marketplace. Financial instruments in this category primarily include corporate securities, U.S.

Government-sponsored enterprise securities, municipal securities and certain mortgage and asset-backed securities.

Level 3 is comprised of financial instruments whose fair value is estimated based on non-binding broker prices utilizing significant inputs not based on or corroborated by readily available market information. There were no securities in this category at March 31, 2018.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

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

March 31, 2018				
Financial Assets	Level 1	Level 2	Level 3	Total Fair Value
(In thousands)				
Available-for-sale investments				
Fixed maturities:				
U.S. Treasury and U.S. Government-sponsored enterprises	\$ 11,493	4,372	—	15,865
States and political subdivisions	—	569,680	—	569,680
Corporate	407	393,307	—	393,714
Residential mortgage-backed	—	1,715	—	1,715
Foreign governments	—	121	—	121
Total fixed maturities available-for-sale	11,900	969,195	—	981,095
Equity securities				
Stock mutual funds	3,117	—	—	3,117
Bond mutual funds	12,167	—	—	12,167
Common stock	21	—	—	21
Non-redeemable preferred stock	144	—	—	144
Total equity securities	15,449	—	—	15,449
Total financial assets	\$ 27,349	969,195	—	996,544
December 31, 2017				
Financial Assets	Level 1	Level 2	Level 3	Total Fair Value
(In thousands)				
Available-for-sale investments				
Fixed maturities:				
U.S. Treasury and U.S. Government-sponsored enterprises	\$ 11,808	4,496	—	16,304
States and political subdivisions	—	567,503	—	567,503
Corporate	—	388,703	—	388,703
Residential mortgage-backed	—	1,978	—	1,978
Foreign governments	—	121	—	121
Total fixed maturities available-for-sale	11,808	962,801	—	974,609
Equity securities				
Stock mutual funds	3,217	—	—	3,217
Bond mutual funds	12,367	—	—	12,367
Common stock	24	—	—	24
Preferred stock	556	—	—	556
Total equity securities	16,164	—	—	16,164
Total financial assets	\$ 27,972	962,801	—	990,773



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

## Financial Instruments Valuation

Fixed maturity securities, available-for-sale. At March 31, 2018, our fixed maturity securities, valued using a third-party pricing source, totaled \$969.2 million for Level 2 assets and comprised 97.3% of total reported fair value of our financial assets. The Level 1 and Level 2 valuations are reviewed and updated quarterly through random testing by comparisons to separate pricing models, other third-party pricing services, and back tested to recent trades. In addition, we obtain information annually relative to the third-party pricing models and review model parameters for reasonableness. There were no Level 3 assets at March 31, 2018. For the three months ended March 31, 2018, there were no material changes to the valuation methods or assumptions used to determine fair values, and no broker or third-party prices were changed from the values received.

Equity securities. Our equity securities are classified as Level 1 assets as their fair values are based upon quoted market prices.

We review the fair value hierarchy classifications each reporting period. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets. Such reclassifications are reported as transfers in and out of Level 3 at the beginning fair value for the reporting period in which the changes occur. There were no transfers in or out of Level 3.

## Financial Instruments not Carried at Fair Value

Estimates of fair values are made at a specific point in time, based on relevant market prices and information about the financial instruments. The estimated fair values of financial instruments presented below are not necessarily indicative of the amounts the Company might realize in actual market transactions.

The carrying amount and fair value for the financial assets and liabilities on the consolidated balance sheets not otherwise disclosed for the periods indicated are as follows:

	March 31, 2018		December 31, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(In thousands)			
Financial assets:				
Fixed maturities, held-to-maturity	\$230,705	235,827	233,961	241,377
Mortgage loans	193	226	195	228
Policy loans	75,636	75,636	73,735	73,735
Cash and cash equivalents	41,247	41,247	46,064	46,064
Financial liabilities:				
Annuity - investment contracts	55,821	55,109	55,035	57,575

Fair values for fixed income securities, which are characterized as Level 2 assets in the fair value hierarchy, are based on quoted market prices for the same or similar securities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other assumptions, including a discount rate and estimates of future cash flows.

Mortgage loans are secured principally by residential properties. Weighted average interest rates for these loans were approximately 6.56% at March 31, 2018 and 6.60% at December 31, 2017. At March 31, 2018, maturities ranged from 20 to 24 years. Management estimated the fair value using an annual interest rate of 6.25% at March 31, 2018. Our mortgage loans are considered Level 3 assets in the fair value hierarchy.

Policy loans had a weighted average annual interest rate of 7.7% as of March 31, 2018 and December 31, 2017, and no specified maturity dates. The aggregate fair value of policy loans approximates the carrying value reflected on the consolidated balance sheets. These loans typically carry an interest rate that is tied to the crediting rate applied to the related policy and contract re

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

serves. Policy loans are an integral part of the life insurance policies we have in force, cannot be valued separately and are not marketable. Therefore, the fair value of policy loans approximates the carrying value and policy loans are considered Level 3 assets in the fair value hierarchy.

The fair value of cash and cash equivalents approximate carrying value and are characterized as Level 1 assets in the fair value hierarchy.

The fair value of the Company's liabilities under annuity contract policies, which are considered Level 3 assets, was estimated at March 31, 2018 using discounted cash flows based upon spot rates ranging from 2.34% to 3.67% based upon swap rates adjusted for various risk adjustments. The fair value of liabilities under all insurance contracts are taken into consideration in the overall management of interest rate risk, which seeks to minimize exposure to changing interest rates through the matching of investment maturities with amounts due under insurance contracts.

## (7) Short Duration Contracts

The Company's short duration contracts consist of credit life and credit disability in the Life segment and property insurance in the Home Service segment. The following table presents information on changes in the liability for credit life, credit disability, and property policy and contract claims for the periods ended March 31, 2018 and March 31, 2017.

	March 31,	
	2018	2017
	(In thousands)	
Policy claims payable at January 1,	\$573	544
Less: reinsurance recoverable	—	—
Net balance at January 1,	573	544
Add claims incurred, related to:		
Current year	497	673
Prior years	(111 )	(42 )
	386	631
Deduct claims paid, related to:		
Current year	250	428
Prior years	262	300
	512	728
Net balance March 31,	447	447
Plus: reinsurance recoverable	—	—
Policy claims payable, March 31,	\$447	447



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

(8) Commitments and Contingencies

Qualification of Life Products

As of December 31, 2014, we determined that a portion of the life insurance policies issued by our subsidiary insurance companies failed to qualify for the favorable U.S. federal income tax treatment afforded by Section 7702 of the Internal Revenue Code ("IRC") of 1986. This tax code section allows for qualifying products sold to clients to have favorable tax treatment such as the product's inside build up being not taxable unless distributions are made. Because these policies were sold with the intention that they would qualify for this favorable tax treatment, holders of these policies and the Company may now be subject to additional tax liabilities. The policies at issue were sold most substantially to non-U.S. citizens residing abroad and to a lesser extent domestically. Based upon a review of the options available to the Company, we have determined that we will not remediate our endowments and life products under IRC Section 7702 that we have sold to non-U.S. citizens but will propose an offer to the IRS to settle potential liabilities. We do intend to remediate the domestic products we have sold to U.S. citizens. Accordingly, we submitted an offer to enter into a Closing Agreement for CICA and CNLIC in May 2017. We have not received a response from the IRS on this submission. In addition, as part of our continuing review, we determined in July 2015 that certain annuity contracts do not contain qualifying language under IRC 72(s) as intended that would have provided for favorable tax treatment of the annuities. This issue affects both our domestic and international contract holders. We endorsed the majority of the affected domestic annuity contracts to comply with the IRC in December 2017 and intend to submit a Closing Agreement offer in 2018 to address past non-compliance. The Company has continued to refine the understanding of the tax failures as previously reported by preparing an individual policy calculation and has reflected the related exposure for the current reporting period as noted below. Failure of these policies to qualify under IRC Sections 7702 and 72(s) has resulted in additional liabilities and expenses as described below. The products have been and continue to be appropriately reported under U.S. GAAP for financial reporting.

The failure of these policies to qualify under Sections 7702 and 72(s) results in an estimated liability as of March 31, 2018 of \$5.1 million, after tax, related to projected IRS toll charges and fees reported in other general expenses of \$4.7 million and reserves increases to bring policies into compliance totaling \$0.4 million. The range of financial estimates relative to this issue is \$4.2 million to \$45.5 million, after tax. At December 31, 2017, the best estimate reserve liability was \$12.3 million, net of tax and the probability weighted range of financial estimates relative to this issue was \$5.9 million to \$48.2 million, net of tax. Our liability and range disclosures are evaluated each reporting period and reflect our continued refinement of estimates and considerations as we prepare to submit offers to enter into closing agreements with the IRS related to these matters.

The estimated range includes projected toll charges and fees payable to the IRS, as well as any other costs attributed to remediation of non-compliant domestic life insurance policies. The estimated liability and the estimated range will be updated as we continue to refine our estimates. The amount of our liabilities and expenses depends on a number of uncertainties, including the number of prior tax years for which we may be liable to the IRS, the number of domestic life insurance policies we will be required to remediate, and the methodology applicable to the calculation of the toll charges for non-compliant policies. Given the range of potential outcomes and the significant variables assumed in establishing our estimates, actual amounts incurred may exceed our reserve and also could exceed the high end of our estimated range of liabilities and expenses. To the extent the amount reserved by the Company is insufficient to meet the actual amount of our liability and expenses, or if our estimates of those liabilities and expenses change in the future, our financial condition and results of operation may be materially adversely affected. Management believes that based upon current information we have recorded the best estimate liability to date.

Accruals for loss contingencies are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. The process of determining our best estimate and the estimated range was a complex undertaking including insight from external consultants and involved management's judgment based upon a variety of factors known at the time. We expect to incur additional costs in 2018 associated with these issues. We believe these costs could be an additional \$0.5 million to \$1.5 million, but due to the uncertainty of actions, we cannot reasonably estimate these costs with any reliability. Actual amounts incurred may exceed this estimate and will be recorded as they become probable and can be reasonably estimated.

#### Unclaimed Property Contingencies

The Company was informed in 2012 by the Louisiana Department of Treasury, Arkansas Auditor of State and the Texas State Comptroller, that they authorized an audit of Citizens, Inc. and its affiliates for compliance with unclaimed property laws. This audit is being conducted by Verus Financial LLC on behalf of the states. This audit is not active and there has been no activity related to this audit for several years.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

If the external audit was performed it could result in additional payments to beneficiaries, additional escheatment of funds deemed abandoned under state laws, administrative penalties, interest, and changes to the Company's procedures for the identification and escheatment of abandoned property. The Company believes additional escheatment of funds in Arkansas or Texas will not be material to our financial condition or results of operations. However, additional escheatment of funds in Louisiana, which may subsequently be deemed abandoned under the Louisiana Department of Treasury's audit, could be substantial for SPLIC if the Louisiana Department of Treasury chooses to disregard recent court decisions regarding unclaimed property litigation in favor of the insurance industry. At this time, the Company is not able to reasonably estimate any of these possible amounts.

Litigation

On or about March 16, 2017, Juan Gamboa filed a putative class action lawsuit against the Company and five of its current and former directors and executive officers in the United States District Court, Western District of Texas. The lawsuit alleges the defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by making false and/or misleading statements, as well as failing to disclose material adverse facts about the Company's business, operations and prospects. On May 25, 2017, the court appointed lead plaintiffs, and on July 31, 2017, the lead plaintiffs filed an amended complaint. The amended complaint seeks an award of damages in an unspecified amount on behalf of a putative class consisting of persons who purchased the Company's common stock between March 11, 2015 and March 8, 2017, inclusive. On September 28, 2017, we filed a motion to dismiss, which remains pending before the court. The Company believes that the lawsuit is without merit, and it intends to vigorously defend against all claims asserted. At this time, the Company is unable to reasonably determine the outcome of this litigation.

From time to time we are subject to legal and regulatory actions relating to our business. We defend all claims vigorously. As a result, we incur defense costs, including attorneys' fees, other direct litigation costs and the expenditure of management time that otherwise would be devoted to our business. If we suffer an adverse judgment as a result of litigation claims, it could have a material adverse effect on our business, results of operations and financial condition.

(9) Income Taxes

The effective tax rate was 98.6% and (118.0)% for the three months ended March 31, 2018 and March 31, 2017, respectively. Additionally there were \$0.7 million of tax expense and \$0.8 million tax benefit related to interest expense on an uncertain tax position in the three months ended March 31, 2018 and March 31, 2017, respectively. The effective tax rate is affected by our tax compliance issues discussed in Note 8 "Commitments and Contingencies", as IRS toll charge penalties are not tax deductible and can move up or down depending on the net adjustment to our best estimate liability. In addition, we report the interest component of our uncertain tax positions in income tax expense, which can move up or down depending on the tax compliance issues as well as statute expirations. Absent the effect on our effective tax rate of our tax compliance issues, in prior years where our effective tax rate was lower than the statutory tax rate of 35%, the difference was primarily due to tax-exempt state and local bond income which reduce the effective tax rate.

Beginning in 2018, the statutory tax rate is 21%. In accordance with the SEC's Staff Accounting Bulletin No. 118 ("SAB 118"), the Company recorded provisional amounts related to the impacts of the New Tax Act as of December 31, 2017, including but not limited to the change in corporate tax rate and immediate expensing of certain

capital assets. The amounts are considered provisional estimates due to complexities and ambiguities in New Tax Act which resulted in incomplete accounting for the tax effects of these provisions. Further guidance, either legislative or interpretive, and analysis will be required to complete the accounting for these items. A final determination is required to be made within a measurement period not to extend beyond one year from the enactment date of the New Tax Act. Upon further analysis of certain aspects of the Act during the three months ended March 31, 2018, we determined that no adjustment to our provisional amount recorded as of December 31, 2017 was required. We will continue our analysis of the New Tax Act and will record an update to our provisional amount if needed during the measurement period allowed by SAB 118.

For the three months ended March 31, 2018, our effective tax rate was significantly higher than the three months ended March 31, 2017, as the Company recorded a net reduction in the overall accrual for IRS toll charge penalties and a tax benefit on the Company's uncertain tax position interest accrual compared to a net increase for these items in the three months ended March 31, 2017.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2018

(Unaudited)

## (10) Benefit Plans

The Company has an employer-sponsored 401(k) plan available to all eligible employees. This is an additional benefit offered to employees, which supplements the defined contribution profit-sharing plan. Employees with one year of service can participate in the plan. Contributions are made by employees and the Company provides a matching contribution based upon the employee's level of contribution. The Company's expense related to contributions into the 401(k) plan totaled \$187,000 and \$177,000 for the three months ended March 31, 2018 and March 31, 2017, respectively.

## (11) Stock Compensation

In January, 2018, the Company's Board of Directors approved awards of restricted stock units under the Citizens, Inc. Omnibus Incentive Plan for non-employee directors and the executive management team totaling \$10,500 per director and \$976,000 in total to the executive management team. The grant date was February 15, 2018 with a one-year vesting schedule for the directors and a two-year vesting schedule for the executive management team. In addition, the Board also approved equity grants for 2018 not to exceed \$1.2 million for other employees with a delegation to the CEO to determine the value to be awarded.

	Restricted Stock Units	
	Units	Aggregate Fair Value (1)
Outstanding at January 1, 2018	—	\$—
Granted	148,883	1,070,500
Vested	—	—
Forfeited	—	—
Outstanding at March 31, 2018	148,883	\$1,070,500

(1) Fair value per share of restricted stock units on March 31, 2018 was equal to Grant Date fair value per share.

Restricted stock awards give the participant the right to receive common stock or a cash payment equal to the fair market value of common stock in the future, subject to certain restrictions and a risk of forfeiture. Compensation expense of \$111,000 was recognized as of March 31, 2018 related to these awards.

## (12) Related Party Transactions

The Company has various routine related party transactions in conjunction with our holding company structure, such as a management service agreement related to costs incurred, a tax sharing agreement between entities, and inter-company dividends and capital contributions. There were no changes related to these relationships during the three months ended March 31, 2018. See our Annual Report on Form 10-K for the year ended December 31, 2017 for a comprehensive discussion of related party transactions.

In the first quarter of 2018, CICA made a capital contribution to CNLIC of \$450,000 and SPLIC made a capital contribution of \$450,000 to MGLIC.



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

Certain statements contained in this report are not statements of historical fact and constitute forward-looking statements within the meaning of the federal securities laws, 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. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, income or loss, earnings or loss per share, the payment or non-payment of dividends, capital structure, and other financial items, (ii) statements of our plans and objectives by our management or Board of Directors, including those relating to products or services, (iii) statements of future economic performance and (iv) statements of assumptions underlying such statements. Words such as "believes," "anticipates," "assumes," "estimates," "plans," "projects," "could," "expects," "intends," "targeted," "may," "will" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements.

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

- Changes in the application, interpretation or enforcement of foreign insurance laws that impact our business, which derives the majority of its revenues from residents of foreign countries;
- Potential changes in amounts reserved for in connection with the noncompliance of a portion of our insurance policies with Sections 7702 under the Internal Revenue Code, the failure of certain annuity contracts to qualify under Section 72(s) of the Internal Revenue Code and the anticipated timing of finalization of our proposed closing agreements with the IRS to address these matters;
- The anticipated transition of our international business to a new Bermuda-based entity, the adoption of our international business to regulatory oversight by the Bermuda Monetary Authority and potential shifts in policyholder behavior arising from these changes;
- Changes in foreign and U.S. general economic, market, and political conditions, including the performance of financial markets and interest rates;
- Changes in consumer behavior or regulatory oversight, which may affect the Company's ability to sell its products and retain business;
- The timely development of and acceptance of new products of the Company and perceived overall value of these products and services by existing and potential customers;
- Fluctuations in experience regarding current mortality, morbidity, persistency and interest rates relative to expected amounts used in pricing the Company's products;
- The performance of our investment portfolio, which may be adversely affected by changes in interest rates, adverse developments and ratings of issuers whose debt securities we may hold, and other adverse macroeconomic events;
- Results of litigation we may be involved in;
- Changes in assumptions related to deferred acquisition costs and the value of any businesses we may acquire;
- Regulatory, accounting or tax changes that may affect the cost of, or the demand for, the Company's products or services;
- Our concentration of business from persons residing in Latin America and the Pacific Rim;

Changes in tax laws;

Effects of acquisitions and restructuring, including possible difficulties in integrating and realizing the projected results of acquisitions;

Changes in statutory or U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), policies or practices;

Changes in leadership among our board and senior management team.

Our success at managing risks involved in the foregoing; and

The risk factors discussed in "Part II-Item 1A-Risk Factors" of this report.



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

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 report.

Overview

Citizens, Inc. ("Citizens" or the "Company") is an insurance holding company incorporated in Colorado serving the life insurance needs of individuals in the United States since 1969 and internationally since 1975. Through our insurance subsidiaries, we pursue a strategy of offering traditional insurance products in niche markets where we believe we are able to achieve competitive advantages. As of March 31, 2018, we had approximately \$1.6 billion of total assets and approximately \$4.4 billion of insurance in force. Our core insurance operations include issuing and servicing:

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

We were formed in 1969 and historically, our Company has experienced growth through acquisitions in the domestic market and through organic market expansion in the international market. We strive to generate bottom line returns using knowledge of our niche markets and our well-established distribution channels.

Strategic Initiatives

In 2015, we began a process to evaluate the expansion of our international footprint and initiated a strategic analysis of our current international business model. As a result of these strategic initiatives, on May 22, 2017, we incorporated CICA Life Ltd. in Bermuda, as a direct and wholly-owned subsidiary of the Company. On February 23, 2018, CICA Life Ltd. received its Class E, long term insurance license from the Bermuda Monetary Authority ("BMA") and we initially capitalized the entity. Bermuda was chosen for its strong regulatory environment and suitability with the Company's priorities to protect our customers. We expect to operate our international business from this entity beginning in 2018 related to current and new business.

The Company's Board of Directors and new executive management team are continuing their assessment of the Company's domestic and international business models and business strategies with the assistance and support of external consultants and advisors. Specifically, our evaluation of the Company's international business model is ongoing under the leadership of our new Chief Marketing Officer and our CEO. We are focused on (1) new products and our profitability in both the domestic and international markets of our Life Segment as well as our Homes Service Segment; (2) a potential restructuring of our international business and operations which may include a withdrawal

from certain markets; (3) a strategic modernization and upgrade from our legacy technology systems and IT operations with a focus on digitization, our future business needs and cyber risk; (4) effectively operating our international life insurance business offshore in Bermuda through CICA Life, Ltd. (Bermuda); and (5) assessing and optimizing our investment portfolio strategy.

As a result of the Company's strategic review, the Company announced in April 2018 that it had decided to discontinue accepting life insurance applications from Brazilian residents or citizens. Although the financial impact of this change is uncertain, the Company does not currently anticipate it to be material, due to the fact that less than 6% of premiums and less than 1% of the

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

Company's in force policies stem from applications underwritten on Brazilian residents or citizens as of December 31, 2017. The Company intends to continue fulfilling commitments under existing policies and to refocus its resources on other more attractive potential markets, products and opportunities. The Company is continuing with its strategic review and may make further changes to its business model in the future.

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

Current Financial Highlights

Financial highlights for the three month period ended March 31, 2018, compared to the same period in 2017 were:

Insurance premiums decreased slightly for the three month period ended March 31, 2018 totaling \$44.0 million down from \$45.4 million for the corresponding period in 2017, a decrease of 3.0% driven by declines in first year and renewal premiums in our Life segment.

Net investment income increased 8.1% for the three month period ended March 31, 2018, compared to the corresponding period in 2017, primarily due to a growing asset base from cash flows from our insurance operations. The average yield on the consolidated portfolio as of the three months ended March 31, 2018 was an annualized rate of 4.31% compared to 4.22% for the same period in 2017.

A realized loss of \$225,000 was recorded for the three month period ended March 31, 2018 related to an additional writedown on a single issuer. The company recorded a gain of \$1.1 million in the first quarter of 2017 on the sale of an office building in Little Rock, Arkansas. We also recorded losses of \$302,000 due to fair value changes related to equity securities still owned at March 31, 2018.

Claims and surrenders expense decreased 2.6% for the three month period ended March 31, 2018, compared to corresponding period in 2017.

General expenses decreased 35.9% for the three month period ended March 31, 2018, compared to the corresponding period in 2017, due primarily to a decrease of \$7.2 million in our 7702/72(s) tax compliance best estimate liability as we continue to refine our calculations and prepare to submit offers to enter into closing agreements with the IRS related to these matters. We did have additional costs from internal and external audit fees related to the 2017 audit and higher permanent salaries related to executive officers added in 2017 which are reported as of March 31, 2018. These higher expenses are offset partially by the 7702/72(s) items as noted.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

## Our Operating Segments

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

## Life Insurance

## Home Service Insurance

Our insurance operations are the primary focus of the Company, as those operations generate the majority of our income. See the discussion under Segment Operations for detailed analysis. The amount of insurance, number of policies, and average face amounts of ordinary life policies issued during the periods indicated are shown below.

	Three Months Ended March 31,		2017		2018	
	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	\$58,790,652	1,054	\$55,779	\$72,965,275	1,298	\$56,214
Home Service	49,947,692	6,838	7,304	50,864,113	7,429	6,847

Note: All discussions below compare or state results for the three-month period ended March 31, 2018 compared to the three-month period ended March 31, 2017.

## Consolidated Results of Operations

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

## Revenues

Revenues are generated primarily by insurance premiums and investment income on invested assets.

	Three Months Ended March 31,	
	2018	2017
	(In thousands)	
Revenues:		
Premiums:		
Life insurance	\$42,529	43,804
Accident and health insurance	291	328
Property insurance	1,209	1,249
Net investment income	13,771	12,739
Realized investment gains (losses), net	(575)	1,263
Other income	208	198
Total revenues	\$57,433	59,581



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

Premium Income. Premium income derived from life, accident and health, and property insurance sales decreased 3.0% for the three month period ended March 31, 2018 compared to the same period in 2017. The decrease is driven primarily by a decrease in first year and renewal premiums in our Life Segment. See the detail distribution of premiums below by segment.

Net investment income performance is summarized as follows.

	March 31, 2018	December 31, 2017	March 31, 2017
	(In thousands, except for %)		
Net investment income, annualized	\$55,084	53,146	50,956
Average invested assets, at amortized cost	1,277,670	1,233,580	1,208,149
Annualized yield on average invested assets	4.31 %	4.31 %	4.22 %

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

Investment income from debt securities accounted for approximately 87.8% of total investment income for the three months ended March 31, 2018.

	Three Months Ended March 31, 2018 2017 (In thousands)	
Gross investment income:		
Fixed maturity securities	\$12,424	11,505
Equity securities	160	192
Mortgage loans	3	3
Policy loans	1,535	1,387
Long-term investments	—	51
Other investment income	30	7
Total investment income	14,152	13,145
Investment expenses	(381 )	(406 )
Net investment income	\$13,771	12,739

The consolidated invested asset portfolio has increased approximately 0.3% from year end 2017 to March 31, 2018 with investments in the fixed maturity securities portfolio accounting for the increase in investment income. In addition, the increase in policy loans, which represents policyholders utilizing their accumulated policy cash value, contributed to the increase in investment income.

Realized Investment Gains (Losses), Net. Realized losses in the three months ended March 31, 2018 were related to losses on an additional bond issuer impairment of \$225,000. A realized gain was recorded for the three month period ended March 31, 2017 resulting from a \$1.1 million gain on the sale of an office building in Little Rock, Arkansas in the first quarter of 2017. One other-than-temporary impairment was recorded on a common stock in 2017 of \$17,000. We also recorded losses of \$302,000 due to fair value changes related to equity securities still owned at March 31, 2018.



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

## Benefits and Expenses

	Three Months Ended March 31, 2018      2017 (In thousands)	
Benefits and expenses:		
Insurance benefits paid or provided:		
Claims and surrenders	\$21,151	21,724
Increase in future policy benefit reserves	14,608	14,536
Policyholders' dividends	1,307	1,304
Total insurance benefits paid or provided	37,066	37,564
Commissions	8,959	9,925
Other general expenses	6,507	10,156
Capitalization of deferred policy acquisition costs	(5,963 )	(6,901 )
Amortization of deferred policy acquisition costs	7,606	7,375
Amortization of cost of customer relationships acquired	679	519
Total benefits and expenses	\$54,854	58,638

Claims and Surrenders. A detail of claims and surrender benefits is provided below.

	Three Months Ended March 31, 2018      2017 (In thousands)	
Death claims	\$6,183	6,304
Surrender benefits	9,159	9,830
Endowments	3,192	3,607
Matured endowments	1,424	649
Property claims	385	622
Accident and health benefits	81	92
Other policy benefits	727	620
Total claims and surrenders	\$21,151	21,724

- Death claims decreased 1.9% for the three months ended March 31, 2018 compared to the same period in 2017. Mortality experience is closely monitored by the Company and the activity is within expected levels.
- Surrenders decreased 6.8% for the three months ended March 31, 2018 compared to 2017 primarily due to activity in the life insurance segment.

Increase in Future Policy Benefit Reserves. The change in future policy benefit reserves was relatively flat for the three months ended March 31, 2018, compared to the same period in 2017.

Policyholders' Dividends. Policyholders' dividends were comparable for both the three months ended March 31, 2018 and March 31, 2017.





Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

Commissions. Commission expense for the three months ended March 31, 2018 fluctuated directly in relation to the decrease in first year and renewal premiums compared to premium levels for the three months ended March 31, 2017.

Other General Expenses. Expenses decreased for the three months ended March 31, 2018 due primarily to a decrease of \$7.1 million related to our 7702/72(s) tax compliance best estimate liability as we continue to refine our calculations and prepare to submit offers to enter into closing agreements with the IRS related to these matters. We did have additional costs from internal and external audit fees related to the 2017 audit and higher permanent salaries related to executive officers added in 2017 which are reported as of March 31, 2018. These higher expenses are offset partially by the 7702/72(s) items as noted.

Capitalized and Amortized Deferred Policy Acquisition Costs. Costs capitalized include certain commissions, policy issuance costs, and underwriting and agency expenses that relate to successful sales efforts for insurance contracts. The decrease for the three months ended March 31, 2018, compared to the same period in 2017 was the result of a decline in first year premium production in the current period, which decreased capitalized amounts. Commissions paid on renewal premiums are significantly lower than those paid on first year business.

Amortization for the three months ended March 31, 2018, increased compared to the same period in 2017.

Amortization of deferred policy acquisition costs is impacted by persistency and may fluctuate from year to year.

Federal Income Tax. The effective tax rate was 98.6% and (118.0)% for the three months ended March 31, 2018 and 2017, respectively. Additionally there is \$0.7 million of tax expense and \$0.8 million tax benefit related to an uncertain tax position in the three months ended March 31, 2018 and March 31, 2017, respectively. Differences between our effective tax rate and the statutory tax rate result from income and expense items that are treated differently for financial reporting and tax purposes, as well as impacts from our tax compliance issues and uncertain tax positions. See Note 9 - Income Taxes in the consolidated financial statements for further discussion.

## Segment Operations

The Company has two reportable segments: Life Insurance and Home Service Insurance. These segments are reported in accordance with U.S. GAAP. The Company also operates other non-insurance portions of the Company, which primarily include the Company's IT and Corporate-support functions, which are included in the table presented below to properly reconcile the segment information with the consolidated financial statements of the Company. The Company evaluates profit and loss performance of its segments based on net income before income taxes.

	Three Months Ended March 31, 2018    2017	
Segments:	(In thousands)	
Life Insurance	\$5,948	1,679
Home Service Insurance	(1,823 )	260
Total Segments	4,125	1,939
Other Non-Insurance Enterprises	(1,546 )	(996 )
Income before federal income tax	\$2,579	943

## Life Insurance

Our Life Insurance segment issues ordinary whole life insurance in the United States 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 and can utilize rider benefits to provide additional increasing or decreasing coverage and annuity benefits to enhance accumulations. Additionally, endowment contracts are issued by the Company, which are principally accumulation contracts that

32

---

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

incorporate an element of life insurance protection. For the majority of our business, we retain the first \$100,000 of risk on any one life, reinsuring the remainder of the risk. We operate this segment through our CICA and CNLIC insurance subsidiaries.

International Sales

We focus our sales of U.S. Dollar-denominated ordinary whole life insurance and endowment policies to residents in Latin America and the Pacific Rim. We have participated in the foreign marketplace since 1975. 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 reduces our administrative expenses, accelerates cash flow and results in lower policy lapse rates than premiums with more frequently scheduled payments; and
- persistency experience and mortality rates that are comparable to U.S. policies.

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, the owner becomes entitled to policy cash dividends as well as annual premium benefits, if the annual premium benefit was elected. According to the policy language, the policyowner has several options with regard to the policy dividends and annual premium benefits. Any annual policy cash dividend may, at the option of the policyowner and provided the value of a dividend is not encumbered by a policy loan, be applied under one of the following options: (1) paid in cash to the policy owner; (2) credited toward payment of premiums on the policy; (3) left with the Company to accumulate at a defined interest rate; (4) applied to increase the amount of insurance benefit by purchase of paid-up additions to the policy; or (5) be assigned to a third party. If the policy is encumbered by a loan, only option 3 will apply to secure the outstanding loan. Similarly, all annual premium benefits credited to the policy may at the option of the policyowner, and provided the policy is not encumbered by a policy loan, be applied under one of the following options: (1) paid in cash to the policy owner; (2) credited toward payment of premiums on the policy; (3) left with the Company to accumulate at an annually company declared interest rate; or (4) be assigned to a third party. Likewise, if the policy is encumbered by a loan, only option (3) will apply to secure the outstanding loan. Under the “assigned to a third party” provision, the Company has historically allowed policyowners, only after receiving a copy of the Citizens, Inc. Stock Investment Plan (the “CISIP”) prospectus and acknowledging their understanding of the risks of investing in Citizens stock, the right to assign policy values

outside of the policy to the CISIP, which is administered in the United States by Computershare, our plan administrator and transfer agent. The CISIP is a direct stock purchase plan available to our policyowners, our shareholders, our employees, our independent consultants, and other potential investors through the Computershare website. The Company has registered the shares of Class A common stock issuable to participants under the CISIP on a registration statement under the Securities Act of 1933, as amended (the "Securities Act") that is on file with the Securities and Exchange Commission. Computershare administers the CISIP in accordance with the terms and conditions of the CISIP, which is available on the Computershare website and as part of the Company's registration statement on file with the Securities and Exchange Commission.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

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

Country	Three Months Ended March 31,	
	2018	2017
	(In thousands)	
Colombia	\$6,053	6,386
Venezuela	6,041	6,766
Taiwan	4,792	5,107
Ecuador	3,664	3,562
Brazil	2,111	2,090
Other Non-U.S.	8,579	8,593
Total	\$31,240	32,504

We have noted declines in premiums during the first quarter of 2018 and will continue to monitor key indicators in these markets for signs of weakening sales. This business is dependent on our clients having access to U.S. dollars. Our international business may also be affected by economic or other events in foreign countries in which our policies are marketed. Venezuela, for example, is continuing to experience civil unrest due to local demonstrations against crime, corruption and soaring inflation and conditions have recently worsened due to political unrest and deteriorating economic conditions. As shown above, direct premiums from Venezuela have already begun to decline, and we expect that overall premiums from Venezuela will continue to decline if the deteriorating political and economic environment continues to adversely impact our ability to make sales and collect premiums. Our international business and premium collections also could be impacted by our inability to comply with current or future foreign laws or regulations applicable to the Company or our independent consultants in the countries from which we accept applications as well as by marketing or operational changes made by the Company to comply with those laws or regulations. See "Item 1A. Risk Factors" for additional information.

## Domestic Sales

The majority of our domestic inforce business results from blocks of business of insurance companies we have acquired over the past 20 years. We discontinued new sales of our non-home service domestic products beginning January 1, 2017.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

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

	Three Months Ended March 31, 2018 2017	
	(In thousands)	
State		
Texas	\$390	476
Indiana	278	314
Florida	146	143
Missouri	102	113
Kentucky	49	83
Other States	440	511
Total	\$1,405	1,640

We report premiums based upon the current residence of our policyholders and therefore the increase in premiums received from Florida are related to policyholders moving into that state and updating their state of residence. 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 the majority of our accident and health insurance business to an unaffiliated insurance company under a coinsurance agreement.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

The results of operations for the life insurance segment for the periods indicated are as follows.

	Three Months Ended March 31, 2018      2017 (In thousands)	
Revenue:		
Premiums	\$32,360	33,563
Net investment income	10,130	9,131
Realized investment gains (losses), net	(185 )	77
Other income	209	118
Total revenue	42,514	42,889
Benefits and expenses:		
Insurance benefits paid or provided:		
Claims and surrenders	15,291	15,676
Increase in future policy benefit reserves	13,582	13,260
Policyholders' dividends	1,297	1,295
Total insurance benefits paid or provided	30,170	30,231
Commissions	5,228	6,007
Other general expenses	(884 )	3,872
Capitalization of deferred policy acquisition costs	(4,640 )	(5,378 )
Amortization of deferred policy acquisition costs	6,540	6,306
Amortization of cost of customer relationships acquired	152	172
Total benefits and expenses	36,566	41,210
Income before income tax expense	\$5,948	1,679

Premiums. Premium revenues decreased for the three months ended March 31, 2018, compared to the same period in 2017 due primarily to a decrease in both first year and renewal international business. First year premium revenues have declined for the three months ended March 31, 2018, primarily as a result of the decrease in applications received from Venezuela as noted previously. Sales internationally have continued to be driven by our endowment to age sixty-five and the twenty-year endowment products which have been the top performers in the last several years.

Life insurance premium breakout is detailed below.

	Three Months Ended March 31, 2018      2017 (In thousands)	
Premiums:		
First year	\$3,074	4,173
Renewal	29,286	29,390
Total premiums	\$32,360	33,563



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

Net Investment Income. Net investment income increased primarily due to the growth in average invested assets.

	Three Months Ended March 31, 2018	Year Ended December 31, 2017	Three Months Ended March 31, 2017
(In thousands, except for %)			
Net investment income, annualized	\$40,520	38,578	36,524
Average invested assets, at amortized cost	938,665	890,705	862,621
Annualized yield on average invested assets	4.32 %	4.33 %	4.23 %

Realized Investment Losses, Net. Realized investment losses recorded for the three month period ended March 31, 2018 were primarily due to an additional impairment of one single issuer which totaled \$150,000.

Claims and Surrenders. These amounts fluctuate from period to period but were within anticipated ranges based upon management's expectations.

	Three Months Ended March 31, 2018 2017	
(In thousands)		
Death claims	\$1,599	1,795
Surrender benefits	8,424	9,112
Endowment benefits	3,189	3,598
Matured endowments	1,302	502
Accident and health benefits	54	52
Other policy benefits	723	617
Total claims and surrenders	\$15,291	15,676

Death claims expense was favorable for the three months ended March 31, 2018 compared with the same period in 2017. Mortality experience is closely monitored by the Company as a key performance indicator and these amounts were within expected levels.

Surrenders decreased in the three month period ended March 31, 2018 by 7.6% compared to 2017. The majority of policy surrender benefits paid is attributable to our international business and is in the later durations after the surrender charges are reduced or for periods in which the surrender charges have concluded. This is due to a maturing book of business.

Endowment benefit expense primarily results from the election by policyholders of a product feature providing an annual guaranteed benefit. This is a fixed benefit over the life of the contract, thus this expense will vary with new sales and persistency of the business.

Matured endowments increased for the three month period ended March 31, 2018, compared to 2017, as more policies reached maturity in the current periods. We anticipate this trend will continue as endowments products age toward maturity.

Other policy benefits resulted primarily from interest paid on premium deposits and policy benefit accumulations.

Increase in Future Policy Benefit Reserves. The change in policy benefit reserves increased for the three months ended March 31, 2018 compared to the same period in 2017, primarily impacted by the surrender activity noted

above.

Policyholders' Dividends. Policyholders' dividends were comparable for both the three months ended March 31, 2018, and March 31, 2017, as we adjusted our dividend rates for later durations in our policies beginning in 2016.

37

---

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

Commissions. Commission expense decreased for the three months ended March 31, 2018, compared to the same period in 2017. This expense fluctuates directly with new premium revenues and commission rates paid are higher on first year premium sales, which were down for the three months ended March 31, 2018, compared to the same period in 2017. Renewal premiums for the three months, for which we pay commissions at lower rates, also decreased from the prior year.

Other General Expenses. These expenses are allocated by segment, based upon an annual expense study performed by the Company. Expenses declined during the three months ended March 31, 2018, compared to the same period in 2017 due primarily to a decrease of \$7.5 million related to our 7702/72(s) tax compliance best estimate liability which was adjusted down as we refined our estimate in preparation for submitting offers to enter into closing agreements with the IRS. This decline offset higher expenses related to internal and external audit fees and higher permanent salaries.

Capitalization of Deferred Policy Acquisition Costs ("DAC"). Capitalized costs fluctuate in direct relation to commissions, decreasing for the three months ended March 31, 2018, based upon first year and renewal premiums and commissions paid compared to the same period in 2017.

Amortization of Deferred Policy Acquisition Costs. Amortization for the three months ended March 31, 2018 increased compared to the same period in 2017. As previously noted, persistency is monitored closely by the Company and was within expectations.

## Home Service Insurance

We operate in the Home Service insurance market through our subsidiaries Security Plan Life Insurance Company ("SPLIC"), Magnolia Guaranty Life Insurance Company ("MGLIC") 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 employee-agents who work full time on a route system and through funeral homes that sell policies, collect premiums and service policyholders.

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

	Three Months Ended March 31, 2018    2017	
	(In thousands)	
State		
Louisiana	\$10,670	10,652
Mississippi	567	701
Arkansas	416	458
Other States	231	219
Total	\$11,884	12,030

## Home Service Insurance Products

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. To a much

lesser extent, our home service insurance segment sells limited-liability, named-peril property policies covering dwellings and contents. We provide \$30,000 maximum coverage on any one dwelling and contents, while content only coverage and dwelling only coverage is limited to \$20,000, respectively.

We provide final expense ordinary life insurance and annuity products primarily to middle and lower income individuals in Louisiana, Mississippi and Arkansas.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

The results of operations for the home service insurance segment for the periods indicated are as follows.

	Three Months Ended March 31, 2018      2017	
	(In thousands)	
Revenue:		
Premiums	\$11,669	11,818
Net investment income	3,302	3,259
Realized investment gains (losses), net	(352 )	1,186
Other income	(1 )	(1 )
Total revenue	14,618	16,262
Benefits and expenses:		
Insurance benefits paid or provided:		
Claims and surrenders	5,860	6,048
Increase in future policy benefit reserves	1,026	1,276
Policyholders' dividends	10	9
Total insurance benefits paid or provided	6,896	7,333
Commissions	3,731	3,918
Other general expenses	5,544	4,858
Capitalization of deferred policy acquisition costs	(1,323 )	(1,523 )
Amortization of deferred policy acquisition costs	1,066	1,069
Amortization of cost of customer relationships acquired	527	347
Total benefits and expenses	16,441	16,002
Income (loss) before income tax expense	\$(1,823 )	260

Premiums. Premiums were down for the three month periods ended March 31, 2018, compared to the same period in 2017. For the three month period ended March 31, 2018, first year premiums were down 3.9% and renewal premiums were also down by 0.8%.

Net Investment Income. Net investment income for our home service insurance segment was as follows.

	Three Months Ended March 31, 2018	Year Ended December 31, 2017	Three Months Ended March 31, 2017
	(In thousands, except for %)		
Net investment income, annualized	\$13,208	13,132	13,036
Average invested assets, at amortized cost	291,301	289,634	289,792
Annualized yield on average invested assets	4.53 %	4.53 %	4.50 %

Realized Investment Gains (Losses), Net. During the three months ended March 31, 2018 net losses were recorded related to an additional impairment on one bond issuer totaling \$75,000. A realized gain was recorded for the three month period ended March 31, 2017 of \$1.1 million related to our first quarter 2017 sale of an office building in Little

Rock, Arkansas. We also recorded losses of \$259,000 due to fair value changes related to equity securities still owned at March 31, 2018.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

Claims and Surrenders. Claims and surrenders decreased for the three months ended March 31, 2018, compared to the same period in 2017, based upon reported claims compared to the prior year, but were within expected ranges.

	Three Months Ended March 31, 2018 2017 (In thousands)	
Death claims	\$4,584	4,509
Surrender benefits	735	718
Endowment benefits	3	9
Matured endowments	122	147
Property claims	385	622
Accident and health benefits	27	40
Other policy benefits	4	3
Total claims and surrenders	\$5,860	6,048

Death claims expense fluctuates based upon reported claims. We experienced similar reported claims in the three months ended March 31, 2018 compared to the same period in 2017. Mortality experience is closely monitored by the Company as a key performance indicator and amounts were within expected levels.

Surrender benefits increased slightly for the three months ended March 31, 2018 compared to the same period in 2017.

Property claims decreased for the three months ended March 31, 2018 as we experienced fewer weather-related claims in the first three months of 2018 compared to the same period in 2017.

Increase in Future Policy Benefit Reserves. The change in future policy benefit reserves for the three months ended March 31, 2018, was relatively flat compared to the same period in 2017.

Commissions. Commission expense decreased for the three months ended March 31, 2018, compared to the same period in 2017, consistent with premium collections.

Other General Expenses. Expenses are allocated by segment based upon an annual expense study performed by the Company. The expenses increased between 2018 and 2017 due primarily to additional internal and external audit fees and added executive salaries.

Capitalization of Deferred Policy Acquisition Costs ("DAC"). Capitalized costs decreased for the three months ended March 31, 2018, as commission expense decreased during the period. DAC capitalization is directly correlated to fluctuations in new business and commissions.

Amortization of Deferred Policy Acquisition Costs. Amortization for the three months ended March 31, 2018 decreased compared to the corresponding period in 2017 and remained generally in line with this segment experienced persistency.

**Other Non-Insurance Enterprises**

This represents the administrative support entities to the insurance operations whose revenues are primarily intercompany and have been eliminated in consolidation under GAAP. The loss reported for the three months of 2018

and 2017 is typical since the elimination of intercompany revenue is its primary source of revenue.



Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

## Investments

The administration of our investment portfolios is handled by our management, pursuant to board-approved investment guidelines, with all trading activity approved by a committee of each entity's respective boards of directors. The guidelines used require that fixed maturities, both government and corporate, are 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 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 cash, cash equivalents and investments.

	March 31, 2018		December 31, 2017	
	Carrying Value	% of Total Carrying Value	Carrying Value	% of Total Carrying Value
	(In thousands)		(In thousands)	
Marketable debt securities:				
U.S. Treasury and U.S. Government-sponsored enterprises	\$ 15,865	1.2	\$ 16,304	1.2
States and political subdivisions	780,303	57.8	780,557	57.7
Corporate	413,796	30.6	409,610	30.4
Mortgage-backed <sup>(1)</sup>	1,715	0.1	1,978	0.1
Foreign governments	121	—	121	—
Total fixed maturity securities	1,211,800	89.7	1,208,570	89.4
Cash and cash equivalents	41,247	3.1	46,064	3.4
Other investments:				
Policy loans	75,636	5.6	73,735	5.5
Equity securities	15,449	1.1	16,164	1.2
Mortgage loans	193	—	195	—
Real estate held for investment	7,334	0.5	7,416	0.5
Other long-term investments	35	—	36	—
Total cash, cash equivalents and investments	\$ 1,351,694	100.0	\$ 1,352,180	100.0

<sup>(1)</sup> Includes \$1.5 million and \$1.8 million of U.S. Government-sponsored enterprises at March 31, 2018 and December 31, 2017, respectively.

Cash and cash equivalents decreased as of March 31, 2018 due to timing of cash inflows and investment of cash into marketable securities.

The held-to-maturity portfolio as of March 31, 2018 represented 19.0% of the total fixed maturity securities owned based upon carrying values, with the remaining 81.0% classified as available-for-sale. Held-to-maturity securities are reported in the financial statements at amortized cost and available-for-sale securities are reported at fair value.

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

The following table sets forth the distribution of the credit ratings of our portfolio of fixed maturity securities by carrying value as of March 31, 2018 and December 31, 2017.

	March 31, 2018		December 31, 2017	
	Carrying Value (In thousands)	% of Total Carrying Value	Carrying Value (In thousands)	% of Total Carrying Value
AAA	\$92,506	7.6	\$93,911	7.8
AA	488,509	40.3	488,675	40.4
A	311,881	25.8	325,476	27.0
BBB	284,777	23.5	266,461	22.0
BB and other	34,127	2.8	34,047	2.8
Totals	\$1,211,800	100.0	\$1,208,570	100.0

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 or Fitch Ratings. A credit rating assigned by an 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 an NRSRO are included in the “other” category.

The Company has no direct sovereign European debt exposure as of March 31, 2018. We do have indirect exposure in one bond mutual fund holding, but the amount is deemed immaterial to the current investment holdings and consolidated financials.

As of March 31, 2018, 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.

## Municipal securities shown including third party guarantees

	March 31, 2018						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	Fair Value	Amortized Cost	
	(In thousands)								
AAA	\$58,052	56,855	32,207	31,797	—	—	90,259	88,652	11.5
AA	169,669	166,271	268,472	263,651	24,975	24,251	463,116	454,173	59.1
A	26,599	26,564	157,430	151,356	10,970	10,433	194,999	188,353	24.5
BBB	6,994	7,298	21,849	21,623	1,957	2,012	30,800	30,933	4.0
BB and other	4,082	4,438	2,084	2,587	—	—	6,166	7,025	0.9
Total	\$265,396	261,426	482,042	471,014	37,902	36,696	785,340	769,136	100.0

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

## Municipal securities shown excluding third party guarantees

	March 31, 2018		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)								
AAA	\$23,666	23,527	29,553	29,259	—	—	53,219	52,786	6.9
AA	158,971	156,092	195,163	191,836	17,958	17,220	372,092	365,148	47.5
A	44,437	44,154	193,664	186,773	13,652	13,157	251,753	244,084	31.7
BBB	13,181	13,331	33,960	33,787	1,956	2,012	49,097	49,130	6.4
BB and other	25,141	24,322	29,702	29,359	4,336	4,307	59,179	57,988	7.5
Total	\$265,396	261,426	482,042	471,014	37,902	36,696	785,340	769,136	100.0

The Company held investments in special revenue bonds that had a greater than 10% exposure based upon activity as noted in the table below.

	Fair Value	Amortized Cost	% of Total Fair Value
	(In thousands)		
Utilities	\$157,406	152,166	20.0%
Education	115,803	112,431	14.8%
General Obligations	81,332	79,905	10.4%

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

The Company's exposure of municipal holdings is spread across many states, with Texas and Florida as the two states with the largest municipal holdings as of March 31, 2018. The Company holds 21.9% of its municipal security holdings in Texas issuers and 11.8% in Florida issuers based on fair value. There were no other states or individual issuer holdings that represented or exceeded 10% of the total municipal portfolio as of March 31, 2018. The tables below represent the exposure the Company holds in these two states.

	March 31, 2018							
	General Obligation		Special Revenue		Other		Total	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost
(In thousands)								
Texas securities including third party guarantees								
AAA	\$56,034	54,876	14,820	14,408	—	—	70,854	69,284
AA	46,788	46,330	30,173	29,626	—	—	76,961	75,956
A	—	—	15,299	14,841	—	—	15,299	14,841
BBB	—	—	6,888	6,562	—	—	6,888	6,562
BB and other	752	752	1,313	1,813	—	—	2,065	2,565
Total	\$103,574	101,958	68,493	67,250	—	—	172,067	169,208
Texas securities excluding third party guarantees								
AAA	\$21,648	21,547	12,167	11,870	—	—	33,815	33,417
AA	72,354	71,049	20,989	20,551	—	—	93,343	91,600
A	6,533	6,443	24,482	23,916	—	—	31,015	30,359
BBB	1,220	1,162	7,438	7,106	—	—	8,658	8,268
BB and other	1,819	1,757	3,417	3,807	—	—	5,236	5,564
Total	\$103,574	101,958	68,493	67,250	—	—	172,067	169,208

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

	March 31, 2018							
	General Obligation		Special Revenue		Other		Total	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost
	(In thousands)							
Florida securities including third party guarantees								
AAA	\$518	509	3,616	3,551	—	—	4,134	4,060
AA	—	—	58,967	58,162	5,227	5,246	64,194	63,408
A	—	—	13,889	13,570	10,745	10,209	24,634	23,779
BBB	—	—	—	—	—	—	—	—
BB and other	—	—	—	—	—	—	—	—
Total	\$518	509	76,472	75,283	15,972	15,455	92,962	91,247
Florida securities excluding third party guarantees								
AAA	\$518	509	3,616	3,551	—	—	4,134	4,060
AA	—	—	49,172	48,547	5,227	5,246	54,399	53,793
A	—	—	21,148	20,770	10,745	10,209	31,893	30,979
BBB	—	—	—	—	—	—	—	—
BB and other	—	—	2,536	2,415	—	—	2,536	2,415
Total	\$518	509	76,472	75,283	15,972	15,455	92,962	91,247

## Valuation of Investments

We evaluate the carrying value of our fixed maturity and equity securities at least quarterly. The Company monitors all debt and equity securities on an on-going basis relative to changes in credit ratings, market prices, earnings trends and financial performance, in addition to specific region or industry reviews. The assessment of whether other-than-temporary impairments have occurred is based on a case-by-case evaluation of underlying reasons for the decline in fair value. The Company determines other-than-temporary impairment by reviewing all relevant evidence related to the specific security issuer as well as the Company's intent to sell the security, or if it is more likely than not that the Company would be required to sell a security before recovery of its amortized cost.

When an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the investment's cost and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is separated into the following: a) the amount representing the credit loss; and b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings becomes the new amortized cost basis of the investment. The new amortized cost basis is not adjusted for subsequent recoveries in fair value.



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

The Company recognized other-than-temporary impairments of \$225,000 on one bond issuer for the three months ended March 31, 2018 and \$17,000 for the three months ended March 31, 2017 on one equity security that were in an unrealized loss position for greater than one year.

Liquidity and Capital Resources

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

Liquidity requirements of the Company are met primarily by funds provided from operations. Premium deposits and revenues, investment income and investment maturities are the primary sources of funds, while investment purchases, policy benefits, and operating expenses are the primary uses of funds. We historically have not had to liquidate investments to provide cash flow and did not do so during the first three months of 2018. Our investments as of March 31, 2018, consist of 74.9% of marketable debt securities classified as available-for-sale that could be readily converted to cash for liquidity needs.

Our whole life and endowment products provide the policyholder with alternative election decisions once the policy matures. The policyholder can choose to take a lump sum payout or leave the money on deposit at interest with the Company. The Company has a significant amount of endowment products representing approximately 45-49% of total inforce with older contracts sold historically that will begin reaching their maturities over the next several years and policyholder election behavior is not known. If policyholders elect lump sum distributions, the Company could be exposed to liquidity risk in years of high maturities. Meeting these distributions could require the Company to sell securities at inopportune times to pay policyholder withdrawals. Alternatively, if the policyholder were to leave the money on deposit with the Company at interest, our profitability could be impacted if the product guaranteed rate is higher than the current market rate we can earn on our investments. We currently anticipate that available liquidity sources and future cash flows will be adequate to meet our needs for funds, but we will monitor closely our policyholder behavior patterns.

A large portion of our debt security investment portfolio will mature in the next seven years and could be called sooner as we were subject to significant call activity beginning in 2009 due to the declining interest rate environment and we reinvested into shorter durations that are now approaching maturity. We will need to reinvest these maturing funds in the current interest rate environment. Our profitability could be negatively impacted depending on the market rates at the time of reinvestment. This could result in a decrease in our spread between our policy liability crediting rates and our investment earned rates. This could also negatively impact our liquidity.

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

Cash flows from our insurance operations historically have been sufficient to meet current needs. Cash flows from operating activities were \$22.0 million and \$21.6 million for the three months ended March 31, 2018 and March 31, 2017, respectively. We have traditionally also had significant cash flows from both scheduled and unscheduled investment security maturities, redemptions, and prepayments. These cash flows, for the most part, are reinvested in fixed income securities. Net cash outflows from investing activities totaled \$27.1 million and \$17.3 million for the three months ended March 31, 2018 and March 31, 2017, respectively. The investing activities fluctuate from period to period due to timing of securities activities such as calls and maturities and reinvestment of those funds.

In 2015, we determined that a portion of the life insurance and annuity policies issued by our subsidiary insurance companies failed to qualify for the favorable U.S. federal income tax treatment afforded by Sections 7702 and 72(s) of the Internal Revenue



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

Code ("IRC") of 1986. As of March 31, 2018, we have established a liability reserve of \$5.1 million, net of tax, for probable liabilities and expenses associated with this tax compliance matter, which represents management's estimate and we have disclosed an estimated range related to probable liabilities and expenses of \$4.2 million to \$45.5 million, net of tax. This estimate and range includes projected toll charges and fees payable to the IRS, as well as any other costs attributed to remediation of non-compliant domestic life insurance. The amount of our liabilities and expenses depends on a number of uncertainties, including the number of prior tax years for which we may be liable to the IRS, the number of domestic life insurance policies we will be required to remediate, and the methodology applicable to the calculation of taxable benefits under non-compliant policies. Given the range of potential outcomes and the significant variables assumed in establishing our estimates, actual amounts incurred may exceed our reserve and also could exceed the high end of our estimated range of liabilities and expenses.

In May 2017, we submitted an offer under Rev Proc 2008-40 to enter into closing agreements with the IRS covering certain CICA and CNLIC domestic life insurance contracts. A voluntary, taxpayer-initiated closing agreement under this IRS revenue procedure generally addresses situations where a taxpayer has inadvertently failed to meet the requirements of Internal Revenue Code section 7702, which defines life insurance for federal tax purposes. A voluntary closing agreement allows taxpayers to come forward to the IRS with self-identified violations or deficiencies and work with the IRS towards a mutual resolution to correct the violations or deficiencies. The consideration offered by CICA and CNLIC under the proposed closing agreements totaled approximately \$124,000 and \$4,000, respectively. The consideration that will be required under the final closing agreements could be different and will depend on how the IRS responds to the closing agreements offer. We expect to file other offers for additional closing agreements with the IRS for the SPLIC and MGLIC life insurance businesses, the CICA international life insurance business and our annuity business in 2018.

This tax compliance issue impacts our policyholders and their tax liabilities relative to these products that fail 7702 and 72(s) for those that will not be remediated. The exposure related to future sales or products in force is unknown at this time. Policyholders could decide to surrender their policies due to this issue which would subsequently result in higher cash outflows due to an increase in surrender activity.

Dividends are declared and paid from time to time from the insurance affiliates as determined by their respective boards.

The NAIC has established minimum capital requirements in the form of Risk-Based Capital ("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 RBC fall below 200%, a series of remedial actions by the affected company would be required. Capital balances could be impacted by this tax compliance issue for the insurance companies affected. The holding company would anticipate funding the life companies as needed to keep capital amounts within required levels.

All insurance subsidiaries were above the RBC minimums at March 31, 2018.

Contractual Obligations and Off-balance Sheet Arrangements

There have been no material changes in contractual obligations from those reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. The Company does not have off-balance sheet arrangements at March 31, 2018. We do not utilize special purpose entities as investment vehicles, nor are there any such entities in

which we have an investment that engage in speculative activities of any nature, and we do not use such investments to hedge our investment positions.

#### Parent Company Liquidity and Capital Resources

Citizens is a holding company and has had minimal operations of its own. Its assets consist primarily of the capital stock of its subsidiaries, cash, fixed income securities, mutual funds and investment real estate. Accordingly, Citizens' cash flows depend upon the availability of statutorily permissible payments, primarily payments under management agreements from its two primary life insurance subsidiaries, CICA and SPLIC. The ability to make payments is limited by applicable laws and regulations of

Table of Contents

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

Colorado, CICA's state of domicile, and Louisiana, SPLIC's state of domicile, which subject insurance operations to significant regulatory restrictions. These laws and regulations require, among other things, that these insurance subsidiaries maintain minimum solvency requirements and limit the amount of dividends these subsidiaries can pay to the holding company. Citizens historically has not relied upon dividends from subsidiaries for its cash flow needs. However, CICA and SPLIC do dividend available funds from time to time in relation to new acquisition target strategies.

## Critical Accounting Policies

We have prepared a current assessment of our critical accounting policies and estimates in connection with preparing our interim unaudited consolidated financial statements as of and for the three months ended March 31, 2018 and March 31, 2017. We believe that the accounting policies set forth in the Notes to our Consolidated Financial Statements and "Critical Accounting Policies and Estimates" in the Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2017 continue to describe the significant judgments and estimates used in the preparation of our consolidated financial statements.

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

## General

The nature of our business exposes us to market risk relative to our invested assets and policy liabilities. Market risk is the risk of loss that may occur when changes in interest rates and public equity prices adversely affect the value of our invested assets. Interest rate risk is our primary market risk exposure. Substantial and sustained increases and decreases in market interest rates can affect the fair value of our investments. The fair value of our fixed maturity portfolio generally increases when interest rates decrease and decreases when interest rates increase. For additional information regarding market risks to which we are subject, see "Item 1. Financial Statements - Note 5. Investments - Valuation of Investments in Fixed Maturity and Equity Securities" above.

The following table summarizes net unrealized gains and losses as of the dates indicated.

	March 31, 2018			December 31, 2017		
	Amortized Cost	Fair Value	Net Unrealized Gains	Amortized Cost	Fair Value	Net Unrealized Gains
	(In thousands)					
Fixed maturities, available-for-sale	\$960,303	981,095	20,792	935,977	974,609	38,632
Fixed maturities, held-to-maturity	230,705	235,827	5,122	233,961	241,377	7,416
Total fixed maturities	\$1,191,008	1,216,922	25,914	1,169,938	1,215,986	46,048
Total equity securities	\$14,907	15,449	542	15,289	16,164	875

## Market Risk Related to Interest Rates

Our exposure to interest rate changes results from our significant holdings of fixed maturity investments, which comprised 92.5% of our investment portfolio based on carrying value as of March 31, 2018. These investments are mainly exposed to changes in U.S. Treasury rates. Our fixed maturity investments include U.S. Government-sponsored enterprises, U.S. Government bonds, securities issued by government agencies, municipal

bonds and corporate bonds.

To manage interest rate risk, we perform periodic projections of asset and liability cash flows to evaluate the potential sensitivity of our investments and liabilities. We assess interest rate sensitivity annually with respect to our available-for-sale fixed maturities

48

---

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

investments using hypothetical test scenarios that assume either upward or downward shifts in the prevailing interest rates. The changes in fair values of our debt and equity securities as of March 31, 2018 were within the expected range of this analysis.

Changes in interest rates typically have a sizable effect on the fair values of our debt and equity securities. The interest rate of the ten-year U.S. Treasury bond increased to 2.74% during the three months ended March 31, 2018, from 2.40% at December 31, 2017. Net unrealized gains on fixed maturity securities totaled \$26.0 million at March 31, 2018, compared to \$46.0 million at December 31, 2017.

The fixed maturity portfolio is exposed to call risk, as a significant portion of the current bond holdings are callable. A decreasing interest rate environment can result in increased call activity as experienced over the past several years, and an increasing rate environment will likely result in securities being paid at their stated maturity.

There are no fixed maturities or other investments classified as trading instruments. Approximately 80.6% of fixed maturities were held in available-for-sale and 19.4% in held-to-maturity based upon fair value at March 31, 2018. At March 31, 2018 and December 31, 2017, we had no investments in derivative instruments, nor did we have any subprime or collateralized debt obligation risk.

Market Risk Related to Equity Prices

Changes in the level or volatility of equity prices affect the value of equity securities we hold as investments. Our equity investments portfolio represented 1.2% of our total investments at March 31, 2018, with 98.9% invested in diversified equity and bond mutual funds. We believe that significant decreases in the equity markets would not have a material adverse impact on our total investment portfolio.

Item 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, to allow timely decisions regarding required disclosures.

Our management, including our principal executive officer, principal financial officer, principal accounting officer and principal operating officer, evaluated the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) under the Exchange Act as of March 31, 2018. Based on such evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective due to the material weaknesses in internal control over financial reporting that were reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 ("2017 Annual Report"), which remain unremediated as of March 31, 2018.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

During the three months ended March 31, 2018, there were no changes in the Company's internal controls over financial reporting (as defined in rules 13a-15(f) and 15d-15(f) under the Exchange Act) that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

STATUS OF REMEDIATION OF MATERIAL WEAKNESSES

While we have made progress on strengthening our internal controls relative to the previously identified material weaknesses, material weaknesses continue to exist. Management, with oversight from our principal executive officer and principal financial officer, has identified and initiated actions that, once fully implemented and operating for a sufficient period of time, are designed to remediate the material weaknesses in each of the five components of internal control (control environment, risk assessment, control activities, information and communication, and monitoring) as defined by the Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO 2013") identified in the Company's 2017 Annual Report. Specifically, the Company intends to take the following actions to remediate the Company's identified material weaknesses:

- For information technology, design and implement controls related to user access, privileged access and change management processes that operate effectively;
- Perform user acceptance testing of system generated reports that are used in the operation of business process and management review controls to provide a baseline to support reliance on change management controls going forward;
- Implement an End User Control ("EUC") Policy, which includes (i) an inventory and risk assessment of all financially relevant spreadsheets, and (ii) designing and implementing EUC controls over the accuracy and completeness of those spreadsheets;
- Reevaluate the design of business process and management review controls with a focus on the precision of those controls;
- Review and enhance the design of outsourced service provider controls used to monitor processes that are outsourced to third parties, including the precision of any monitoring, business process, information technology and management review controls;
- Enhance and deliver COSO 2013 internal control awareness training for all relevant employees;
- Conduct a comprehensive risk assessment which will include a focus on risks related to processing and reporting financial information that are relevant for the Company, our products and our geographies; and
- Reevaluate the criteria established in COSO 2013 to make further enhancements to entity-level controls in order to demonstrate that our internal controls framework addresses relevant principles and points of focus of COSO 2013.

We will make further changes as appropriate. We believe the remediation steps outlined above have improved and will continue to improve the effectiveness of our internal control over financial reporting and our compliance with the COSO 2013 framework as a whole. We will test the ongoing operating effectiveness of all new controls subsequent to implementation and consider the material weaknesses remediated after the applicable remedial controls operate effectively for a sufficient period of time.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

On or about March 16, 2017, Juan Gamboa filed a putative class action lawsuit against the Company and five of its current and former directors and executive officers in the United States District Court, Western District of Texas. The lawsuit alleges the defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by making false and/or misleading statements, as well as failing to disclose material adverse facts about the Company's business, operations and prospects. On May 25, 2017, the court appointed lead plaintiffs, and on July 31, 2017, the lead plaintiffs filed an amended complaint. The amended complaint seeks an award of damages in an unspecified amount on behalf of a putative class consisting of persons who purchased the Company's common stock between March 11, 2015 and March 8, 2017, inclusive. On September 28, 2017, we filed a

motion to dismiss, which remains pending before the court. The Company believes that the lawsuit is without merit, and it intends to vigorously defend against all claims asserted. At this time, the Company is unable to reasonably estimate the outcome of this litigation.



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

As disclosed in prior periods, the legal and regulatory actions facing the Company include those relating to compliance with U.S. federal securities laws. Specifically, the Company has been the subject of an investigation by the Securities and Exchange Commission ("SEC"), which appears to be focused on the Company's internal control over financial reporting and disclosure controls and procedures in light of the Company's determination in 2015 that a portion of the life insurance and annuity policies issued by its subsidiary insurance companies failed to qualify for the favorable U.S. federal income tax treatment afforded by Sections 7702 and 72(s) of the Internal Revenue Code of 1986. There have been no allegations of fraud presented by the SEC. We have cooperated fully with the investigation and expect that the matter will be resolved soon, although we cannot predict the timing of a resolution or the ultimate outcome of the investigation.

In the normal course of business, the Company is subject to various legal and regulatory actions which are immaterial to the Company's financial statements. For more information about the risks related to litigation and regulatory actions, please see the risk factor titled "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." in Item 1A. Risk Factors.

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 risk factors set forth in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 and 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

The majority of our sales derives from residents of foreign countries and is subject to risks associated with political instability, currency control laws and foreign insurance laws. A significant loss of sales in these foreign markets could have a material adverse effect on our results of operations and financial condition.

The majority of our direct premiums, approximately 70% in 2018, are from foreign countries, primarily those in Latin America and the Pacific Rim. These sales are made through independent consultants who are located in these foreign countries. Many of these countries have a history of political instability, including regime changes, political uprisings, currency fluctuations and anti-democratic or anti-U.S. policies. There is a risk that political instability in these countries could have a material adverse effect on the ability of people living in these countries to purchase our insurance policies or our ability to sell our policies in those countries through our independent consultants or otherwise. Our Company's future sales and financial results depend upon avoiding significant regulatory restraints on receiving insurance policy applications and premiums from, and issuing insurance policies to, residents outside of the United States.

Currency control laws or other currency exchange restrictions in foreign countries could materially adversely affect our revenues by imposing restrictions on asset transfers outside of a country where our insureds reside. Difficulties in

transferring funds from or converting currencies to U.S. dollars in certain countries could prevent our insureds in those countries from purchasing or paying premiums on our policies. There can be no assurance that such restrictions will not be imposed and that our revenues, results of operations and financial condition will not be materially adversely affected if they do occur.

We also face risks associated with the application of foreign laws to our sales of policies to residents in foreign countries. Generally, all foreign countries in which we offer insurance products require a license or other authority to conduct insurance business in that country. Some of these countries also require that local regulatory authorities approve the terms of any insurance product sold to residents of that country. We have never sought to qualify to do business in any foreign country and have never submitted the insurance policies that we issue to residents of foreign countries for approval by any foreign or domestic insurance regulatory agency. Traditionally, we have sought to address risks associated with the potential application of foreign laws to our sales of insurance policies in our foreign markets by, among other things, not locating any of our offices or assets in foreign countries, selling policies only through independent consultants rather than our own employees, requiring that all applications for insurance

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

be submitted to and accepted only in our offices in the U.S., and requiring that policy premiums be paid to us only in U.S. Dollars. We rely on our independent consultants to comply with laws applicable to them in marketing our insurance products in their respective countries. Even with the precautionary measures, practices and policies mentioned above, the Company may determine that the risks associated with a particular market and its regulatory environment outweigh the benefits of conducting further business in that market.

We have undertaken a comprehensive compliance review of risks associated with the potential application of foreign laws to our sales of insurance policies in foreign countries. The application of foreign laws to our sales of insurance policies in foreign countries varies by country. There is a lack of uniform regulation and lack of clarity in certain regulations. Our compliance review has confirmed the previously disclosed risks related to foreign insurance laws associated with our current business model, at least in certain foreign countries. There are risks that a foreign government could determine under its existing laws that its residents may not purchase life insurance from us unless we become qualified to do business in that country or unless our policies purchased by its residents receive prior approval from its insurance regulators. There also is a risk that foreign regulators may become more aggressive in enforcing any perceived violations of their laws and seek to impose monetary fines, criminal penalties, and/or order us to cease our sales in that jurisdiction. There is no assurance that, if a foreign country were to deem our sales of policies in that country to require that we qualify to do business in that country or submit our policies for approval by that country's regulatory authorities, we would be able to, or would conclude that it is advisable to, comply with those requirements. Any determination by a foreign country that we or our policy sales are subject to regulation under their laws, or any actions by a foreign country to enforce such laws more aggressively, could therefore have a material adverse effect on our ability to sell policies in that country and, in turn, on our results of operations and financial condition. We are exploring alternatives to our current business model in one or more jurisdictions, including withdrawing from particular markets.

Any disruption to the marketing and sale of our policies to residents of a foreign country, resulting from the action of foreign regulatory authorities or otherwise, could have a material adverse effect on our results of operations and financial condition.

Our operating results and financial condition may be affected if the liabilities actually incurred differ, or if our estimates of those liabilities change, from the amounts we have reserved for in connection with the noncompliance of a portion of our life insurance policies with Section 7702 of the Internal Revenue Code and the failure of certain annuity contracts to qualify under Section 72(s) of the Internal Revenue Code.

We previously announced that we determined that a portion of the life and annuity insurance policies issued by our subsidiary insurance companies failed to qualify for the favorable U.S. federal income tax treatment afforded by Sections 7702 and 72(s) of the Internal Revenue Code ("IRC") of 1986. We may be liable to the IRS for failure to withhold taxes or to tax report on IRS information returns and payee statements. We have undertaken an analysis of our potential liability to the IRS arising from this matter, as well as other expenses we may incur to remediate (i.e., conform to the requirements of the IRS) certain previously issued domestic life insurance and annuity policies and to address any missed reporting and withholding for policies issued to non-U.S. citizens and have established a best estimate reserve of \$5.1 million, net of tax as of March 31, 2018 for probable liabilities and expenses. The probability weighted range of financial estimates relative to this issue is \$4.2 million to \$45.5 million, net of tax. This estimated range includes projected toll charges and fees payable to the IRS, as well as any other costs attributed to remediation of non-compliant domestic life insurance. The amount of our liabilities and expenses depends on a number of uncertainties, including the number of prior tax years for which we may be liable to the IRS, the number of domestic life and annuity insurance policies we will be required to remediate, the methodology applicable to the calculation of toll charges for non-compliant policies and the amount of time and resources we will require from external advisors

who are assisting us with resolving these issues. Given the range of potential outcomes and the significant variables assumed in establishing our estimates, actual amounts incurred may exceed our reserve and also could exceed the high end of our estimated range of liabilities and expenses. To the extent the amount reserved is insufficient to meet the actual amount of our liabilities and expenses, or if our estimates of those liabilities and expenses change in the future, our financial condition and results of operations may be materially adversely affected.

On May 17, 2017, we submitted an offer to enter into Closing Agreements with the IRS covering the CICA and CNLIC domestic life insurance business. The toll charges calculated and enumerated in the Closing Agreements totaled \$124,000 and \$4,000 for the CICA and CNLIC domestic life insurance businesses, respectively.

We expect to submit offers to enter into Closing Agreements with the IRS for the SPLIC and MGLIC life insurance business and for the CICA international business and our annuity business in 2018.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

The new CICA Life Ltd. (Bermuda) will be subject to extensive government regulation by the Bermuda Monetary Authority (“BMA”), which is a new regulatory regime for the Company. Regulation by the BMA, is subject to change and may increase our costs of doing business, restrict the conduct of our business and negatively impact our results of operations, liquidity and financial condition.

For over 40 years, the Company’s life insurance subsidiaries have been regulated in the U.S. by the state insurance departments of their states of domicile. In 2018, CICA Life Ltd. will be subject to extensive regulation and supervision by the BMA in jurisdictions where we do business, including global insurance regulations, tax, financial services, privacy, anti-money laundering, bank secrecy, anti-corruption and foreign asset control laws. Bermuda 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, the BMA has broad powers to regulate business activities of CICA Life Ltd, mandate capital and surplus requirements, regulate trade and claims practices and require strong enterprise risk management and corporate governance activities. The Company has no prior experience operating in a foreign jurisdiction and limited experience with regulation by the BMA. We cannot predict with certainty how the international business model described above will be affected by the novation of our international policies to a foreign sovereign jurisdiction.

We face financial, liquidity 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 in recent years, we experienced significant call activity on our fixed income portfolio that decreased our investment yields compared to prior years. We also have recorded other-than-temporary impairments in the past several years due to credit related market declines and equity market volatility.

We face potential liquidity risks if policyholders with mature policies elect to receive lump sum distributions at greater levels than anticipated. Our whole life and endowment products provide the policyholder with alternatives once the policy matures. The policyholder can choose to take a lump sum payout or leave the money on deposit at interest with the Company. As of December 31, 2017, the Company has a significant amount of endowment products representing approximately 45.9% of total inforce with older contracts sold historically that will begin reaching their maturities over the next several years and policyholder election behavior is not known. If policyholders elect lump sum distributions, the Company could be exposed to liquidity risk in years of high maturities. Meeting these distributions could require the Company to sell securities at inopportune times to pay policyholder withdrawals. Alternatively, if the policyholder were to leave the money on deposit with the Company at interest, our profitability could be negatively impacted if the product guaranteed rate is higher than the current market rate we can earn on our investments.

A large portion of our debt security investment portfolio will mature in the next seven years and could be called sooner as we were subject to significant call activity beginning in 2009 due to the declining interest rate environment and we reinvested into shorter durations that are now approaching maturity. We will need to reinvest these maturing funds in the current interest rate environment. Our profitability could be negatively impacted depending on the market rates at the time of reinvestment. This could result in a decrease in our spread between our policy liability crediting rates and our investment earned rates. This could also negatively impact our liquidity.

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 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 an integral component of our net income.

If 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 approximately 55% of the portfolio is callable as of December 31, 2017. Lowering our 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.

An increase in interest rates will decrease the net unrealized gain position of our investment portfolio and may subject us to disintermediation risk. Disintermediation risk is the risk that in a change from a low interest rate period to a significantly higher and increasing interest rate period, policyholders may surrender their policies or make early withdrawals in order to increase their

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

returns, requiring us to liquidate investments in an unrealized loss position (i.e. the market value less the carrying value of the investments). This risk is discussed further in the two risk factors below.

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 March 31, 2018, fixed maturities represented \$1.2 billion or 92.5% of our total investments of \$1.3 billion. 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 resulting from the repayment of principal might occur earlier than anticipated because of declining interest rates or later than anticipated because of rising interest rates. The impact of value fluctuations affects our consolidated financial statements, as a large portion of our fixed maturities 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. Although at March 31, 2018, approximately 97.2% of our fixed maturities were investment grade with 73.7% rated A 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 be downgraded (with a concurrent decrease 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.

Valuation of our investments and the determination of whether a decline in the fair value of our invested assets is other-than-temporary are based on estimates that may prove to be incorrect.

U.S. GAAP requires that when the fair value of any of our invested assets declines and the decline is deemed to be other-than-temporary, we recognize a loss in either other comprehensive income or in our statement of income based on certain criteria in the period for which the determination is made. The determination of the fair value of certain invested assets, particularly those that do not trade on a regular basis, requires an assessment of available data and the use of assumptions and estimates. Once it is determined that the fair value of an asset is below its carrying value, we must determine whether the decline in fair value is other-than-temporary, which is based on subjective factors and involves a variety of assumptions and estimates.

There are risks and uncertainties associated with determining whether declines in market value are other-than-temporary. These include significant changes in general economic conditions and business markets, trends in certain industry segments, interest rate fluctuations, rating agency actions, changes in significant accounting

estimates and assumptions and legislative actions. In the case of mortgage- and asset-backed securities, there is added uncertainty as to the performance of the underlying collateral assets. To the extent that we are incorrect in our determination of the fair value of our investment securities or our determination that a decline in their value is other-than-temporary, we may realize losses that never actually materialize or may fail to recognize losses within the appropriate reporting period.

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 March 31, 2018 were \$7.8 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



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

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.

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. 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 policy benefit reserves, which may have a material adverse effect on our results of operations and financial condition in the periods in which such increases occur.

Unanticipated increases in early policyholder withdrawals or surrenders could negatively impact liquidity.

A primary liquidity concern is the risk of unanticipated or extraordinary early policyholder withdrawals or surrenders. Our insurance policies include provisions, such as surrender charges, that help limit and discourage early withdrawals, and we track and manage liabilities and attempt to align our investment portfolio to maintain sufficient liquidity to support anticipated withdrawal demands. However, early withdrawal and surrender levels may differ from anticipated levels for a variety of reasons, including changes in economic conditions, changes in policyholder behavior or financial needs, changes in relationships with our independent consultants, changes in our claims-paying ability, or increases in surrenders among policies that have been in force for more than fifteen years and are no longer subject to surrender charges. Any of these occurrences could adversely affect our liquidity, profitability and financial condition.

While we own a significant amount of liquid assets, a certain portion of investment assets are relatively illiquid. If we experience unanticipated early withdrawal or surrender activity, we could exhaust all other sources of liquidity and be forced to obtain additional financing or liquidate assets, perhaps on unfavorable terms. The availability of additional financing will depend on a variety of factors, such as market conditions, the availability of credit in general or more specifically in the insurance industry, the strength or weakness of the capital markets, the volume of trading activities, our credit capacity, and the perception of our long- or short-term financial prospects if we incur large realized or unrealized investment losses or if the level of business activity declines due to a market downturn. If we are forced to dispose of assets on unfavorable terms, it could have an adverse effect on our liquidity, results of operations and financial condition.

Catastrophes may adversely impact liabilities for policyholder claims and reinsurance availability.

Our insurance operations are exposed to the risk of catastrophic events. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Most catastrophes are restricted to small geographic areas; however, hurricanes, earthquakes, tsunamis and man-made catastrophes may produce significant damage or loss of life in larger areas, especially those that are heavily populated. Claims resulting from catastrophic events could cause substantial volatility in our financial results for any fiscal quarter or year and could materially reduce our profitability or harm our financial condition. In addition, catastrophic

events could harm the financial condition of issuers of obligations we hold in our investment portfolio, resulting in impairments to these obligations, and the financial condition of our reinsurers, thereby increasing the probability of default on reinsurance recoveries. Large-scale catastrophes may also reduce the overall level of economic activity in affected countries, which could hurt our business and the value of our investments or our ability to sell new policies.

Our life insurance operations are exposed to the risk of catastrophic mortality, such as a pandemic or other event that causes a large number of deaths, especially if concentrated in our top foreign markets. A significant pandemic could have a major impact on the global economy or the economies of particular countries or regions, including travel, trade, tourism, the health system, food supply, consumption, overall economic output and, eventually, on the financial markets. In addition, a pandemic that affected our employees, our policyholders, our independent consultants or other companies with which we do business could disrupt our business operations. The effectiveness of external parties, including governmental and non-governmental organizations, in

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

combating the spread and severity of such a pandemic could have a material impact on the losses experienced by us. These events could cause a material adverse effect on our results of operations in any period and, depending on their severity, could also materially and adversely affect our financial condition.

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 March 31, 2018, we had \$165.6 million of deferred policy acquisition costs, or DAC. DAC represents costs that vary with and are directly related to the successful 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 for our type of insurance products, DAC is amortized over the premium-paying period of the policies.

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 March 31, 2018, we had \$16.9 million of CCRA. We amortize the value of this intangible asset in a manner similar to the amortization of DAC.

The amortization of DAC and CCRA is subject to acceleration and 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 might 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, the amount that is not recoverable is 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. In 2017, we recognized a goodwill impairment of \$4.6 million on our Home Service Segment. Goodwill in our consolidated financial statements was \$12.6 million as of

March 31, 2018.

Management's determination of the fair value of each reporting unit incorporates multiple inputs including discounted cash flow calculations based on assumptions that market participants would make in valuing the reporting unit. Other assumptions can include levels of economic capital, future business growth, and earnings projections.

Our conversion to a new actuarial valuation system is not yet complete and contains known uncertainties that could result in identification of additional errors in our financial reporting.

The Company is in the process of converting its actuarial valuation from a third party service provider to an actuarial valuation modeling software system purchased from a vendor. In connection with our ongoing actuarial valuation conversion, certain legacy system immaterial errors were discovered in both 2017 and 2016. As we complete this validation and conversion, we could identify

56

---

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

additional differences that will be evaluated for financial reporting purposes. The conversion to the new system is expected to be completed in 2018.

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.

From time to time we are, and have been, subject to a variety of legal and regulatory actions and investigations relating to our business operations, including, but not limited to:

- disputes over insurance coverage or claims adjudication;
- regulatory compliance with state laws, including insurance and securities regulations;
- regulatory compliance with U.S. federal securities laws, tax, anti-money laundering, bank secrecy, anti-bribery, anti-corruption and foreign asset control laws, among others;
- disputes with our independent marketing firms, independent consultants and employee-agents over compensation, termination of contracts, noncompliance with applicable laws and regulations 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. Further, 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.

As noted above, and as disclosed in prior periods, the legal and regulatory actions facing the Company include those relating to compliance with U.S. federal securities laws. Specifically, the Company has been the subject of an investigation by the Securities and Exchange Commission ("SEC"), which appears to be focused on the Company's internal control over financial reporting and disclosure controls and procedures in light of the Company's determination in 2015 that a portion of the life insurance and annuity policies issued by its subsidiary insurance companies failed to qualify for the favorable U.S. federal income tax treatment afforded by Sections 7702 and 72(s) of the Internal Revenue Code of 1986. There have been no allegations of fraud presented by the SEC. We have cooperated fully with the investigation and expect that the matter will be resolved soon, although we cannot predict the timing of a resolution or the ultimate outcome of the investigation.

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 canceled for new business, 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 2017, we reinsured \$503.7 million of the face amount of our life insurance policies. Amounts reinsured in 2017 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.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

Our international markets face significant competition. If we are unable to compete effectively in our markets, our business, results of operations and profitability may be adversely affected.

Our international marketing plan focuses on making available U.S. dollar-denominated life insurance products to individuals residing in foreign countries. New competition could increase the supply of available insurance, which could adversely affect our ability to price our products at attractive profitable rates and thereby adversely affect our revenues, results of operations and financial condition. Existing barriers to entry in the foreign markets we serve may not be sufficient to impede potential competitors from entering such markets. 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-denominated policies. We face direct competition from companies that operate in the same manner as we operate in our international markets.

• Another group of our competitors in the international marketplace consists of foreign operated companies that have locally operated subsidiaries that offer both local jurisdiction regulated products in local currency and off-shore U.S. dollar-denominated policies. This arrangement creates competition in that the U.S. dollar-denominated policies are offered in conjunction with high-need local insurance policies such as health insurance.

• 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 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.

Sales of our insurance products could decline 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, 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. Modifications in our international business model may have an adverse impact on our ability to attract and retain effective sales representatives.



Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

There may be adverse tax, legal or financial consequences if our sales representatives are determined not to be independent contractors.

Our international sales representatives are independent contractors who operate their own businesses. Although we believe that we have properly classified our representatives as independent contractors, there is nevertheless a risk that the IRS, a foreign agency, a court or other authority will take the different view that our sales representatives should be treated like employees. Furthermore, the tests governing the determination of whether an individual is considered to be an independent contractor or an employee are typically fact-sensitive and vary from jurisdiction to jurisdiction. Laws and regulations that govern the status and misclassification of independent sales representatives are subject to change or interpretation.

If there is a change in the manner in which our independent contractors are classified or an adverse determination with respect to some or all of our independent contractors by a court or governmental agency, we could incur significant costs in complying with such laws and regulations, including in respect of tax withholding, social security payments, government and private pension plan contributions and recordkeeping, or we may be required to modify our business model, any of which could have a material adverse effect on our business, financial condition and results of operations. In addition, there is the risk that we may be subject to significant monetary liabilities arising from fines or judgments as a result of any such actual or alleged non-compliance with applicable federal, state, local or foreign laws.

We are subject to extensive governmental regulation in the United States, which is subject to change and may increase our costs of doing business, restrict the conduct of our business and negatively impact our results of operations, liquidity and financial condition.

We are subject to extensive regulation and supervision in U.S. jurisdictions where we do business, including state insurance regulations and U.S. federal securities, tax, financial services, privacy, anti-money laundering, bank secrecy, anti-corruption and foreign asset control laws. 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 legal powers with respect to 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.

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

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

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.

Failures of disclosure controls and procedures and internal control over financial reporting could materially and adversely affect our business, financial condition and results of operations, impair our ability to timely file reports with the SEC and subject us to litigation and/or regulatory scrutiny and penalties.

We maintain disclosure controls and procedures designed to ensure that we timely report information as specified in SEC rules and regulations. We also maintain a system of internal control over financial reporting. However, these controls may not achieve, and in some cases have not achieved, their intended objectives. Control processes that involve human diligence and oversight, such as our disclosure controls and procedures and internal control over financial reporting, are subject to human error. Controls that rely on models may be subject to inadequate design or inaccurate assumptions or estimates. Controls also can be circumvented by improper management override of such controls. Because of such limitations, there are risks that material misstatements due to error or fraud may not be prevented or detected, and that information may not be reported on a timely basis. The failure of our controls to be effective could have a material adverse effect on our business, financial condition, results of operations and the market for our common stock, and could subject us to litigation, regulatory scrutiny and/or penalties.

As disclosed in Part II, Item 9A of our Annual Report on Form 10-K as of December 31, 2017, we have identified control deficiencies in our disclosure controls and financial reporting process that constitute material weaknesses and for which remediation is still in process as of March 31, 2018. If we fail to design effective controls, fail to remediate control deficiencies or fail to otherwise maintain effective internal controls over financial reporting in the future, such failures could result in a material misstatement of our annual or quarterly financial statements that would not be prevented or detected on a timely basis and which could cause investors to lose confidence in our financial statements, have a negative effect on the trading price of our common stock, limit our ability to obtain financing if needed or increase the cost of any financing we may obtain. In addition, these failures may negatively impact our business, financial condition and results of operations, impair our ability to timely file our periodic reports with the SEC, subject us to litigation and regulatory scrutiny and cause us to incur substantial additional costs in future periods relating to the implementation of remedial measures.

Our failure to protect confidential information and privacy could result in the unauthorized disclosure of sensitive or confidential corporate or customer information, damage to our reputation, loss of customers, fines, penalties and adverse effects on 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.

We have a written information security program with appropriate administrative, technical and physical safeguards to protect such confidential information. Cyber security attacks are on the rise throughout the world and while we believe we have taken reasonable steps to secure our customer information we could experience a breach of data. We

closely monitor cyber attack attempts on our system, and we are not aware of any material breach of our cyber security, administrative, technical and physical safeguards or client data. Nevertheless, it is possible a cyber attack could go undetected and that preventative actions we take to reduce this risk of cyber incidents and protect our information may be insufficient to prevent cyber attacks or other security breaches.

If we do not comply with privacy regulations and protect confidential information, we could experience adverse consequences, including regulatory sanctions, loss of reputation, litigation exposure, disruptions to our operations or significant technical, legal and operating expenses, 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

March 31, 2018

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 or 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.

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.

We face a greater risk of money laundering activity associated with sales derived from residents of certain foreign countries.

Some of our top international markets are in countries identified by the U.S. Department of State as jurisdictions of high risk for money laundering. As required by Bank Secrecy Act ("BSA") regulations applicable to insurance companies, we have developed and implemented an anti-money laundering program that includes policies and procedures for complying with our applicable BSA program, auditing, reporting and recordkeeping requirements and for deterring, preventing and detecting potential money laundering, fraud and other criminal activity ("BSA Program").

We have an enhanced BSA Program with additional controls, such as list screening software beyond sanctions screening required by the Office of Foreign Assets Control (“OFAC”), enhanced payment due diligence and transaction controls. However, there can be no assurance that these enhanced controls will entirely mitigate money laundering risk associated with these jurisdictions.

#### Risks Relating to Our Capital Stock

If our foreign policyholders reduced or ceased participation in our Stock Investment Plan (the “Plan”) or if a securities regulatory authority were to deem the CISIP's operation contrary to securities laws, the volume of Class A common stock purchased on the open market through the CISIP, and the price of our Class A common stock, could fall.

More than 96% of the shares of Class A common stock purchased under the CISIP in 2017 were purchased by foreign holders of life insurance policies (or related brokers); the remaining 4% of the shares of Class A common stock purchased under the CISIP in 2017 were purchased by approximately 1,864 participants resident in the United States. The CISIP is registered with the SEC pursuant to a registration statement under the Securities Act of 1933, but is not registered under the laws of any foreign jurisdiction. If

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

a foreign securities regulatory authority were to determine the offer and sale of our Class A common stock under the CISIP were contrary to applicable laws and regulations of its jurisdiction, such authority may issue or assert a fine, penalty or cease and desist order against us in that foreign jurisdiction. There is a risk our Class A common stock price could be negatively impacted by a decrease in participation in the CISIP. 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 common stock may decline from its present levels, the demand for our Class A common stock could be negatively impacted and the price of our Class A common stock could fall.

Due to required regulatory approval for acquisition of control of a regulated U.S. domestic insurance company, control of our Company, through the ownership of our Class B common stock, has not yet transferred from our founder's trust to a 501(c)(3) charitable foundation established by our founder, and we cannot determine whether or when any change in our management, operations, or operating strategies will occur.

Harold E. Riley, our founder, was the beneficial owner of 100% of our Class B common stock, which was held in the name of the Harold E. Riley Trust ("Trust"), of which he had served as Trustee until his death in September 2017. Our 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 common stock. The Class A common stock elects the remainder of the Board. The Trust documents provided that upon Mr. Riley's death, the Class B common stock will transfer from the Trust to the Harold E. Riley Foundation, a charitable organization established under 501(c)(3) of the Internal Revenue Code (the "Foundation").

To date, the estate process related to the Class B common stock is not complete and the required state insurance regulatory approvals for change of control to occur have not been received. The Foundation has not sought to acquire record ownership of the Class B common stock, exercise voting power with respect to such shares or otherwise seek to exercise control over the Company's management or operations, and the Trust currently remains the holder of record of the Class B common stock. The Foundation and the Estate of Harold E. Riley are proceeding independent of the Company to obtain regulatory approval from the Colorado Division of Insurance, the Texas Department of Insurance, the Louisiana Department of Insurance and the Mississippi Department of Insurance through the requisite Form A approval process. The Company does not know if or when regulatory approvals of the transfer ultimately will be granted. If such approvals are obtained from the states department of insurances listed above, the Company will record the transfer the controlling Class B common stock from the Trust to the Foundation in the Company's shareholder records.

The Foundation is organized as a public support charity for the benefit of its charitable beneficiaries, Baylor University and Southwestern Baptist Theological Seminary. The Foundation is governed by 11 trustees, five of which were appointed by Harold Riley prior to his death, three of which were appointed by Baylor University and three of which were appointed by Southwestern Baptist Theological Seminary. It is unclear what, if any, change may occur to our board, management, or corporate operating strategies as a result of different ownership of our Class B common stock.

If and when the Foundation becomes the record holder of the Class B common stock, the first of two prongs of certain "change in control" provisions in the employment agreements of our top two executives Chief Executive Officer Geoff Kolander and Chief Financial Officer Kay Osbourn will be triggered. Under each employment agreement, a "change in control" includes, among other things (1) the transfer of a majority of the Company's Class B common stock from the Trust to an individual other than Harold E. Riley, an entity not beneficially owned by Harold E. Riley, or a trust not controlled by Harold E. Riley and (2) the exercise of a power of attorney granted by Harold E. Riley over the Company's Class B common stock. Upon a termination of the executive by Citizens without cause or the executive's voluntary termination with Good Reason, in each case other than within the ninety (90) day period prior to the consummation of a change in control or within one (1) year following a change in control, the executive would be entitled to certain cash payments and benefits.





Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

There are a substantial number of our shares of Class A common stock issued to our executive officers and directors which are 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 49,080,114 shares of our Class A common stock issued and outstanding as of December 31, 2017. Our executive officers and directors owned approximately 54,436 shares of our Class A common stock as of December 31, 2017, representing approximately 0.1% 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.

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 CISIP 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 international markets, and the specific manner in which we conduct our business in those jurisdictions, may be subject to negative publicity in social media or other channels, which may negatively impact the market price of our Class A common stock.

We interface with and distribute our products to residents of foreign countries that may be subject to the risks disclosed in our Item 1A. Risk Factor under the heading, "The majority of our sales derives from residents of foreign countries and is subject to risks associated with widespread political instability, currency control laws and foreign insurance laws. A significant loss of sales in these foreign markets could have a material adverse effect on our results of operations and financial condition". Venezuela is one such example. Accordingly, from time to time, bloggers or other social media outlets relevant to investors may focus attention on our exposure to these countries and the negative circumstances surrounding their governments, thereby subjecting us to periodic negative publicity. Negative publicity on investor blogs or through other media channels could impact trading in our stock especially due to aggressive and coordinated efforts between anonymous bloggers and short sellers which ultimately cause the market price of our Class A common stock to fall.

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 held by the Harold E. Riley Trust until such time that the Harold E. Riley Foundation receives regulatory approval for acquisition of the Class B common stock and becomes holder of record; 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

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

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.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. OTHER INFORMATION

None.

64

---

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2018

Item 6. EXHIBITS

Exhibit  
Number

The following exhibits are filed herewith:

- 3.1 Restated and Amended Articles of Incorporation (incorporated herein by reference to Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 15, 2004)
- 3.2 Third Amended and Restated Bylaws dated November 2, 2017 (incorporated herein by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K, filed on November 8, 2017)
- 11 Statement re: Computation of per share earnings (see financial statements)
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act\*
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act\*
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act\*
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act\*
- 101.INS XBRL Instance Document\*
- 101.SCH XBRL Taxonomy Extension Schema\*
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase\*
- 101.DEF XBRL Taxonomy Extension Definition Linkbase\*
- 101.LAB XBRL Taxonomy Extension Label Linkbase\*
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase\*

\* Filed herewith.

Table of Contents

SIGNATURES

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

CITIZENS, INC.

By: /s/ Geoffrey M. Kolander  
Geoffrey M. Kolander  
President and Chief Executive Officer

By: /s/ Kay E. Osbourn  
Kay E. Osbourn  
Executive Vice President, Chief Financial Officer,  
and Chief Investment Officer

Date: May 4, 2018