

**06694 - Lincoln Heritage Life Insurance Company****LINCOLN HERITAGE LIFE INSURANCE COMPANY**

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**BEST'S RATING**

Based on our opinion of the company's Financial Strength, it is assigned a Best's Rating of A- (Excellent). The company's Financial Size Category is Class VII.

**RATING RATIONALE**

**Rating Rationale:** The rating of Lincoln Heritage Life Insurance Company reflects the company's well-established market position in the final expense and other senior market life insurance segments, consistent growth in new business premiums, continuing positive trends of statutory operating earnings, and a strong risk-adjusted capitalization position. Partially offsetting these factors are the company's increasing exposure to competition in the senior marketplace, modest business risk associated with the Medicare Supplement market, and limited business profile.

Lincoln Heritage continues to sustain its strong position in the core final expense market that has provided the company with consistently positive statutory operating earnings despite the high level of surplus strain from new business growth and intense competitive pressures. Lincoln Heritage has remained a formidable competitor in the senior life insurance marketplace as a result of its pro-active lead procurement programs and partnership with Funeral Consumer Guardian Society, which offers assistance to families in planning and purchasing funerals. In addition, the company has developed strategic alliances, expanded distribution channels into direct marketing through cable television, and created cross selling opportunities with a focus on expanding its presence in the growing senior markets. These product and distribution enhancements are expected to improve Lincoln Heritage's core competency and sustain its growth strategy in its target senior market. Also, increasing levels of premium and profitability in the pre-need and Medicare Supplement businesses in recent years have positively contributed to the company's overall operating results. The company's strong statutory earnings performance has resulted in achieving a record high level of capital and surplus position to allow the company to further grow its new business opportunities without incurring financial leverage.

As the population of older Americans grows and the demands for final expense, pre-need and senior products increase, many life insurers are beginning to conduct business in this expanding market segment creating intense competition for this business. Lincoln Heritage has responded to these challenges by offering new products, enhancing its distribution system through direct marketing, and aligning itself with marketing organizations which serve the senior market. Lincoln Heritage has entered the Medicare Supplement market over the last few years. A.M. Best notes that the Medicare Supplement insurance is a commodity business and remains vulnerable to regulatory and competitive pricing threats. These challenges combined with the volatile nature of the Medicare Supplement business could pose operational risks to the company. Lincoln Heritage plans to mitigate this risk by implementing prudent growth marketing strategies that would support its pricing and profitability posture while remaining more competitive in certain marketplaces and states.

**Best's Rating: A-****Outlook: Stable**

## FIVE YEAR RATING HISTORY

| <u>Date</u> | <u>Best's<br/>Rating</u> |
|-------------|--------------------------|
| 04/14/06    | A-                       |
| 03/30/05    | B++                      |
| 04/07/04    | B++                      |
| 02/20/04    | B++                      |
| 04/10/03    | B++                      |
| 01/24/03    | B++                      |
| 05/22/02    | A-                       |
| 04/23/01    | A-                       |

## KEY FINANCIAL INDICATORS (in thousands of dollars)

| <u>Year</u> | <u>Assets</u> | <u>Total Capital</u>                 |                                       |                                     |                                  |                       | <u>Net<br/>Income</u> |
|-------------|---------------|--------------------------------------|---------------------------------------|-------------------------------------|----------------------------------|-----------------------|-----------------------|
|             |               | <u>Capital<br/>Surplus<br/>Funds</u> | <u>Condit'l<br/>Reserve<br/>Funds</u> | <u>Net<br/>Premiums<br/>Written</u> | <u>Net<br/>Invest<br/>Income</u> | <u>Net<br/>Income</u> |                       |
| 2000        | 339,809       | 56,047                               | 3,540                                 | 112,723                             | 22,830                           | 5,445                 |                       |
| 2001        | 359,383       | 67,149                               | 4,598                                 | 73,649                              | 22,183                           | 10,988                |                       |
| 2002        | 420,210       | 66,073                               | 937                                   | 93,627                              | 22,554                           | 3,917                 |                       |
| 2003        | 467,553       | 70,998                               | 2,977                                 | 102,311                             | 20,916                           | 5,241                 |                       |
| 2004        | 485,846       | 72,595                               | 3,125                                 | 111,999                             | 21,821                           | 6,380                 |                       |
| 2005        | 514,320       | 79,419                               | 3,452                                 | 141,753                             | 22,878                           | 9,739                 |                       |
| 03/2005     | 499,758       | 72,752                               | 3,994                                 | 36,109                              | 5,538                            | 2,649                 |                       |
| 03/2006     | 519,298       | 83,251                               | 3,377                                 | 33,812                              | 6,359                            | 1,784                 |                       |

## BUSINESS REVIEW

Lincoln Heritage Life Insurance Company operates as a subsidiary of the Londen Insurance Group. The current company was created in 1999 with the merger of Lincoln Heritage into Life of Boston Insurance Company, an affiliated company. The surviving company assumed the Lincoln Heritage name. The company is headed by Jack Londen, chairman of the board and chief executive officer. Mr. Londen and the balance of the official staff serve in executive capacities with the Londen Insurance Group.

Lincoln Heritage offers a complete portfolio of the standard forms of ordinary life coverages and individual annuity contracts. Operations of the company are conducted through a large network of general and soliciting agents. The company is licensed in 49 states, the District of Columbia and Puerto Rico. In 2004, management decided to cease the company's Canadian operations and entered into an assumption reinsurance treaty with Unity Life of Canada. During the past few years, the company has added new agents to its sales force, while eliminating non-producing agents with emphasis in the final expense and senior marketplace.

Until 1998, business growth had been funded internally through the capital support of the parent organizations. Due to the 40% increase in new business that year, a surplus relief agreement was entered into with Cologne Life. In April 1999, a 50% coinsurance agreement was executed covering new final expense business issued during the year. This was done to allow the company to continue producing new business at the higher levels while mitigating surplus strain. However, in year 2000, management elected to recapture the outstanding coinsurance treaty with Cologne Life, in addition to recapturing an outstanding final expense reinsurance treaty with Capital Re. In December 2001, the company entered into a financial reinsurance treaty with London Life Re on a block of final expense business to fund the acquisition of the broadcasting assets of

a television station in April 2002. This television station has since been sold to a private trust. Subsequently, in 2005, Lincoln Heritage recaptured the financial reinsurance treaty with London Life Re.

On a strategic basis, the company intends to develop and implement several new growth initiatives. These initiatives will include additional lines of business as well as fee income revenue stream. At the same time, the company continues to focus on acquisition opportunities, especially blocks of business and their administration. In 2001, Lincoln Heritage developed a Medicare Supplement program in conjunction with Wakely & Associates, which is 75% reinsured by Hannover Life Re. Wakely & Associates is providing the turnkey claims administration and premium rate review and analysis for the segment. Additionally, Lincoln Heritage also developed an association program named Heritage Plus, in conjunction with the Funeral Consumer Guardian Society, providing consumers with a hybrid final expense and pre-need product. In recent years direct production has led to the increased level of new life production. The majority of this new business production has been derived from the sale of final expense (burial) coverages, pre-need, and the new Medicare supplement product, with a lesser amount of payroll deduction and flexible premium annuity business also being conducted.

### PREMIUM AND RESERVE ANALYSIS

| <u>Direct Premiums (000)</u> | <u>2005</u>    | <u>2004</u>    | <u>2003</u>    | <u>2002</u>    | <u>2001</u>    |
|------------------------------|----------------|----------------|----------------|----------------|----------------|
| Ordinary life                | 124,869        | 112,657        | 114,981        | 115,410        | 109,210        |
| Group life                   | 5,918          | 5,432          | 5,597          | 4,981          | 4,420          |
| Individual annuities         | 1,034          | 961            | 1,134          | 1,103          | 991            |
| Individual A&H               | 40,972         | 30,510         | 15,600         | 2,495          | 35             |
| Group A&H                    | ...            | ...            | 14             | 16             | 18             |
| Total                        | <u>172,793</u> | <u>149,559</u> | <u>137,326</u> | <u>124,003</u> | <u>114,675</u> |

| <u>Reins Assumed Prens (000)</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|
| Ordinary life                    | ...         | -1          | 1           | 2           | 3           |
| Total                            | <u>...</u>  | <u>-1</u>   | <u>1</u>    | <u>2</u>    | <u>3</u>    |

| <u>Reins Ceded Prens (000)</u> | <u>2005</u>   | <u>2004</u>   | <u>2003</u>   | <u>2002</u>   | <u>2001</u>   |
|--------------------------------|---------------|---------------|---------------|---------------|---------------|
| Ordinary life                  | 1,060         | 14,010        | 23,655        | 28,537        | 41,029        |
| Group life                     | ...           | 1,480         | ...           | ...           | ...           |
| Individual A&H                 | 29,980        | 22,070        | 11,361        | 1,842         | ...           |
| Total                          | <u>31,040</u> | <u>37,560</u> | <u>35,016</u> | <u>30,379</u> | <u>41,029</u> |

| <u>Net Premiums &amp; Deposits</u><br><u>(000)</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--|-------------|-------------|-------------|-------------|-------------|
| Ordinary life                                      | 123,848     | 98,687      | 91,401      | 86,954      | 68,184      |
| Group life   | 5,918       | 3,952       | 5,597       | 4,981       | 4,420       |
| Individual annuities                               | 1,470       | 1,286       | 1,281       | 1,427       | 1,045       |
| Group annuities                                    | 170         | 137         | 164         | 154         | 176         |
| Individual A&H                                     | 10,992      | 8,440       | 4,238       | 653         | 35          |
| Group A&H  | ...         | ...         | 14          | 16          | 18          |
| Total  | 142,398     | 112,503     | 102,696     | 94,184      | 73,879      |
| Deposits (incl. above)                             | 645         | 504         | 385         | 557         | 230         |

| <u>General Account</u><br><u>Reserve Distribution (000)</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|---|-------------|-------------|-------------|-------------|-------------|
| Ordinary life   | 367,832     | 344,527     | 328,870     | 304,325     | 243,942     |
| Group life  | 12,913      | 10,471      | 8,952       | 6,082       | 4,051       |
| Supplementary contracts                                     | 476         | 488         | 506         | 534         | 546         |
| Individual annuities  | 22,498      | 22,466      | 22,364      | 22,025      | 21,302      |
| Group annuities   | 1,396       | 1,603       | 1,681       | 1,768       | ...         |
| Deposit type contracts                                      | 6,612       | 6,572       | 6,585       | 6,656       | 6,204       |
| Individual A&H  | 1,883       | 1,665       | 1,092       | 457         | 198         |
| Group A&H   | ...         | ...         | ...         | ...         | 1           |
| Total   | 413,608     | 387,793     | 370,050     | 341,846     | 276,244     |

**Current Year Geographic Direct Premium Distribution (\$000):** California, \$25,162 (15.1%); Texas, \$12,472 (7.5%); Illinois, \$11,382 (6.8%); South Carolina, \$10,668 (6.4%); Indiana, \$10,169 (6.1%); other jurisdictions, \$96,309 (58.0%).

## EARNINGS

Lincoln Heritage has consistently reported positive statutory operating results over the last five years that are attributed to the strong performance in its core final expense line of business and the favorable returns from its diversified investment portfolio. The introduction of a Medicare supplement product, which was initially successful through marketing to its existing Lincoln policyholders, has, in recent years, begun to make a contribution to the company's statutory net operating gains. Lincoln Heritage has also produced modest gains from its individual annuity line of business. Lincoln Heritage continues to maintain its positive earnings performance through its established presence and sales in the senior marketplace. Net investment income remains a stable source of revenue as a result of the company's positive yield from its invested assets. Lincoln Heritage has continued to generate strong levels of net investment income in recent years while improving the composition of its investment portfolio from one with a high exposure to higher risk and fairly illiquid assets into a portfolio with assets of much higher quality and liquidity. Premium volume has recorded strong growth over the past several years due to marketing initiatives in its final expense and Medicare supplement products.

## PROFITABILITY TESTS

| <u>Year</u> | Comm &                      |                        | NOG<br>to Tot<br><u>Assets</u> | NOG to<br><u>Tot Rev</u> | Operating<br>Return on<br><u>Equity</u> | Net<br><u>Yield</u> | Total<br><u>Return</u> |
|-------------|-----------------------------|------------------------|--------------------------------|--------------------------|---|---------------------|------------------------|
|             | Ben Paid<br>to NPW<br>& Dep | Exp to<br>NPW<br>& Dep |                                |                          |   |                     |                        |
| 2001        | 69.7                        | 70.7                   | 3.3                            | 9.2                      | 18.5                                    | 7.23                | 6.94                   |
| 2002        | 42.7                        | 46.6                   | 1.9                            | 5.6                      | 11.0                                    | 6.57                | 4.58                   |
| 2003        | 49.6                        | 41.3                   | 0.7                            | 2.4                      | 4.8                                     | 5.28                | 6.26                   |
| 2004        | 46.9                        | 40.8                   | 1.2                            | 4.0                      | 8.1                                     | 5.07                | 5.08                   |
| 2005        | 51.7                        | 39.7                   | 1.6                            | 4.4                      | 10.8                                    | 5.06                | 5.37                   |
| 03/2005     | 55.7                        | 32.6                   | 0.4                            | 4.3                      | 2.9                                     | 1.22                | 1.26                   |
| 03/2006     | 60.5                        | 43.5                   | 0.2                            | 2.1                      | 1.1                                     | 1.34                | 1.60                   |

### PROFITABILITY ANALYSIS

| <u>Net Operating Gain (000)</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|
| Ordinary life                   | 7,148       | 4,102       | 2,244       | 6,763       | 10,310      |
| Group life                      | 27          | 399         | 316         | 568         | 468         |
| Supplementary contracts         | 93          | 9           | 3           | 1           | 8           |
| Individual annuities            | 48          | 157         | 192         | 3           | 576         |
| Group annuities                 | 180         | ...         | ...         | ...         | ...         |
| Individual A&H                  | 676         | 1,165       | 536         | 4           | 54          |
| Group A&H                       | ...         | ...         | 1           | -11         | 4           |
| Total                           | 8,172       | 5,833       | 3,293       | 7,328       | 11,420      |

### ACCIDENT & HEALTH STATISTICS

| <u>Year</u>                     | Net Premiums<br><u>Written</u> | Net Premiums<br><u>Earned</u> | Loss<br><u>Ratio</u> | Exp.<br><u>Ratio</u> | Under-<br>writing<br><u>Results</u> |
|---------------------------------|--------------------------------|-------------------------------|----------------------|----------------------|-------------------------------------|
| 2001                            | 54                             | 54                            | 16.5                 | 0.7                  | 44                                  |
| 2002                            | 2,517                          | 2,246                         | 11.0                 | 48.2                 | 785                                 |
| 2003                            | 4,422                          | 4,253                         | 54.5                 | 11.8                 | 1,410                               |
| 2004                            | 8,465                          | 7,940                         | 59.8                 | 15.6                 | 1,868                               |
| 2005                            | 10,930                         | 10,992                        | 67.6                 | 24.0                 | 945                                 |
| <b>Current Year Experience:</b> |                                |                               |                      |                      |                                     |
| Guaranteed renew                | 10,930                         | 10,992                        | 67.6                 | 24.0                 | 945                                 |

### CAPITALIZATION

Lincoln Heritage's current level of risk-adjusted capitalization is more than adequate to support its business, investment and insurance risks. Overall capital and surplus has grown to record levels in the last several years and has been supported over this period by the company's consistently positive statutory operating earnings and realized gains from its investment portfolio. The company continues its strategy of reducing its exposure to higher risk and lower liquidity investments which had represented a sizeable percentage of capital and surplus. This continuing re-alignment of the investment portfolio has resulted in the company's more than adequate level of risk-adjusted capitalization.

**LEVERAGE TESTS**

| <u>Year</u> | C&S<br>to<br><u>Liabilities</u> | Surplus<br><u>Relief</u> | Reins<br><u>Leverage</u> | NPW<br>& Dep<br><u>to Capital</u> | Change<br>in NPW<br>& Dep | Change<br>in<br><u>Capital</u> |
|-------------|---------------------------------|--------------------------|--------------------------|-----------------------------------|---------------------------|--------------------------------|
| 2001        | 24.9                            | 1.7                      | 122.3                    | 1.0                               | -34.5                     | 20.4                           |
| 2002        | 19.0                            | 19.4                     | 122.2                    | 1.4                               | 27.5                      | -6.6                           |
| 2003        | 18.8                            | 19.0                     | 110.7                    | 1.4                               | 9.0                       | 10.4                           |
| 2004        | 18.5                            | 22.7                     | 104.6                    | 1.5                               | 9.5                       | 2.4                            |
| 2005        | 19.2                            | 19.9                     | 87.8                     | 1.7                               | 26.6                      | 9.4                            |
| 03/2005     | 18.1                            | 9.2                      | XX                       | 0.5                               | 42.5                      | 1.4                            |
| 03/2006     | 20.0                            | 4.0                      | XX                       | 0.4                               | -6.4                      | 4.5                            |

2005 BCAR: 281

**SOURCES OF CAPITAL GROWTH  
(in thousands of dollars)**

| <u>Year</u> | Net<br><u>Gain</u> | Realized<br>Capital<br><u>Gains</u> | Unrealized<br>Capital<br><u>Gains</u> | Change<br><u>AVR</u> | Other<br><u>Changes</u> | Change<br>in<br><u>C&amp;S</u> |
|-------------|--------------------|-------------------------------------|---------------------------------------|----------------------|-------------------------|--------------------------------|
| 2001        | 11,420             | -432                                | -336                                  | -1,058               | 1,508                   | 11,102                         |
| 2002        | 7,328              | -3,412                              | -3,449                                | 3,661                | -5,205                  | -1,076                         |
| 2003        | 3,293              | 1,948                               | 1,966                                 | -2,040               | -242                    | 4,925                          |
| 2004        | 5,833              | 548                                 | -646                                  | -148                 | -3,989                  | 1,598                          |
| 2005        | 8,172              | 1,567                               | -247                                  | -327                 | -2,342                  | 6,823                          |
| 03/2005     | 2,114              | 535                                 | -605                                  | XX                   | XX                      | XX                             |
| 03/2006     | 913                | 871                                 | 417                                   | XX                   | XX                      | XX                             |

**CAPITAL TRENDS  
(in thousands of dollars)**

| <u>Year</u> | Year<br>end<br><u>C&amp;S</u> | Surplus<br><u>Notes</u> | Stock-<br>holder<br><u>Divs</u> | Policy-<br>holder<br><u>Divs</u> | Asset<br>Valuation<br><u>Reserve</u> | Interest<br>Maintenance<br><u>Reserve</u> |
|-------------|-------------------------------|-------------------------|---------------------------------|----------------------------------|--------------------------------------|---|
| 2001        | 67,149                        | ...                     | 5,500                           | 769                              | 4,598                                | ...                                       |
| 2002        | 66,073                        | ...                     | ...                             | 757                              | 937                                  | ...                                       |
| 2003        | 70,998                        | ...                     | ...                             | 745                              | 2,977                                | 202                                       |
| 2004        | 72,595                        | ...                     | ...                             | 385                              | 3,125                                | 985                                       |
| 2005        | 79,419                        | ...                     | ...                             | 471                              | 3,452                                | 221                                       |
| 03/2005     | 72,752                        | XX                      | ...                             | 138                              | 3,994                                | 1,149                                     |
| 03/2006     | 83,251                        | XX                      | ...                             | 134                              | 3,377                                | 216                                       |

**INVESTMENTS AND LIQUIDITY**

Lincoln Heritage maintains a high credit-quality, diversified investment portfolio with its invested assets composed primarily of

investment grade fixed-income securities, mortgage and contract loans, cash and short-term instruments. The company's bond portfolio is concentrated in high-quality corporate bonds, with smaller amounts of government agency-backed and U.S. Treasury obligations, and public utility issues. Up until the last few years, Lincoln Heritage had sizeable investments, relative to its adjusted capital and surplus, in higher risk assets including mortgage loans, real estate and other affiliated investments. In recent years, management has continued with its strategy of reducing the level of these assets as these investments exposed the company to a heavy geographic concentration risk with the majority of the real estate and mortgages being located in the state of Arizona. While these investments have a higher risk and lower liquidity than other investment opportunities available to Lincoln, they have been actively managed and have historically performed well. A.M. Best notes that the company continues to realign its investment portfolio by investing in more traditional asset classes that offer liquidity, investment quality, and lower risk charges.

### LIQUIDITY TESTS

| Year    | Operating<br>Cash<br>Flow (\$000) | Quick<br>Liquidity | Current<br>Liquidity | Non-Inv<br>Grade<br>Bonds to<br>Capital | Delinq &<br>Foreclsd<br>Mtg to<br>Capital | Mtg & Cred<br>Ten Lns<br>& RE<br>to Cap | Affil<br>Invest<br>to<br>Capital |
|---------|-----------------------------------|--------------------|----------------------|---|---|---|----------------------------------|
| 2001    | 12,850                            | 58.5               | 66.5                 | 23.1                                    | ...                                       | 50.4                                    | 34.1                             |
| 2002    | 55,705                            | 60.2               | 67.3                 | 14.5                                    | ...                                       | 71.8                                    | 69.3                             |
| 2003    | 46,631                            | 64.0               | 71.5                 | 31.1                                    | ...                                       | 50.7                                    | 12.8                             |
| 2004    | 22,546                            | 66.3               | 75.0                 | 38.5                                    | ...                                       | 46.8                                    | 4.9                              |
| 2005    | 24,847                            | 66.8               | 76.8                 | 11.0                                    | ...                                       | 38.1                                    | 4.3                              |
| 03/2005 | 10,208                            | XX                 | XX                   | 36.3                                    | ...                                       | 46.0                                    | XX                               |
| 03/2006 | 4,880                             | XX                 | XX                   | 10.4                                    | ...                                       | 28.0                                    | XX                               |

### INVESTMENT YIELDS

| Year | Net<br>Yield | Bonds | Stocks | Mort-<br>gages | Cash &<br>Short<br>Term | Real Estate<br>Gross | Net   | Invest.<br>Exp.<br>Ratio |
|------|--------------|-------|--------|----------------|-------------------------|----------------------|-------|--------------------------|
| 2001 | 7.23         | 6.95  | 8.72   | 17.05          | 3.18                    | 20.55                | 17.51 | 11.27                    |
| 2002 | 6.57         | 5.68  | 11.31  | 17.39          | 1.43                    | 21.29                | 18.30 | 12.29                    |
| 2003 | 5.28         | 4.75  | 5.49   | 15.07          | 0.71                    | 20.60                | 17.54 | 15.10                    |
| 2004 | 5.07         | 4.71  | 5.81   | 15.12          | 1.08                    | 22.91                | 19.76 | 11.75                    |
| 2005 | 5.06         | 4.89  | 5.63   | 10.81          | 2.60                    | 24.00                | 20.82 | 11.36                    |

### INVESTMENT DATA

#### Current Year Distribution of Bonds By Maturity

|                       | -----Years----- |      |      |       |      | 20-<br>Maturity | Yrs-Avg<br>Maturity |
|-----------------------|-----------------|------|------|-------|------|-----------------|---------------------|
|                       | 0-1             | 1-5  | 5-10 | 10-20 | 20-  |                 |                     |
| Government            | 2.5             | 1.5  | 1.7  | 0.2   | 3.4  | 11              |                     |
| Gov't Agencies & Muni | 0.8             | 4.0  | 4.8  | 5.0   | 1.9  | 10              |                     |
| Public Utilities      | 0.1             | 1.3  | 2.5  | 0.6   | 3.4  | 15              |                     |
| Industrial & Misc     | 5.0             | 24.6 | 17.2 | 10.7  | 8.7  | 9               |                     |
| Total                 | 8.5             | 31.5 | 26.1 | 16.5  | 17.4 | 10              |                     |

|                               | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|
| <u>Bonds (000)</u>            | 395,971     | 355,386     | 321,318     | 266,989     | 210,330     |
| US Government                 | 8.7         | 15.5        | 17.1        | 26.8        | 20.1        |
| Foreign Government            | 0.6         | 2.0         | 0.3         | 0.3         | 0.6         |
| Foreign - All Other           | 0.2         | 0.2         | 2.4         | 2.3         | 2.4         |
| State/Special Revenue - US    | 16.4        | 19.6        | 18.8        | 20.3        | 27.0        |
| Public Utilities - US         | 7.9         | 6.8         | 5.6         | 5.3         | 4.6         |
| Industrial & Misc - US        | 66.2        | 55.9        | 55.9        | 45.0        | 45.2        |
| Private Issues                | 4.1         | 8.8         | 5.9         | 5.3         | 9.1         |
| Public Issues                 | 95.9        | 91.2        | 94.1        | 94.7        | 90.9        |
| <u>Bond Quality (%)</u>       | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
| Class 1                       | 84.0        | 69.0        | 72.5        | 77.1        | 67.5        |
| Class 2                       | 13.7        | 23.0        | 20.3        | 19.2        | 24.6        |
| Class 3                       | 2.2         | 6.9         | 5.9         | 1.4         | 4.1         |
| Class 4                       | ...         | 0.9         | 1.0         | 1.3         | 1.3         |
| Class 5                       | 0.1         | 0.1         | 0.2         | 0.4         | 2.0         |
| Class 6                       | 0.0         | 0.0         | 0.0         | 0.5         | 0.5         |
| <u>Mortgages (000)</u>        | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
| Commercial                    | 20,616      | 24,508      | 25,335      | 35,447      | 23,341      |
| Residential                   | 91.5        | 88.1        | 92.1        | 94.2        | 99.8        |
|                               | 8.5         | 11.9        | 7.9         | 5.8         | 0.2         |
| <u>Real Estate (000)</u>      | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
| Property Occupied by Co       | 10,993      | 10,952      | 12,141      | 12,646      | 12,797      |
| Property Held for Inc         | ...         | ...         | 6.7         | 6.7         | 6.9         |
| Property Held for Sale        | 95.1        | 95.3        | 88.7        | 87.9        | 87.0        |
|                               | 4.9         | 4.7         | 4.5         | 5.4         | 6.1         |
| <u>Stocks (000)</u>           | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
| Unaffiliated Common           | 4,500       | 1,329       | 2,120       | 3,902       | 2,820       |
| Unaffiliated Preferred        | ...         | ...         | ...         | 3.1         | 6.1         |
| Affiliated Preferred          | 100.0       | 100.0       | 100.0       | 96.9        | 70.9        |
|                               | ...         | ...         | ...         | ...         | 23.1        |
| <u>Other Inv Assets (000)</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
| Cash                          | 38,543      | 53,628      | 64,138      | 59,350      | 73,535      |
| Short-Term                    | 23.5        | 27.3        | 41.5        | 28.9        | 51.9        |
| Schedule BA Assets            | ...         | 18.6        | ...         | ...         | ...         |
| All Other                     | 14.9        | 12.2        | 26.3        | 37.3        | 23.5        |
|                               | 61.6        | 41.9        | 32.2        | 33.7        | 24.6        |

## HISTORY

**Date Incorporated:** 08/15/1963

**Date Commenced:** 10/19/1963

**Domicile:** IL

Originally incorporated as Massachusetts Life Insurance Company, in 1969 the name was changed to Life of America



Insurance Corporation of Boston, and in 1986 the name was changed to Life of Boston Insurance Company. During 1991 the company redomesticated from Massachusetts to Oklahoma, and in 1999 the company redomesticated to Illinois, and the title was changed to Lincoln Heritage Life Insurance Company.

The company was originally formed by a group of prominent Boston businessmen. On September 24, 1987, Life of Boston accepted an offer from Laurentian Mutual Insurance of Canada to purchase all outstanding stock of the company. The acquisition was structured as a merger of a wholly-owned subsidiary of Laurentian Mutual with and into Life of Boston. The transaction was approved by the shareholders and regulatory authorities on April 15, 1988.

In 1968, the company changed its operations from the general agency plan to a direct mail basis, offering a special modified whole life policy. During 1970, the company began writing a special whole life guaranteed issue policy for ages 46 through 87.

**Mergers:** National Capital Life Insurance Company, Oklahoma, 1992. Lincoln Heritage Life Insurance Company, Illinois, 1999.

## OFFICERS

Chairman of the Board and Chief Executive Officer, Jack W. Londen; President, Thomas A. Londen; Senior Vice President and Chief Financial Officer, Larry R. Schuneman; Senior Vice President, Secretary and Treasurer, Dean A. Lathrop; Vice President and Actuary, James M. Jerome; Vice Presidents, Norman J. Beazer, Francis J. McGovern, Monica L. Mone, Mary B. Pace, Y. Keith Perkins, Doug L. Turner, Cheryl K. Wilson.

## DIRECTORS

Gregory T. Bruner, Michael T. Hellon, Dean A. Lathrop, Jack W. Londen, Thomas A. Londen, Francis J. McGovern, Byron L. Narcisse, Larry R. Schuneman.

## REINSURANCE

During October 1992, Life of Boston assumptively reinsured the traditional ordinary life insurance in force of Consumer's Life Insurance Company and Consumers Life Insurance Company of North Carolina. In 1994 Life of Boston assumed United Liberty's block of ordinary life business. In 2002, the company assumptively reinsured the life insurance in force of Provident Indemnity Life Insurance Company. Maximum net retention on any one life is \$100,000.

## REGULATORY

An examination of the financial condition was made as of December 31, 2002 by the Insurance Department of Illinois. The 2005 annual independent audit of the company was conducted by Dalby, Wendland & Company. The annual statement of actuarial opinion is provided by James M. Jerome, Vice President & Actuary.

**Territory:** The company is licensed in the District of Columbia, Puerto Rico, AL, AK, AZ, AR, CA, CO, CT, DE, FL, GA, HI, ID, IL, IN, IA, KS, KY, LA, ME, MD, MA, MI, MN, MS, MO, MT, NE, NV, NH, NJ, NM, NC, ND, OH, OK, OR, PA, RI, SC, SD, TN, TX, UT, VT, VA, WA, WV, WI and WY.

**Reserve basis:** (Current ordinary business): 1980 CSO 4%; CRVM valuation.

## FINANCIAL INFORMATION

### BALANCE SHEET - December 31, 2005 (in thousands of dollars)

| <b>Assets</b>           |         | <b>Liabilities</b>      |         |
|-------------------------|---------|-------------------------|---------|
| *Total bonds            | 395,971 | +Net policy reserves    | 406,997 |
| *Total preferred stocks | 4,500   | Policy claims           | 7,986   |
| Mortgage loans          | 20,616  | Deposit type contracts  | 6,612   |
| Real estate             | 10,993  | Interest maint reserve  | 221     |
| Contract loans          | 23,372  | Comm taxes expenses     | 4,216   |
| Cash & short-term inv   | 9,076   | Asset val reserve       | 3,452   |
| Prem and consid due     | 28,895  | Other liabilities       | 5,418   |
| Accrued invest income   | 5,286   | Total Liabilities       | 434,902 |
| Other assets            | 15,611  | Common stock            | 2,500   |
|                         |         | Paid in & contrib surpl | 38,213  |
|                         |         | Unassigned surplus      | 38,706  |
| Assets                  | 514,320 | Total                   | 514,320 |

\*Securities are reported on the bases prescribed by the National Association of Insurance Commissioners. + Analysis of reserves; Life \$376,319; annuities \$23,894; supplementary contracts with life contingencies \$476; accidental death benefits \$1,703; disability active lives \$152; disability disabled lives \$510; miscellaneous reserves \$2,062; accident & health \$1,883.

### SUMMARY OF OPERATIONS (in thousands of dollars)

|                          |         |                         |         |
|--------------------------|---------|-------------------------|---------|
| Premiums:                |         | Death benefits          | 53,802  |
| Ordinary life            | 123,810 | Matured endowments      | 852     |
| Individual annuities     | 1,034   | Annuity benefits        | 2,056   |
| Group life               | 5,918   | Coup endow/similar ben  | 2       |
| Acc & health other       | 10,992  | Surrender benefits      | 9,099   |
| Total premiums           | 141,753 | Acc & health benefits   | 7,235   |
| Supplementary contracts  | 247     | Int on policy funds     | 281     |
| Net investment income    | 22,878  | Supplementary contracts | 272     |
| Amort interest maint res | 130     | Incr life reserves      | 24,640  |
| Comm & exp reins ceded   | 15,773  | Incr a & h reserves     | 218     |
| Other income             | 2,488   | Commissions             | 44,667  |
| Mgt and/or service fee   | 427     | Interest expenses       | 162     |
|                          |         | Insur taxes lic & fees  | 2,820   |
|                          |         | General ins expenses    | 24,601  |
| Total                    | 183,696 | Total                   | 170,709 |

|  |        |
|--|--------|
| Gain from operations before FIT & div to policyholders | 12,987 |
| Dividends to policyholders: life                       | 471    |
| Gains from operations after dividends to policyholders | 12,516 |
| Federal income taxes incurred                          | 4,344  |
| Net gain from operations after FIT and dividends       | 8,172  |

### CASH FLOW ANALYSIS (in thousands of dollars)

| <b>Funds Provided</b>   |                | <b>Funds Applied</b>     |                |
|-------------------------|----------------|--------------------------|----------------|
| Gross cash from oper    | 175,618        | Benefits paid            | 72,566         |
| Long-term bond proceeds | 265,839        | Comm, taxes, expenses    | 71,609         |
| Other cash provided     | 24,768         | Long-term bonds acquired | 308,878        |
| Decr cash & short-term  | 15,516         | Other cash applied       | 28,688         |
| Total                   | <u>481,740</u> | Total                    | <u>481,740</u> |

**INTERIM BALANCE SHEET**  
**(in thousands of dollars)**

|                         |                   |     |     |
|-------------------------|-------------------|-----|-----|
| <u>Assets</u>           | <u>03/31/2006</u> |     |     |
| Total bonds             | 406,089           | ... | ... |
| Total preferred stocks  | 5,000             | ... | ... |
| Total common stocks     | 120               | ... | ... |
| Mortgage loans          | 13,317            | ... | ... |
| Real estate             | 10,924            | ... | ... |
| Contract loans          | 23,524            | ... | ... |
| Cash & short-term inv   | 11,391            | ... | ... |
| Premis and consid due   | 27,724            | ... | ... |
| Accrued invest income   | 4,874             | ... | ... |
| Other assets            | 16,335            | ... | ... |
| Assets                  | <u>519,298</u>    |     |     |
| <u>Liabilities</u>      | <u>03/31/2006</u> |     |     |
| Net policy reserves     | 411,568           | ... | ... |
| Policy claims           | 8,313             | ... | ... |
| Interest maint reserve  | 216               | ... | ... |
| Comm taxes expenses     | 792               | ... | ... |
| Asset val reserve       | 3,377             | ... | ... |
| Other liabilities       | 11,780            | ... | ... |
| Total liabilities       | <u>436,047</u>    |     |     |
| Common stock            | 2,500             | ... | ... |
| Paid in & contrib surpl | 38,213            | ... | ... |
| Unassigned surplus      | 42,538            | ... | ... |
| Total                   | <u>519,298</u>    |     |     |

**INTERIM SUMMARY OF OPERATIONS**

|   | Period Ended<br><u>3/31/2006</u> | Period Ended<br><u>3/31/2005</u> | Increase/<br><u>(Decrease)</u> |
|---|----------------------------------|----------------------------------|--------------------------------|
| Prem & ann consid   | 33,812                           | 36,109                           | -2,297                         |
| Total premiums  | <u>33,812</u>                    | <u>36,109</u>                    | <u>-2,297</u>                  |
| Supplementary contracts                                   | 11                               | 24                               | -12                            |
| Net investment income                                     | 6,359                            | 5,538                            | 821                            |
| Amort interest main res                                   | -20                              | 245                              | -264                           |
| Comm & exp reins ceded                                    | 3,321                            | 6,706                            | -3,384                         |
| Other income  | 754                              | 704                              | 50                             |
| Total   | <u>44,238</u>                    | <u>49,326</u>                    | <u>-5,087</u>                  |
| Death benefits  | 14,685                           | 14,541                           | 144                            |
| Matured endowments  | 149                              | 199                              | -50                            |
| Annuity benefits  | 481                              | 589                              | -108                           |
| Coup endow/similar ben                                    | 1                                | 1                                | 0                              |
| Surrender benefits  | 2,408                            | 2,060                            | 348                            |
| Disability and A&H ben                                    | 2,589                            | 2,575                            | 14                             |
| Int on policy funds                                       | 68                               | 75                               | -6                             |
| Supplementary contracts                                   | 68                               | 77                               | -10                            |
| Change in reserves  | 4,365                            | 7,667                            | -3,302                         |
| Commissions   | 12,385                           | 10,665                           | 1,720                          |
| Comm exp reins assumed                                    | 74                               | ...                              | 74                             |
| Insur taxes lic & fees                                    | 307                              | 795                              | -488                           |
| General ins expenses                                      | 5,240                            | 6,974                            | -1,734                         |
| Other disbursements                                       | 39                               | 40                               | -1                             |
| Total   | <u>42,860</u>                    | <u>46,259</u>                    | <u>-3,399</u>                  |
| Gain from operations before<br>FIT & div to policyholders | 1,378                            | 3,066                            | -1,688                         |
| Dividends to policyholders                                | 134                              | 138                              | -4                             |
| Gain from operations after<br>dividends to policyholders  | 1,244                            | 2,928                            | -1,684                         |
| Federal income taxes<br>incurred                          | 331                              | 813                              | -483                           |
| Net gain from operations<br>after FIT and dividends       | 913                              | 2,114                            | -1,201                         |

## ORDINARY LIFE STATISTICS

| <u>Year</u> | <u>Ord. Lapse Ratio %</u> | <u>Average Ord. Policy (in dollars) Issued</u> | <u>In Force</u> | <u>Avg. Prem (\$/M)</u> | <u>1st Yr Prem / Total</u> | <u>1st Yr Comm / 1st Yr Prem</u> | <u>Gen. Exp. / Policies In Force</u> |
|-------------|---------------------------|--|-----------------|-------------------------|----------------------------|----------------------------------|--------------------------------------|
| 2001        | 15.6                      | 8,210  | 6,516           | 53.92                   | 18.9                       | 111.9                            | 50.28                                |
| 2002        | 9.9                       | 7,586  | 6,425           | 53.58                   | 17.6                       | 113.5                            | 48.93                                |
| 2003        | 9.5                       | 7,035  | 6,402           | 55.51                   | 13.3                       | 130.5                            | 51.27                                |
| 2004        | 9.7                       | 7,801  | 6,530           | 54.42                   | 15.7                       | 99.8                             | 58.56                                |
| 2005        | 8.5                       | 7,950  | 6,635           | 58.46                   | 17.3                       | 107.2                            | 52.99                                |

| <u>Year</u> | <u># Policies Issued (000)</u> | <u># Policies in Force (000)</u> | <u>First Year Premium (000)</u> | <u>Gen'l Exp/ Reserves (%)</u> | <u>Return on Reserves (%)</u> |
|-------------|--------------------------------|----------------------------------|---------------------------------|--------------------------------|-------------------------------|
| 2001        | 58                             | 311                              | 20,664                          | 6.32                           | 4.17                          |
| 2002        | 45                             | 335                              | 20,333                          | 5.33                           | 2.20                          |
| 2003        | 30                             | 324                              | 15,317                          | 4.99                           | 0.68                          |
| 2004        | 35                             | 317                              | 17,651                          | 5.34                           | 1.18                          |
| 2005        | 40                             | 322                              | 21,546                          | 4.60                           | 1.93                          |

### NEW LIFE BUSINESS ISSUED (in thousands of dollars)

| <u>Year</u> | <u>Whole Life &amp; Endow</u> | <u>Term</u> | <u>Credit</u> | <u>Group</u> | <u>Total Non-Industrial Insurance Issued</u> | <u>Par (%)</u> | <u>Par (%)</u> |
|-------------|-------------------------------|-------------|---------------|--------------|--|----------------|----------------|
| 2000        | 442,752                       | ...         | ...           | 8,121        | ...  | 450,873        | 100 ...        |
| 2001        | 474,326                       | ...         | ...           | 4,939        | ...  | 479,265        | 100 ...        |
| 2002        | 341,513                       | ...         | ...           | 4,066        | ...  | 345,579        | 100 ...        |
| 2003        | 214,464                       | ...         | ...           | 4,400        | ...  | 218,864        | 100 ...        |
| 2004        | 272,482                       | ...         | ...           | 6,716        | ...  | 279,198        | 100 ...        |
| 2005        | 317,682                       | ...         | ...           | 6,816        | ...  | 324,498        | 100 ...        |

### LIFE INSURANCE IN FORCE (in thousands of dollars)

| <u>Year</u> | <u>Whole Life Endow &amp; Adds</u> | <u>Term</u> | <u>Credit</u> | <u>Group</u> | <u>Industrial</u> | <u>Total Insurance In Force</u> |
|-------------|------------------------------------|-------------|---------------|--------------|-------------------|---------------------------------|
| 2000        | 1,841,108                          | 135,297     | ...           | 21,726       | ...               | 1,998,131                       |
| 2001        | 1,895,105                          | 130,240     | ...           | 24,545       | ...               | 2,049,890                       |
| 2002        | 2,020,902                          | 133,040     | ...           | 26,646       | ...               | 2,180,588                       |
| 2003        | 1,945,478                          | 125,937     | ...           | 29,160       | ...               | 2,100,575                       |
| 2004        | 1,951,814                          | 118,327     | ...           | 31,329       | ...               | 2,101,470                       |
| 2005        | 2,025,092                          | 110,742     | ...           | 35,776       | ...               | 2,171,610                       |

