DELPHI FINANCIAL GROUP INC/DE
Form 10-Q
November 09, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2004

[ ] 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 001-11462

DELPHI FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	(302) 478-5142	13-3427277
(State or other jurisdiction of incorporation or organization)	(Registrant's telephone number, including area code)	(I.R.S. Employer Identificatio Number)

1105 North Market Street, Suite 1230, P.O. Box 8985, Wilmington, Delaware	19899
(Address of principal executive offices)	(Zip Code

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 filing requirements for the past 90 days:

Yes [X] No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes [X] No [ ]

As of October 31, 2004, the Registrant had 27,770,771 shares of Class A Common Stock and 3,914,181 shares of Class B Common Stock outstanding.

DELPHI FINANCIAL GROUP, INC.
FORM 10-Q
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PART I. FINANCIAL INFORMATION

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	Three Months Ended September 30,		
	2004	2003	2
Revenue:			
Premium and fee income..................................	$ 210,292	$ 181,211	$
Net investment income..................................	48,220	46,190	
Net realized investment gains..........................	1,433	3,170	

	259,945	230,571	
Benefits and expenses:			
Benefits, claims and interest credited to policyholders.	152,312	133,567	
Commissions...	15,607	12,625	
Amortization of cost of business acquired..............	16,721	13,790	
Other operating expenses...............................	31,199	28,110	
	215,839	188,092	
Operating income....................................	44,106	42,479	
Interest expense:			
Corporate debt..	3,548	4,809	
Junior subordinated deferrable interest debentures......	1,124	1,111	
	4,672	5,920	
Income before income tax expense...................	39,434	36,559	
Income tax expense.......................................	7,255	11,667	
Net income...	$ 32,179	$ 24,892	$
Basic results per share of common stock:			
Net income...	$ 1.00	$ 0.80	$
Diluted results per share of common stock:			
Net income...	$ 0.98	$ 0.78	$
Dividends paid per share of common stock..................	$ 0.08	$ 0.05	$

See notes to consolidated financial statements.

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)

	September 30, 2004
Assets:	
Investments:	
Fixed maturity securities, available for sale	$ 3,018,289
Short-term investments	93,120
Other investments	387,712
	3,499,121
Cash	24,339
Cost of business acquired	214,337
Reinsurance receivables	415,236
Goodwill	93,929
Securities lending collateral	264,703

Other assets	223,872
Assets held in separate account	82,723
Total assets	$ 4,818,260
Liabilities and Shareholders' Equity:	
Future policy benefits:	
Life	$ 261,322
Disability and accident	477,341
Unpaid claims and claim expenses:	
Life	45,355
Disability and accident	204,932
Casualty	608,513
Policyholder account balances	1,020,379
Corporate debt	170,750
Junior subordinated deferrable interest debentures underlying company-obligated mandatorily redeemable capital securities issued by unconsolidated subsidiaries	59,762
Securities lending payable	264,703
Other liabilities and policyholder funds	720,708
Liabilities related to separate account	82,723
Total liabilities	3,916,488
Company-obligated mandatorily redeemable capital securities of subsidiaries...	-
Shareholders' equity:	
Preferred Stock, $.01 par; 10,000,000 shares authorized	-
Class A Common Stock, $.01 par; 40,000,000 shares authorized; 30,310,229 and 29,457,024 shares issued and outstanding, respectively...	303
Class B Common Stock, $.01 par; 20,000,000 shares authorized; 3,914,181 and 4,177,357 shares issued and outstanding, respectively	39
Additional paid-in capital	404,021
Accumulated other comprehensive income	53,253
Retained earnings	503,470
Treasury stock, at cost; 2,573,211 and 2,560,035 shares of Class A Common Stock, respectively	(59,314
Total shareholders' equity	901,772
Total liabilities and shareholders' equity	$ 4,818,260

See notes to consolidated financial statements.

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(DOLLARS IN THOUSANDS)
(UNAUDITED)

	Class A Common	Class B Common	Additional Paid-in	Accumulated Other Comprehensive	Retain

	Stock	Stock	Capital	Income	Earnin
Balance, January 1, 2003............	$ 189	$ 32	$ 373,356	$ 30,003	$ 329,
Net income..........................	-	-	-	-	72,
Other comprehensive income:					
Increase in net unrealized appreciation on investments.....	-	-	-	22,582	
Increase in net loss on cash flow hedge.....................	-	-	-	(4,303)	
Comprehensive income................					
Issuance of stock, exercise of stock options and share conversions.....	6	(4)	5,497	-	
Stock-based compensation............	-	-	847	-	
Acquisition of treasury stock........	-	-	-	-	
Cash dividends......................	-	-	-	-	(4,
Balance, September 30, 2003.........	$ 195	$ 28	$ 379,700	$ 48,282	$ 396,
Balance, January 1, 2004............	$ 295	$ 42	$ 383,573	$ 52,428	$ 421,
Net income..........................	-	-	-	-	89,
Other comprehensive income:					
Increase in net unrealized appreciation on investments.....	-	-	-	236	
Decrease in net loss on cash flow hedge.....................	-	-	-	589	
Comprehensive income................					
Issuance of stock, exercise of stock options and share conversions.....	8	(3)	18,532	-	
Stock-based compensation............	-	-	1,916	-	
Acquisition of treasury stock........	-	-	-	-	
Cash dividends......................	-	-	-	-	(7,
Balance, September 30, 2004.........	$ 303	$ 39	$ 404,021	$ 53,253	$ 503,

See notes to consolidated financial statements.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS)
(UNAUDITED)

	Nine Mont Septemb
	2004
Operating activities:	

Net income	$ 89,933
Adjustments to reconcile net income to net cash provided by operating activities:	
Change in policy liabilities and policyholder accounts	145,556
Net change in reinsurance receivables and payables	(1,422)
Amortization, principally the cost of business acquired and investments	33,087
Deferred costs of business acquired	(66,814)
Net realized gains on investments	(8,595)
Net change in trading account securities	(11,985)
Net change in federal income tax liability	17,635
Other	(31,022)
Net cash provided by operating activities	166,373
Investing activities:	
Purchases of investments and loans made	(1,524,817)
Sales of investments and receipts from repayment of loans	1,109,869
Maturities of investments	167,555
Net change in short-term investments	21,632
Change in deposit in separate account	(2,440)
Net cash used by investing activities	(228,201)
Financing activities:	
Deposits to policyholder accounts	114,830
Withdrawals from policyholder accounts	(66,332)
Proceeds from issuance of 2033 Senior Notes	-
Borrowings under revolving credit facility	32,000
Principal payments under revolving credit facility	(5,000)
Repayments or repurchase of other corporate debt	-
Proceeds from issuance of 2003 Capital Securities	-
Change in liability for Federal Home Loan Bank advances	(15,000)
Other financing activities	6,936
Net cash provided by financing activities	67,434
Increase (decrease) in cash	5,606
Cash at beginning of period	18,733
Cash at end of period	$ 24,339

See notes to consolidated financial statements.

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

The financial statements of Delphi Financial Group, Inc. (the "Company," which term includes the Company and its consolidated subsidiaries unless the context indicates otherwise) included herein were prepared in conformity with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The information

furnished includes all adjustments and accruals of a normal recurring nature which are, in the opinion of management, necessary for a fair presentation of results for the interim periods. Operating results for the nine months ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ended December 31, 2004. For further information refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K/A for the year ended December 31, 2003. Capitalized terms used herein without definition have the meanings ascribed to them in the Company's annual report on Form 10-K/A for the year ended December 31, 2003.

Stock Options

Prior to the second quarter of 2003, the Company accounted for its granted stock options according to Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" and related interpretations. All options granted prior to 2003 had an intrinsic value of zero on the date of grant under APB No. 25, and, therefore, no stock-based employee compensation expense is recognized in the Company's financial statements for these options. During the second quarter of 2003, the Company adopted, effective January 1, 2003, the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation." Under the prospective method provisions of SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," the recognition provisions of SFAS No. 123 are applied to all option awards granted, modified, or settled after January 1, 2003. The amount of the expense related to stock-based compensation included in the determination of the Company's net income for 2004 and 2003 is lower than if these provisions had been applied to all awards granted since the original January 1, 1995 effective date of SFAS No. 123. The following table illustrates the effect on net income and earnings per share as if the Company had begun to apply the fair value recognition provisions of SFAS No. 123 as of its original effective date:

	Three Months Ended September 30,	
	2004	2003
	(dollars in thousands,	
Net income, as reported	$ 32,179	$ 24,892
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	581	439
Deduct: Stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(764)	(680)
Pro forma net income	$ 31,996	$ 24,651
Earnings per share:		
Basic, as reported	$ 1.00	$ 0.80
Basic, pro forma	1.00	0.79
Diluted, as reported	$ 0.98	$ 0.78
Diluted, pro forma	0.96	0.76

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)
(UNAUDITED)

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - (CONTINUED)

Accounting Changes

Effective January 1, 2004, the Company adopted the American Institute of Certified Public Accountants' Statement of Position ("SOP") No. 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts." Prior to adoption of SOP No. 03-1, the Company was required to report the aggregate of all separate account assets as a single caption on its balance sheet, which was titled "Assets held in separate account." Under the provisions of SOP No. 03-1, the Company is required to allocate its proportionate interest in the separate account's assets to the corresponding captions in the Company's balance sheet. At September 30, 2004, the Company's proportionate interest in the separate account's assets was $15.7 million. SOP No. 03-1 also provides specific guidance for accounting for certain nontraditional long-duration insurance contracts. Nontraditional long-duration insurance contracts are annuity and life products which combine fixed and variable features and that are not covered by specific accounting guidance in SFAS No. 60, "Accounting and Reporting by Insurance Enterprises," or SFAS No. 97, "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments." The Company offers nontraditional long-duration insurance contracts such as annuity products with a market value adjustment feature and first year bonus interest rates. The adoption of SOP No. 03-1 did not have a material effect on the financial position or results of operations of the Company.

The Company adopted revised Financial Accounting Standards Board Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities," as of March 31, 2004. The revised interpretation changed the conceptual framework for determining if an entity holds a controlling interest in a variable interest entity and required the Company to deconsolidate its subsidiaries that hold junior subordinated deferrable interest debentures of the Company which underlie the Company-obligated mandatorily redeemable capital securities of these subsidiaries. Therefore, at September 30, 2004, the Company presented in its consolidated financial statements the junior subordinated deferrable interest debentures of $59.8 million as a liability and its interest of $3.7 million in the subsidiaries that hold these debentures as a component of other assets. The adoption of revised FIN 46 did not have a material effect on the Company's financial position, results of operations or ability to comply with its debt covenants.

Recently Issued Accounting Standards

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on the guidance provided in EITF Issue 03-1, "The Meaning of Other-Than-Temporary Impairments and Its Application to Certain Investments," as applicable to debt and equity securities that are within the scope of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and equity securities that are accounted for using the cost method specified in APB No. 18, "The Equity Method of Accounting for Investments in Common Stock." The new guidance for determining whether an impairment in value of a security is other-than-temporary was scheduled to become effective for reporting periods beginning after June 15, 2004. In September 2004, however, the FASB issued FASB Staff Position EITF Issue 03-1-1, "Effective Date of Paragraphs 10-20 of EITF Issue 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," which delayed the effective date for the impairment recognition and measurement guidance of EITF Issue 03-1 until certain implementation issues are addressed.

The FASB is expected to issue finalized guidance in December 2004. Pending a final resolution by the FASB, the Company, as required, will continue to apply existing authoritative literature with respect to the recognition of losses related to the other-than-temporary impairment of securities. In the absence of such final resolution, the Company is unable to determine the impact, if any, that the impairment provisions of EITF Issue 03-1 will have on the Company's consolidated financial statements.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)
(UNAUDITED)

NOTE B - INVESTMENTS

At September 30, 2004, the Company had fixed maturity securities available for sale with a carrying value and a fair value of $3,018.3 million and an amortized cost of $2,917.8 million. At December 31, 2003, the Company had fixed maturity securities available for sale with a carrying value and a fair value of $2,862.0 million and an amortized cost of $2,750.9 million.

The summarized aggregate unaudited net income for the entities in which the Company's balances with independent investment managers have been invested was $632.4 million and $1,411.9 million for the first nine months of 2004 and 2003, respectively, and $(0.3) million and $249.3 million for the third quarters of 2004 and 2003, respectively.

NOTE C - SECURITIES LENDING

The Company maintains a securities lending program under which certain securities from its portfolio are loaned to other institutions for short periods of time. The Company maintains full ownership rights to the securities loaned and continues to earn interest and dividends on them. Accordingly, such securities are included in invested assets. The Company obtains collateral for such loans at approximately 102% of the market value of a loaned security. The Company's institutional lending agent monitors the market value of the securities loaned and obtains additional collateral as necessary. The collateral is deposited by the borrower with, and held by, such agent. Cash collateral is invested by such agent to generate additional income according to specified guidelines. The securities lending collateral is reported as an asset with a corresponding liability reflected for the obligation to return the collateral. At September 30, 2004, the Company had securities on loan with a market value of $259.5 million and cash collateral of $264.7 million.

NOTE D - INCOME TAXES

The Company files a "life/non-life" consolidated federal tax return, pursuant to an election made with the Company's 2001 tax return. RSLIC-Texas and RSLIC are taxed as life insurance companies and comprise the life subgroup. The non-life subgroup includes DFG, SNCC, FRSLIC, SFIC and the non-insurance subsidiaries of the Company. The Company computes a balance sheet amount for deferred income taxes, which is included in other assets or other liabilities, at the rates expected to be in effect when the underlying differences will be reported in the Company's income tax returns. The Company's federal tax returns are routinely audited by the Internal Revenue Service ("IRS"). During the third quarter of 2004, the Company's income taxes payable was reduced by $4.6 million from the favorable resolution of IRS audits of the 1998 through 2002 tax years. This accrual reduction represents the release of previous accruals for potential audit adjustments which were subsequently settled or eliminated.

NOTE E - SEGMENT INFORMATION

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(dollars in thousands)			
Revenues:				
Group employee benefit products...	$ 230,856	$ 201,015	$ 684,186	$ 587,848
Asset accumulation products.......	20,170	19,569	60,292	62,029
Other (1)........................	7,486	6,817	23,041	19,264
	258,512	227,401	767,519	669,141
Net realized investment gains.....	1,433	3,170	8,595	7,849
	$ 259,945	$ 230,571	$ 776,114	$ 676,990
Operating income:				
Group employee benefit products...	$ 39,768	$ 35,668	$ 118,651	$ 102,621
Asset accumulation products.......	5,047	3,667	13,950	12,854
Other (1)........................	(2,142)	(26)	(5,221)	(5,590)
	42,673	39,309	127,380	109,885
Net realized investment gains.....	1,433	3,170	8,595	7,849
	$ 44,106	$ 42,479	$ 135,975	$ 117,734

(1) Consists of operations that do not meet the quantitative thresholds for determining reportable segments and includes integrated disability and absence management services and certain corporate activities.

NOTE F - COMPREHENSIVE INCOME

Total comprehensive income is comprised of net income and other comprehensive income, which includes the change in unrealized gains and losses on securities available for sale and the change in the loss on the cash flow hedge described in the Company's annual report on Form 10-K/A for the year ended December 31, 2003. Total comprehensive income was $90.8 million and $90.4 million for the first nine months of 2004 and 2003, respectively, and $65.7 million and $15.7 million for the third quarters of 2004 and 2003, respectively.

NOTE G - COMPUTATION OF RESULTS PER SHARE

Prior period results per share and applicable share amounts have been restated to reflect the 3-for-2 common stock split distributed in the form of a 50% stock dividend on December 22, 2003. The following table sets forth the calculation of basic and diluted results per share:

	Three Months Ended September 30,	
	2004	2003
	(dollars in thousands,	
Numerator:		
Net income	$ 32,179	$ 24,892
Denominator:		
Weighted average common shares outstanding	32,028	31,181
Effect of dilutive securities	971	924
Weighted average common shares outstanding, assuming dilution...	32,999	32,105
Basic results per share of common stock:		
Net income	$ 1.00	$ 0.80
Diluted results per share of common stock:		
Net income	$ 0.98	$ 0.78

NOTE H - CONTINGENCIES

In the course of its business, the Company is a party to litigation and other proceedings, primarily involving its insurance operations. In some cases, these proceedings entail claims against the Company for punitive damages and similar types of relief. The ultimate disposition of such pending litigation and proceedings is not expected to have a material adverse effect on the Company's consolidated financial position. Incident to its discontinued products, the Company has been a party to two separate arbitrations arising out of two separate accident and health reinsurance arrangements in which it and other companies formerly were participating reinsurers. During the second quarter of 2004, the Company, along with other former participants, reached a settlement resolving the matters in dispute in one of these arbitrations. The Company increased its reserves relating to the reinsurance business in dispute in the settled arbitration by a total of $5.5 million during the first nine months of 2004. At issue in the remaining arbitration, among other things, is whether certain reinsurance risks were validly ceded to the Company. The hearing in such arbitration is scheduled to be held in the second quarter of 2005. While management believes that the Company has substantial legal grounds for avoiding the reinsurance risks at issue or obtaining other relief, it is not at this time possible to predict the ultimate outcome of this arbitration, nor is it feasible to provide reasonable ranges of potential losses. In the opinion of management, the arbitration, when ultimately resolved, will not have a material adverse effect on the Company's consolidated financial position.

DELPHI FINANCIAL GROUP, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

The Company, through its subsidiaries, underwrites a diverse portfolio of group employee benefit products, primarily group life, disability, and excess workers' compensation insurance. Revenues from this group of products are primarily comprised of earned premiums and investment income. The profitability of group employee benefit products is affected by, among other things, differences between actual and projected claims experience, the retention of existing customers and the Company's ability to attract new customers, change premium rates and contract terms and control administrative expenses. The Company transfers its exposure to some group employee benefit risks through reinsurance ceded arrangements with other insurance and reinsurance companies. Therefore, the profitability of group employee benefit products is affected by the amount, cost and terms of reinsurance obtained by the Company. The profitability of certain group employee benefit products is also affected by the difference between the yield achieved on invested assets and the discount rate used to calculate the related reserves. The Company is currently experiencing favorable market conditions for its excess workers' compensation products, due to higher primary workers' compensation rates. For its other group employee benefit products, the Company is maintaining its underwriting discipline under competitive market conditions, and is seeking to increase the size of its sales force in order to enhance its focus on the small case niche (insured groups of 10 to 500 individuals), including employers which are first-time providers of these employee benefits, which it believes to offer opportunities for superior profitability.

The Company also operates an asset accumulation business that focuses primarily on offering fixed annuities to individuals. Deposits from the Company's asset accumulation business consist of new annuity sales, which are recorded as liabilities rather than as premiums. Revenues from the Company's asset accumulation business are primarily comprised of investment income earned on the funds under management. The profitability of asset accumulation products is primarily dependent on the spread achieved between the return on investments and the interest credited to annuity holders. The Company is disciplined in setting the crediting rates offered on its asset accumulation products in order to achieve its targeted interest rate spreads on these products, and is willing to accept lower levels of sales on these products when market conditions make these targeted spreads more difficult to achieve.

The following discussion and analysis of the results of operations and financial condition of the Company should be read in conjunction with the Consolidated Financial Statements and related notes included in this document, as well as the Company's annual report on Form 10-K/A for the year ended December 31, 2003. Capitalized terms used herein without definition have the meanings ascribed to them in the Company's annual report on Form 10-K/A for the year ended December 31, 2003. The preparation of financial statements in conformity with GAAP requires management, in some instances, to make judgments about the application of these principles. The amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period could differ materially from the amounts reported if different conditions existed or different judgments were utilized. A discussion of how management applies certain critical accounting policies is presented in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" of the Company's annual report on Form 10-K/A for the year ended December 31, 2003 under the caption "Critical Accounting Policies" and should be read in conjunction with the following discussion and analysis of results of operations and financial condition of the Company. In addition, a discussion of uncertainties and contingencies which can affect future results and could cause future results to ultimately differ materially from those described below can be found below under the caption "Forward-Looking Statements And Cautionary Statements Regarding Certain Factors That May Affect Future Results."

RESULTS OF OPERATIONS

Nine Months Ended September 30, 2004 Compared to
Nine Months Ended September 30, 2003

Summary of Results. Net income was $89.9 million, or $2.74 per diluted share, for the first nine months of 2004 as compared to $72.1 million, or $2.26 per diluted share, for the first nine months of 2003. Net income in the first nine months of 2004 and 2003 included realized investment gains (net of the related income tax expense) of $5.6 million, or $0.17 per diluted share, and $5.1 million, or $0.16 per diluted share, respectively. The increase in net income in the first nine months of 2004 is attributable to growth in income from group employee benefit products and in net investment income. Premiums from the Company's core group employee benefit products increased 17% in the first nine months of 2004 and the combined ratio (loss ratio plus expense ratio) decreased to 94.5% for the first nine months of 2004 from 94.8% for the first nine months of 2003. The weighted average annualized crediting rate on the Company's asset accumulation products, which reflects the effects of the first year bonus crediting rate on certain newly issued products, decreased from 5.5% in the first nine months of 2003 to 4.7% in the first nine

months of 2004. Net investment income in the first nine months of 2004, which increased 6% from the first nine months of 2003, reflects an 11% increase in average invested assets. In addition, income tax expense was reduced by $4.6 million during 2004 resulting from the favorable resolution of IRS audits of the 1998 through 2002 tax years.

Premium and Fee Income. Premium and fee income for the first nine months of 2004 was $618.1 million as compared to $527.9 million for the first nine months of 2003, an increase of 17%. Premiums from core group employee benefit products increased 17% to $578.4 million for the first nine months of 2004 from $495.1 million for the first nine months of 2003. This increase reflects normal growth in employment and salary levels for the Company's existing customer base, price increases, new business production and a decrease in premiums ceded by the Company to reinsurers for these products. Within core group employee benefit products, premiums from excess workers' compensation insurance for self-insured employers increased 29% to $140.0 million for the first nine months of 2004 from $108.3 million for the first nine months of 2003. This increase was primarily due to the favorable pricing environment and demand for this product as a result of higher primary workers' compensation rates. SNCC obtained average price increases of 10% in connection with its renewals of insurance coverage during the first nine months of 2004, and has continued to obtain significant improvements in contract terms, in particular higher self-insured retention levels, in these renewals. On average, self-insured retention levels increased approximately 9% in the first nine months of 2004. In addition, retention of existing customers for excess workers' compensation products for the first nine months of 2004 was significantly higher than for the first nine months of 2003. Excess workers' compensation new business production, which represents the amount of new annualized premium sold, was $21.3 million for the first nine months of 2004 as compared with exceptionally strong production for the first nine months of 2003 of $35.7 million. The significantly higher renewal ratio and rate increases offset the decline in new business production as the Company focused on achieving rate increases on its existing business and maintained pricing and underwriting discipline as to new sales. Premiums for the Company's other core group employee benefit products increased 13% to $438.4 million for the first nine months of 2004 from $386.8 million for the first nine months of 2003, reflecting new business production and a decrease in premiums ceded by the Company to reinsurers for these products. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Reinsurance." New business production for the Company's other core group employee benefit products was $112.6 million for the first nine

months of 2004 as compared with $116.1 million for the first nine months of 2003. The level of production achieved in 2004 reflects the Company's focus on the small case niche (insured groups of 10 to 500 individuals) which resulted in a 22% increase in production based on the number of cases sold as compared to the first nine months of 2003. The Company continues to maintain its underwriting discipline under competitive market conditions for these products and to implement price increases for certain existing disability and group life customers.

Deposits from the Company's asset accumulation products were $110.7 million for the first nine months of 2004 as compared to $78.4 million for the first nine months of 2003. These deposits consist of new annuity sales, which are recorded as liabilities rather than as premiums. The increase in deposits from the Company's asset accumulation products in 2004 was primarily due to an increase in the number of independent agents and marketing companies distributing the Company's annuity products. The interest rate spreads available on these products remained below average throughout 2003 and the first nine months of 2004. The Company continues to maintain its discipline in setting the crediting rates offered on its asset accumulation products.

Net Investment Income. Net investment income for the first nine months of 2004 was $149.5 million as compared to $141.2 million for the first nine months of 2003, an increase of 6%. The level of net investment income in the 2004 period reflects an increase in average invested assets from the 2003 period, partially offset by a decrease in the tax equivalent weighted average annualized yield. The tax equivalent weighted average annualized yield on invested assets was 6.3% on average invested assets of $3,259.5 million for the first nine months of 2004 and 6.6% on average invested assets of $2,932.0 million for the first nine months of 2003.

Net Realized Investment Gains. Net realized investment gains were $8.6 million for the first nine months of 2004 as compared to $7.8 million for the first nine months of 2003. The Company's investment strategy results in periodic sales of securities and, therefore, the recognition of realized investment gains and losses. During the first nine months of 2004 and 2003, the Company recognized $11.7 million and $20.2 million, respectively, of net gains on the sales of securities. The Company monitors its investments on an ongoing basis. When the market value of a security declines below its cost, and management judges the decline to be other than temporary, the security is written down to fair value, and the decline is reported as a realized investment loss. In the first nine months of 2004 and 2003, the Company recognized $3.1 million and $12.4 million, respectively, of losses due to the other than temporary declines in the market values of certain fixed maturity securities.

The losses of this type in the first nine months of 2004 ($2.0 million on an after-tax basis) resulted primarily from credit quality-related deterioration in certain municipal and asset-backed securities, and the Company may recognize additional losses of this type in the future. The Company anticipates that if certain other existing declines in security values are determined to be other than temporary, it may recognize additional investment losses in the range of $2 million to $5 million, on an after-tax basis, with respect to the relevant securities. However, the extent of any such losses will depend on future market developments and changes in security values, and such losses may be outside this range. The Company continuously monitors the affected

securities pursuant to its procedures for evaluation for the other than temporary impairment in valuation. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward-Looking Statements and Cautionary Statements Regarding Certain Factors That May Affect Future Results"

for a description of these procedures, which take into account a number of factors. It is not possible to predict the extent of any future changes in value, positive or negative, or the results of the future application of these procedures, with respect to these securities. There can be no assurance that the Company will realize investment gains in the future in an amount sufficient to offset any such losses.

Benefits and Expenses. Policyholder benefits and expenses were $640.1 million for the first nine months of 2004 as compared to $559.3 million for the first nine months of 2003, an increase of 14%. This increase primarily reflects the increase in premiums from the Company's group employee benefit products discussed above. The combined ratio (loss ratio plus expense ratio) for the Company's group employee benefits segment was 94.5% for the first nine months of 2004 and 94.8% for the first nine months of 2003. Benefits and expenses related to the Company's asset accumulation products decreased $2.8 million primarily due to a decrease in the weighted average annualized crediting rate on these products, which reflects the effects of the first year bonus crediting rate on certain newly issued products, from 5.5% in the first nine months of 2003 to 4.7% in the first nine months of 2004.

Income Tax Expense. Income tax expense was $32.2 million for the first nine months of 2004 as compared to $32.1 million for the first nine months of 2003. The Company's effective tax rate was 26.4% and 30.8% for the first nine months of 2004 and 2003, respectively. The decrease in the Company's effective tax rate during 2004 primarily reflects a $4.6 million reduction in federal income tax expense resulting from the favorable resolution of IRS audits of the 1998 through 2002 tax years. This accrual reduction represents the release of previous accruals for potential audit adjustments which were subsequently settled or eliminated.

Three Months Ended September 30, 2004 Compared to
Three Months Ended September 30, 2003

Summary of Results. Net income was $32.2 million, or $0.98 per diluted share, for the third quarter of 2004 as compared to $24.9 million, or $0.78 per diluted share, for the third quarter of 2003. Net income in the third quarters of 2004 and 2003 included realized investment gains (net of the related income tax expense) of $0.9 million, or $0.03 per diluted share, and $2.1 million, or $0.07 per diluted share, respectively. The increase in net income in the third quarter of 2004 is attributable to growth in income from group employee benefit products and in net investment income and the decrease in interest expense. Premiums from the Company's core group employee benefit products increased 17% in the third quarter of 2004 and the combined ratio (loss ratio plus expense ratio) decreased to 93.8% in the third quarter of 2004 from 94.2% in the third quarter of 2003. The weighted average annualized crediting rate on the Company's asset accumulation products, which reflects the effects of the first year bonus crediting rate on certain newly issued products, decreased from 5.4% in the third quarter of 2003 to 4.6% in the third quarter of 2004. Net investment income in the third quarter of 2004, which increased 4% from the third quarter of 2003, reflects an 8% increase in average invested assets. In addition, income tax expense was reduced by $4.6 million during the third quarter of 2004 resulting from the favorable resolution of IRS audits of the 1998 through 2002 tax years.

Premium and Fee Income. Premium and fee income in the third quarter of 2004 was $210.3 million as compared to $181.2 million in the third quarter of 2003, an increase of 16%. Premiums from core group employee benefit products increased 17% to $199.4 million for the third quarter of 2004 from $170.1 million for the third quarter of 2003. This increase reflects normal growth in employment and salary levels for the Company's existing customer base, price increases, and new business production and a decrease in premiums ceded by the Company to reinsurers for these products. Within core group employee benefit products,

premiums from excess workers' compensation insurance for self-insured employers increased 26% to $49.7 million for the third quarter of 2004 from $39.5 million for the third quarter of 2003. This increase was primarily due to the favorable pricing environment and demand as a result of higher primary workers' compensation rates. SNCC obtained average price increases of 8% in connection with its renewals of insurance coverage during the third quarter of 2004, and has continued to obtain significant improvements in contract terms, in particular higher self-insured retention levels, in these renewals. In addition, retention of existing customers for excess workers' compensation products for the third quarter of 2004 was significantly higher than for the third quarter of 2003. Excess workers' compensation new business production, which represents the amount of new annualized premium sold, was $11.4 million in the third quarter of 2004 as compared with exceptionally strong production for the third quarter of 2003 of $16.8 million. The significantly higher renewal ratio and rate increases offset the decline in new business production as the Company focused on achieving rate increases on its existing business and maintained pricing and underwriting discipline as to new sales. Premiums from the Company's other core group employee benefit products increased 15% to $149.6 million for the third quarter of 2004 from $130.6 million for the third quarter of 2003, reflecting new business production and a decrease in premiums ceded by the Company to reinsurers for these products. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Reinsurance." New business production for the Company's other core group employee benefit products

was $30.0 million for the third quarter of 2004 and $36.2 million in the third quarter of 2003. The level of production achieved in 2004 reflects the Company's focus on the small case niche (insured groups of 10 to 500 individuals) which resulted in a 27% increase in production based on the number of cases sold as compared to the third quarter of 2003. The Company continues to maintain its underwriting discipline under competitive market conditions for these products and to implement price increases for certain existing disability and group life customers.

Deposits from the Company's asset accumulation products were $40.8 million for the third quarter of 2004 as compared to $25.3 million for the third quarter of 2003. These deposits consist of new annuity sales, which are recorded as liabilities rather than as premiums. The increase in deposits from the Company's asset accumulation products in 2004 was primarily due to an increase in the number of agents and marketing companies distributing the Company's annuity products. The interest rate spreads available on these products remained below average throughout 2003 and the first nine months of 2004. The Company continues to maintain its discipline in setting the crediting rates offered on its asset accumulation products.

Net Investment Income. Net investment income in the third quarter of 2004 was $48.2 million as compared to $46.2 million in the third quarter of 2003, an increase of 4%. The level of net investment income in the 2004 period reflects an increase in average invested assets from the 2003 period, partially offset by a decrease in the tax equivalent weighted average annualized yield. The tax equivalent weighted average annualized yield on invested assets was 5.9% on average invested assets of $3,389.9 million in the third quarter of 2004 and 6.1% on average invested assets of $3,127.4 million in the third quarter of 2003.

Net Realized Investment Gains. Net realized investment gains were $1.4 million in the third quarter of 2004 as compared to $3.2 million in the third quarter of 2003. The Company's investment strategy results in periodic sales of securities and, therefore, the recognition of realized investment gains and losses. During

the third quarters of 2004 and 2003, the Company recognized $2.0 million and $3.2 million, respectively, of net gains on sales of securities. The Company monitors its investments on an ongoing basis. When the market value of a security declines below its cost, and management judges the decline to be other than temporary, the security is written down to fair value, and the decline is reported as a realized investment loss. In the third quarters of 2004 and 2003, the Company recognized $0.6 million and $0, respectively, of losses due to the other than temporary declines in the market values of certain fixed maturity securities.

The Company may recognize additional losses of this type in the future. The Company anticipates that if certain other existing declines in security values are determined to be other than temporary, it may recognize additional investment losses in the range of $2 million to $5 million, on an after-tax basis, with respect to the relevant securities. However, the extent of any such losses will depend on future market developments and changes in security values, and such losses may be outside this range. The Company continuously monitors the affected securities pursuant to its procedures for evaluation for the other than temporary impairment in valuation. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward-Looking Statements and Cautionary Statements Regarding Certain Factors That May Affect Future Results" for a description of these procedures, which take into account a number of factors. It is not possible to predict the extent of any future changes in value, positive or negative, or the results of the future application of these procedures, with respect to these securities. There can be no assurance that the Company will realize investment gains in the future in an amount sufficient to offset any such losses.

Benefits and Expenses. Policyholder benefits and expenses were $215.8 million for the third quarter of 2004 as compared to $188.1 million for the third quarter of 2003, an increase of 15%. This increase primarily reflects the increase in premiums from the Company's group employee benefit products discussed above. The combined ratio (loss ratio plus expense ratio) for the Company's group employee benefits segment was 93.8% for the third quarter of 2004 and 94.2% for the third quarter of 2003. Benefits and expenses related to the Company's asset accumulation products decreased $0.8 million primarily due to a decrease in the weighted average annualized crediting rate on these products, which reflects the effects of the first year bonus crediting rate on certain newly issued products, from 5.4% in the third quarter of 2003 to 4.6% in the third quarter of 2004.

Interest Expense. Interest expense was $4.7 million for the third quarter of 2004 as compared to $5.9 million for the third quarter of 2003, a decrease of $1.2 million. This decrease primarily resulted from the interest expense in the 2003 period relating to the $66.5 million of 8.00% senior notes which matured on October 1, 2003.

Income Tax Expense. Income tax expense was $7.3 million for the third quarter of 2004 as compared to $11.7 million for the third quarter of 2003. The Company's effective tax rate was 18.4% for the third quarter of 2004 and 31.9% for the third quarter of 2003. The decrease in the Company's effective tax rate during 2004 primarily reflects a $4.6 million reduction in federal income tax expense resulting from the favorable resolution of IRS audits of the 1998 through 2002 tax years. This accrual reduction represents the release of previous accruals for potential audit adjustments which were subsequently settled or eliminated.

LIQUIDITY AND CAPITAL RESOURCES

General. The Company had approximately $93.3 million of financial resources

available at the holding company level at September 30, 2004, which was primarily comprised of investments in the common stock of its investment subsidiaries, fixed maturity securities, balances with independent investment managers, and short-term investments. The assets of the investment subsidiaries are primarily invested in balances with independent investment managers. Other sources of liquidity at the holding company level include dividends paid from subsidiaries, primarily generated from operating cash flows and investments. The Company's insurance subsidiaries are permitted, without prior regulatory approval, to make dividends payments totaling $56.5 million during 2004, of which $2.0 million has been paid during the first nine months of 2004. In general, dividends from the company's non-insurance subsidiaries are not subject to regulatory or other restrictions. The Company had $73.0 million of borrowings available to it under its revolving credit facility as of September 30, 2004. A shelf registration statement is also in effect under which securities yielding proceeds of up to $106.2 million may be issued by the Company.

The Company's current liquidity needs, in addition to funding its operating expenses, include principal and interest payments on outstanding borrowings under its revolving credit facility, interest payments on the 2033 Senior Notes, and distributions on the Capital Securities and the 2003 Capital Securities. The maximum amount of borrowings available under the Company's revolving credit facility, which expires in December 2006, is $100.0 million. The 2033 Senior Notes mature in their entirety in May 2033 and are not subject to any sinking fund requirements but are redeemable by the Company at par at any time on or after May 15, 2008. The junior subordinated debentures underlying the Capital Securities are not redeemable prior to March 25, 2007. The junior subordinated debentures underlying the 2003 Capital Securities are redeemable, in whole or in part, beginning May 15, 2008.

On November 4, 2004, the Company's Board of Directors declared a cash dividend of $0.08 per share, which will be paid on the Company's Class A Common Stock and Class B Common Stock on December 2, 2004.

The Company and its subsidiaries expect available sources of liquidity to exceed their current and long-term cash requirements.

Investments. The Company's overall investment strategy emphasizes safety and liquidity, while seeking the best available return, by focusing on, among other things, managing the Company's interest-sensitive assets and liabilities and seeking to minimize the Company's exposure to fluctuations in interest rates. The Company's investment portfolio, which totaled $3.5 billion at September 30, 2004, primarily consists of investments in fixed maturity securities and short-term investments. The weighted average credit rating of the Company's fixed maturity portfolio as rated by Standard & Poor's Corporation was "AA" at September 30, 2004. While ratings of this type address credit risk, they do not address other risks, such as prepayment and extension risks. The Company also invests in balances with independent investment managers, consisting primarily of investments in limited partnerships which invest in various financial instruments. These investments are reflected in the Company's financial statements under the equity method; accordingly, positive or negative changes in the values of the partnerships' investments are included in net investment income. For this purpose, the Company estimates the values of its balances with independent investment managers based on values provided by the managers, as adjusted based on available information concerning the underlying investment portfolios. As of September 30, 2004 and June 30, 2004, there were no adjustments in such values, as compared with reductions in value of $6.7 million at each of March 31, 2004 and December 31, 2003. The Company believes that its estimates reasonably reflect the values of its balances with independent investment managers; however, there can be no assurance that such values will ultimately be realized upon liquidation of such balances. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward-Looking Statements and Cautionary Statements Regarding Certain Factors

That May Affect Future Results" for a discussion of various risks relating to the Company's investment portfolio.

Reinsurance. The Company cedes portions of the risks relating to its group employee benefit products under indemnity reinsurance agreements with various unaffiliated reinsurers. The Company pays reinsurance premiums generally based upon percentages of the Company's premiums on the business reinsured. These agreements expire at various intervals as to new risks, and replacement agreements are negotiated on terms believed appropriate in light of current market conditions. During 2003, the Company replaced certain of its existing reinsurance arrangements for its excess workers' compensation and long-term disability products. Under the replacement arrangements for excess workers' compensation products, the Company reinsures excess workers' compensation risks between $5.0 million (compared to $3.0 million previously) and $50.0 million, and a majority in proportionate amount of the risks between $50.0 million and $100.0 million, per occurrence. For long-term disability products, effective October 1, 2003 for new policies and, for existing policies, the earlier of the next policy anniversary date or October 1, 2004, the Company reinsures risks in excess of $7,500 (compared to $2,500 previously) in benefits per individual per month. These changes reduced the reinsurance premiums paid by the Company for these products. However, in the case of long-term disability products, management does not believe that this reduction is sufficient to compensate for the anticipated level of losses in the $2,500 to $7,500 layer of monthly benefits for which the Company retains the risk under the new reinsurance arrangement. The Company has implemented a variety of initiatives, including pricing and underwriting initiatives, for these products; however, there can be no assurance that such initiatives will be successful. If such initiatives are not successful, the Company's results of operations could be adversely affected. See "Forward-Looking Statements And Cautionary Statements Regarding Certain Factors That May Affect Future Results."

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RSLIC Performance-Contingent Options. In April 2004, the Company granted performance-contingent incentive options to purchase 150,000 shares of the Company's Class A Common Stock to each of the seven members of executive management of RSLIC, for a total of 1,050,000 options, subject to approval by the Company's stockholders at the 2004 annual meeting of the proposed increase in the number of shares reserved for issuance under the Company's option plan under which the options were granted by 1,000,000 shares. This approval has been received. The options, which have a ten-year term and whose exercise price equals the fair market value of a share of such stock (as determined in accordance with the Company's option plan under which the options were granted) on the grant date, will become exercisable only to the extent that RSLIC-Texas, RSLIC's parent company, meets specified cumulative financial performance targets for the three or five fiscal year periods beginning with the current year; otherwise, such options will be forfeited. These targets, as described below, generally require that RSLIC-Texas's aggregate consolidated Pre-Tax Operating Income, as defined and computed under each of the related option agreements ("PTOI"), increases during these periods at an annual average rate of over 11% for any of the options to become exercisable, and at an annual average rate of at least 16% for the options to become fully exercisable.

75,000 of each executive's options will become exercisable if RSLIC-Texas's PTOI for the three year performance period is at least $329.4 million; otherwise, a reduced number of such options will become exercisable to the extent that PTOI for such period exceeds $300.5 million, determined by interpolating between zero and 75,000 according to where the PTOI amount falls in the range between $300.5 million and $329.4 million.

150,000 of each executive's options (minus the number of any options that become

exercisable for the three year performance period) will become exercisable if RSLIC-Texas's aggregate PTOI for the five year performance period is at least $646.2 million; otherwise, a reduced number of such options will become exercisable to the extent that PTOI for such period exceeds $559.9 million, determined by interpolating between zero and 150,000 according to where the PTOI amount falls in the range between $559.9 million and $646.2 million.

Under the option agreements, the formula for determining PTOI incorporates certain adjustments in order to focus on the performance of RSLIC-Texas's insurance operations; in particular, the formula excludes realized investment gains and losses. Accordingly, the PTOI amounts that would result in the applicable financial performance targets being met will not be the same as RSLIC-Texas's income before income tax expense, calculated in accordance with GAAP, for the relevant periods.

The Company believes that these options will provide substantial incentives for these executives to contribute toward RSLIC-Texas's attaining the specified targets, thereby enhancing the Company's financial performance; however, no assurance can be given that such results will be achieved. During the second quarter of 2004, the Company began recognizing compensation expense for these options under the fair value recognition provisions of SFAS No. 123 over the performance period. The compensation expense associated with these options did not have a material effect on the Company's financial position or results of operations.

MARKET RISK

There have been no material changes in the Company's exposure to market risk or its management of such risk since December 31, 2003.

CONTROLS AND PROCEDURES

As of the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer ("CEO") and Vice President and Treasurer (the individual who acts in the capacity of chief financial officer), of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in the rules and regulations of the Securities and Exchange Commission). Based on that evaluation, the Company's management, including the CEO and Vice President and Treasurer, concluded that the Company's disclosure controls and procedures were effective. There were no changes in the Company's internal control over financial reporting during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

FORWARD-LOOKING STATEMENTS AND CAUTIONARY STATEMENTS REGARDING CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS

In connection with, and because it desires to take advantage of, the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Company cautions readers regarding certain forward-looking statements in the above "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Form 10-Q and in any other statement made by, or on behalf of, the Company, whether in future filings with the Securities and Exchange Commission or otherwise. Forward-looking statements are statements not based on historical information and which relate to future operations, strategies, financial results, prospects, outlooks or other developments. Some forward-looking statements may be identified by

the use of terms such as "expects," "believes," "anticipates," "intends," "judgment" or other similar expressions. Forward-looking statements are necessarily based upon estimates and assumptions that are inherently subject to significant business, economic, competitive and other uncertainties and contingencies, many of which are beyond the Company's control and many of which, with respect to future business decisions, are subject to change. Examples of such uncertainties and contingencies include, among other important factors, those affecting the insurance industry generally, such as the economic and interest rate environment, federal and state legislative and regulatory developments, including but not limited to changes in financial services and tax laws and regulations, market pricing and competitive trends relating to insurance products and services, acts of terrorism or war, and the availability and cost of reinsurance, and those relating specifically to the Company's business, such as the level of its insurance premiums and fee income, the claims experience, persistency and other factors affecting the profitability of its insurance products, the performance of its investment portfolio and changes in the Company's investment strategy, acquisitions of companies or blocks of business, and ratings by major rating organizations of its insurance subsidiaries. These uncertainties and contingencies can affect actual results and could cause actual results to differ materially from those expressed in any forward-looking statements made by, or on behalf of, the Company. Certain of these uncertainties and contingencies are described in more detail in the remainder of this section. The Company disclaims any obligation to update forward-looking information.

RESERVES ESTABLISHED FOR FUTURE POLICY BENEFITS AND CLAIMS MAY PROVE INADEQUATE.

The Company establishes reserves for future policy benefits and unpaid claims and claim expenses relating to its insurance products. These reserves are calculated using various generally recognized actuarial methodologies and are based upon assumptions that management believes are appropriate and which vary by type of product. Annually, external actuarial experts also review the Company's methodologies, assumptions and the resulting reserves. The estimation process is complex and involves information obtained from company-specific and industry-wide data, as well as general economic information. The most significant assumptions made in the estimation process for future policy benefits relate to mortality, morbidity, claim termination and discount rates. The reserves for unpaid claims and claim expenses are determined on an individual basis for reported claims and estimates of incurred but not reported losses are developed on the basis of past experience. The most significant assumptions made in the estimation process for unpaid claims and claim expenses are the trend in loss costs, the expected frequency and severity of claims, changes in the timing of the reporting of losses from the loss date to the notification date, and expected costs to settle unpaid claims. The assumptions vary based on the year the claim is incurred. Disability reserves for unpaid claims and claim expenses are discounted using interest rate assumptions based upon projected portfolio yield rates for the assets supporting the liabilities. The assets selected to support these liabilities produce cash flows that are intended to match the timing and amount of anticipated claim and claim expense payments. Excess workers' compensation claim reserves are discounted using interest rate assumptions based on the risk-free rate of return for U.S. Government securities with a duration comparable to the expected duration and payment pattern of the claims at the time the claims are settled. The rates used to discount reserves are determined annually. The methods and assumptions used to establish reserves for future policy benefits and unpaid claims and claim expenses are continually reviewed and updated based on current circumstances, and any resulting adjustments are reflected in earnings currently.

The Company's projected ultimate insurance liabilities and associated reserves are estimates, which are subject to variability. This variability arises because

the factors and events affecting the ultimate liability have not all taken place, and thus cannot be evaluated with certainty. Moreover, under the actuarial methodologies discussed above, these estimates are subject to reevaluation based on developing trends with respect to the Company's loss experience. Such trends may emerge over longer periods of time, and changes in such trends cannot necessarily be identified or predicted at any given time by reference to current claims experience, whether favorable or unfavorable. If the Company's actual loss experience from its current or discontinued products is different from the Company's assumptions or estimates, the Company's reserves could be inadequate. In such event, the Company's results of operations, liquidity or financial condition could be materially adversely affected.

THE MARKET VALUES OF THE COMPANY'S INVESTMENTS FLUCTUATE.

The market values of the Company's investments vary depending on economic and market conditions, including interest rates, and such values can decline as a result of changes in such conditions. Increasing interest rates or a widening in the spread between interest rates available on U.S. Treasury securities and corporate debt, for example, will typically have an adverse impact on the market values of the fixed maturity securities in the Company's investment portfolio. If interest rates decline, the Company generally achieves a lower overall rate of return on investments of cash generated from the Company's operations. In addition, in the event that investments are called or mature in a declining interest rate environment, the Company may be unable to reinvest the proceeds in securities with comparable interest rates. The Company may also in the future be required or determine to sell certain investments at a price and a time when the market value of such investments is less than the book value of such investments.

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Declines in the fair value of investments that are considered in the judgment of management to be other than temporary are reported as realized investment losses. The Company evaluates, among other things, the financial position and prospects of the issuer, conditions in the issuer's industry and geographic area, liquidity of the investment, changes in the amount or timing of expected future cash flows from the investment, and recent downgrades of the issuer by a rating agency to determine if and when a decline in the fair value of an investment below amortized cost is other than temporary. The length of time and extent to which the fair value of the investment is lower than its amortized cost and the Company's ability and intent to retain the investment to allow for any anticipated recovery in the investment's fair value are also considered. The Company has experienced and may in the future experience losses from other than temporary declines in security values. Such losses are recorded as realized investment losses in the income statement. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Results of Operations."

THE COMPANY'S INVESTMENT STRATEGY EXPOSES THE COMPANY TO DEFAULT AND OTHER RISKS.

The management of the Company's investment portfolio is an important component of the Company's profitability since a substantial portion of the Company's operating income is generated from the difference between the yield achieved on invested assets and, in the case of asset accumulation products, the interest credited on policyholder funds and, in the case of the Company's other products for which reserves are discounted, the discount rate used to calculate the related reserves.

The Company is subject to the risk, among others, that the issuers of the fixed maturity securities the Company owns will default on principal and interest

payments. A major economic downturn or any of the various other factors that affect issuers' ability to pay could result in issuer defaults. Because the Company's investments consist primarily of fixed maturity securities and short-term investments, such defaults could materially adversely affect the Company's results of operations, liquidity or financial condition. The Company continually monitors its investment portfolio and attempts to ensure that the risks associated with concentrations of investments in either a particular sector of the market or a single entity are limited.

At September 30, 2004, mortgage-backed securities comprised 22% of the Company's total invested assets. Mortgage-backed securities subject the Company to a degree of interest rate risk, including prepayment and extension risk, which is generally a function of the sensitivity of each security's underlying collateral to prepayments under varying interest rate environments and the repayment priority of the securities in the particular securitization structure. The Company seeks to limit the extent of this risk by emphasizing the more predictable payment classes and securities with stable collateral.

The Company, through its insurance subsidiaries, maintains a program in which investments are financed using advances from various Federal Home Loan Banks. At September 30, 2004, the Company had outstanding advances of $135.0 million, of which $30.0 million were obtained by the Company during the first nine months of 2004. These advances, which were obtained at a fixed rate, have a weighted average term to maturity of 6.7 years. A total of $50.0 million of these advances will mature during the remainder of 2004. In addition, the Company has utilized reverse repurchase agreements, futures and option contracts and interest rate swap contracts from time to time in connection with the Company's investment strategy. These transactions require the Company to maintain securities or cash on deposit with the applicable counterparty as collateral. As the market value of the collateral or contracts changes, the Company may be required to deposit additional collateral or be entitled to have a portion of the collateral returned to it.

The types and amounts of investments made by the Company's insurance subsidiaries are subject to the insurance laws and regulations of their respective states of domicile. Each of these states has comprehensive investment regulations. In addition, the Company's revolving credit facility also contains limitations, with which the Company is currently in compliance in all material aspects, on the composition of the Company's investment portfolio.

THE COMPANY'S FINANCIAL POSITION EXPOSES THE COMPANY TO INTEREST RATE RISKS.

Because the Company's primary assets and liabilities are financial in nature, the Company's consolidated financial position and earnings are subject to risks resulting from changes in interest rates. The Company manages this risk by active portfolio management focusing on minimizing its exposure to fluctuations in interest rates by matching its invested assets and related liabilities and by periodically adjusting the crediting rates on its annuity products. Profitability of certain group employee benefit products is also affected by the difference between the yield achieved on invested assets and the discount rate used to calculate the related reserves. The Company manages this risk by adjusting the prices charged for these products.

THE COMPANY'S ABILITY TO REDUCE ITS EXPOSURE TO RISKS DEPENDS ON THE AVAILABILITY AND COST OF REINSURANCE.

The Company transfers its exposure to some risks through reinsurance arrangements with other insurance and reinsurance companies. Under the Company's reinsurance arrangements, another insurer assumes a specified portion of the Company's

losses and loss adjustment expenses in exchange for a specified portion of policy premiums. The availability, amount, cost and terms of reinsurance may vary significantly based on market conditions. Any decrease in the amount of the Company's reinsurance will increase the Company's risk of loss and any increase in the cost of such reinsurance will, absent a decrease in the reinsurance amount, reduce the Company's premium income. In either case, the Company's operating results could be adversely affected unless it is able to accordingly adjust the prices or other terms of its insurance policies or successfully implement other operational initiatives, as to which no assurance can be given. Furthermore, the Company is subject to credit risk with respect to reinsurance. The Company obtains reinsurance primarily through indemnity reinsurance transactions in which the Company is still liable for the transferred risks if the reinsurers fail to meet their financial obligations. Such failures could materially affect the Company's results of operations, liquidity or financial condition.

Some reinsurers experienced significant losses related to the terrorist events of September 11, 2001. As a result of this and other market factors, higher prices and less favorable terms and conditions continue to be offered in the reinsurance market. These market conditions are reflected in the terms of the replacement reinsurance arrangements entered into during 2003 for the Company's excess workers' compensation and long-term disability products. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Reinsurance." It is likely that, in the future, the Company's reinsurers will continue to seek price increases, although the extent of such increases cannot currently be predicted. Also, there has been significantly reduced availability of reinsurance covering risks such as terrorist and catastrophic events. Accordingly, substantially all of the Company's coverages of this nature were discontinued in 2002, which would result in the Company retaining a higher portion of losses from such events if they occur. The Company has not been able to replace such coverages on acceptable terms due to present market conditions, and there can be no assurance that the Company will be able to do so in the future. However, under the Terrorism Act, the federal government will pay 90% of the Company's covered losses relating to acts of international terrorism from property and casualty products directly written by SNCC above the Company's annual deductible. The Terrorism Act expires at the end of 2005 and, while efforts have been pending in Congress to pass a bill extending the Terrorism Act for an additional two-year term, no assurance can be given that such an extension will occur, or as to the duration of any such extension. The occurrence of a significant catastrophic event could have a material adverse effect on the Company's results of operations, liquidity or financial condition.

THE INSURANCE BUSINESS IS A HEAVILY REGULATED INDUSTRY.

The Company's insurance subsidiaries, like other insurance companies, are highly regulated by state insurance authorities in the states in which they are domiciled and the states in which they conduct business. Such regulations, among other things, limit the amount of dividends and other payments that can be made by such subsidiaries without prior regulatory approval and impose restrictions on the amount and type of investments such subsidiaries may have. These regulations also affect many other aspects of the Company's insurance subsidiaries' businesses, including, for example, risk-based capital requirements, various reserve requirements, the terms, conditions and manner of sale and marketing of insurance products, claims-handling practices and the form and content of required financial statements. These regulations are intended to protect policyholders rather than investors. The ability of the Company's insurance subsidiaries to continue to conduct their businesses is dependent upon the maintenance of their licenses in these various states. The New York State Attorney General recently initiated an investigation into certain insurance

broker compensation arrangements and other aspects of dealings between insurance brokers and insurance companies, and, in connection therewith, filed a civil complaint against a major insurance brokerage firm based on certain of such firm's compensation arrangements with insurers and alleged misconduct in connection with the placement of insurance business. Other state regulators subsequently announced the commencement of similar investigations and reviews. It is not possible to predict the future impact of the various investigations, or any regulatory changes or litigation resulting from such investigations, on the insurance industry or on the Company and its insurance subsidiaries.

From time to time, increased scrutiny has been placed upon the insurance regulatory framework, and a number of state legislatures have considered or enacted legislative measures that alter, and in many cases increase, state authority to regulate insurance companies. In addition to legislative initiatives of this type, the National Association of Insurance Commissioners and insurance regulators are continuously involved in a process of reexamining existing laws and regulations and their application to insurance companies. Furthermore, while the federal government currently does not directly regulate the insurance business, federal legislation and administrative policies (and court interpretations thereof) in a number of areas, such as employee benefits regulation, age, sex and disability-based discrimination, financial services regulation and federal taxation, can significantly affect the insurance business. It is not possible to predict the future impact of changing regulation on the operations of the Company and those of its insurance subsidiaries.

The Company's insurance subsidiaries can also be required, under solvency or guaranty laws of most states in which they do business, to pay assessments to fund policyholder losses or liabilities of insurance companies that become insolvent.

THE FINANCIAL SERVICES INDUSTRY IS HIGHLY COMPETITIVE.

The Company competes with numerous other insurance and financial services companies. Many of these organizations have substantially greater assets, higher ratings from rating agencies, larger and more diversified portfolios of insurance products and larger agency sales operations than the Company. Competition in asset accumulation product markets is also encountered from the expanding number of banks, securities brokerage firms and other financial intermediaries marketing alternative savings products, such as mutual funds, traditional bank investments and retirement funding alternatives.

THE COMPANY MAY BE ADVERSELY IMPACTED BY A DECLINE IN THE RATINGS OF THE COMPANY'S INSURANCE SUBSIDIARIES.

Ratings with respect to claims-paying ability and financial strength have become an increasingly important factor impacting the competitive position of insurance companies. Each of the rating agencies reviews its ratings of companies periodically and there can be no assurance that current ratings will be maintained or improved in the future. Claims-paying and financial strength ratings are based upon factors relevant to policyowners and are not directed toward protection of investors. Downgrades in the ratings of the Company's insurance subsidiaries could adversely affect sales of their products and could have a material adverse effect on the results of the Company's operations.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Incorporated by reference to Note H to the Consolidated Financial Statements included elsewhere herein.

Item 6. Exhibits

11.1 Computation of Results per Share of Common Stock (incorporated by reference to Note G to the Consolidated Financial Statements included elsewhere herein)

31.1 Certification by the Chairman of the Board, President and Chief Executive Officer of Periodic Report Pursuant to Rule 13a-14(a) or 15d-14(a)

31.2 Certification by the Vice President and Treasurer of Periodic Report Pursuant to Rule 13a-14(a) or 15d-14(a)

32.1 Certification of Periodic Report Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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.

DELPHI FINANCIAL GROUP, INC. (Registrant)

/s/ ROBERT ROSENKRANZ

Robert Rosenkranz
Chairman of the Board, President and Chief Executive Officer
(Principal Executive Officer)

/s/ THOMAS W. BURGHART

Thomas W. Burghart
Vice President and Treasurer
(Principal Accounting and Financial Officer)

Date: November 8, 2004