

CNO FINANCIAL GROUP, INC.

FORM 10-Q (Quarterly Report)

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Address	11825 N PENNSYLVANIA ST CARMEL, IN 46032
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Industry	Insurance (Life)
Sector	Financial
Fiscal Year	12/31

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the quarterly period ended March 31, 2013

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 001-31792

CNO Financial Group, Inc.

Delaware

State of Incorporation

11825 N. Pennsylvania Street
Carmel, Indiana 46032

Address of principal executive offices

75-3108137

IRS Employer Identification No.

(317) 817-6100

Telephone

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer [X] Accelerated filer [] Non-accelerated filer [] Smaller reporting company []

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes [] No [X]

Shares of common stock outstanding as of April 17, 2013: 222,169,106

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

**CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET**

(Dollars in millions)
(unaudited)

ASSETS

	March 31, 2013	December 31, 2012
Investments:		
Fixed maturities, available for sale, at fair value (amortized cost: March 31, 2013 - \$22,115.0; December 31, 2012 - \$21,626.8)	\$ 24,894.5	\$ 24,614.1
Equity securities at fair value (cost: March 31, 2013 - \$206.0; December 31, 2012 - \$167.1)	216.9	171.4
Mortgage loans	1,639.8	1,573.2
Policy loans	271.5	272.0
Trading securities	229.8	266.2
Investments held by variable interest entities	1,009.9	814.3
Other invested assets	309.7	248.1
Total investments	28,572.1	27,959.3
Cash and cash equivalents - unrestricted	251.6	582.5
Cash and cash equivalents held by variable interest entities	462.2	54.2
Accrued investment income	315.8	286.2
Present value of future profits	606.6	626.0
Deferred acquisition costs	654.4	629.7
Reinsurance receivables	2,879.5	2,927.7
Income tax assets, net	708.5	716.9
Assets held in separate accounts	15.5	14.9
Other assets	433.0	334.0
Total assets	\$ 34,899.2	\$ 34,131.4

(continued on next page)

The accompanying notes are an integral part
of the consolidated financial statements.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET, continued
(Dollars in millions)
(unaudited)

LIABILITIES AND SHAREHOLDERS' EQUITY

	March 31, 2013	December 31, 2012
Liabilities:		
Liabilities for insurance products:		
Interest-sensitive products	\$ 12,867.1	\$ 12,893.2
Traditional products	11,130.9	11,196.3
Claims payable and other policyholder funds	996.3	985.1
Liabilities related to separate accounts	15.5	14.9
Other liabilities	903.0	570.6
Investment borrowings	1,880.2	1,650.8
Borrowings related to variable interest entities	1,143.4	767.0
Notes payable – direct corporate obligations	934.2	1,004.2
Total liabilities	<u>29,870.6</u>	<u>29,082.1</u>
Commitments and Contingencies		
Shareholders' equity:		
Common stock (\$0.01 par value, 8,000,000,000 shares authorized, shares issued and outstanding: March 31, 2013 - 223,502,106; December 31, 2012 – 221,502,371)	2.2	2.2
Additional paid-in capital	4,173.2	4,174.7
Accumulated other comprehensive income	1,170.7	1,197.4
Accumulated deficit	(317.5)	(325.0)
Total shareholders' equity	<u>5,028.6</u>	<u>5,049.3</u>
Total liabilities and shareholders' equity	<u>\$ 34,899.2</u>	<u>\$ 34,131.4</u>

The accompanying notes are an integral part
of the consolidated financial statements.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS
(Dollars in millions, except per share data)
(unaudited)

	Three months ended	
	March 31,	
	2013	2012
Revenues:		
Insurance policy income	\$ 691.2	\$ 686.3
Net investment income (loss):		
General account assets	351.9	345.2
Policyholder and reinsurer accounts and other special-purpose portfolios	77.7	65.6
Realized investment gains (losses):		
Net realized investment gains, excluding impairment losses	15.3	30.8
Other-than-temporary impairment losses:		
Total other-than-temporary impairment losses	—	(7.9)
Portion of other-than-temporary impairment losses recognized in accumulated other comprehensive income	—	—
Net impairment losses recognized	—	(7.9)
Total realized gains	15.3	22.9
Fee revenue and other income	6.5	3.9
Total revenues	1,142.6	1,123.9
Benefits and expenses:		
Insurance policy benefits	754.1	689.0
Interest expense	27.3	28.8
Amortization	79.3	86.6
Loss on extinguishment of debt	57.7	.2
Other operating costs and expenses	189.6	227.0
Total benefits and expenses	1,108.0	1,031.6
Income before income taxes	34.6	92.3
Income tax expense (benefit):		
Income tax expense on period income	33.2	33.2
Valuation allowance for deferred tax assets	(10.5)	—
Net income	\$ 11.9	\$ 59.1
Earnings per common share:		
Basic:		
Weighted average shares outstanding	222,081,000	240,895,000
Net income	\$.05	\$.25
Diluted:		
Weighted average shares outstanding	243,467,000	297,343,000
Net income	\$.05	\$.21

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of the consolidated financial statements.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollars in millions)
(unaudited)

	Three months ended	
	March 31,	
	2013	2012
Net income	\$ 11.9	\$ 59.1
Other comprehensive income, before tax:		
Unrealized gains (losses) for the period	(183.3)	51.9
Amortization of present value of future profits and deferred acquisition costs	20.7	(20.0)
Amount related to premium deficiencies assuming the net unrealized gains had been realized	135.3	30.3
Reclassification adjustments:		
For net realized investment gains included in net income	(14.8)	(21.6)
For amortization of the present value of future profits and deferred acquisition costs related to net realized investment gains included in net income	.8	1.1
Unrealized gains (losses) on investments	(41.3)	41.7
Change related to deferred compensation plan	1.0	.8
Other comprehensive income (loss) before tax	(40.3)	42.5
Income tax (expense) benefit related to items of accumulated other comprehensive income	13.6	(16.1)
Other comprehensive income (loss), net of tax	(26.7)	26.4
Comprehensive income (loss)	\$ (14.8)	\$ 85.5

The accompanying notes are an integral part
of the consolidated financial statements.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(Dollars in millions)
(unaudited)

	Common stock and additional paid-in capital	Accumulated other comprehensive income	Accumulated deficit	Total
Balance, December 31, 2011	\$ 4,364.3	\$ 781.6	\$ (532.1)	\$ 4,613.8
Net income	—	—	59.1	59.1
Change in unrealized appreciation (depreciation) of investments (net of applicable income tax expense of \$14.3)	—	23.1	—	23.1
Change in noncredit component of impairment losses on fixed maturities, available for sale (net of applicable income tax expense of \$1.8)	—	3.3	—	3.3
Cost of shares acquired	(18.9)	—	—	(18.9)
Stock options, restricted stock and performance units	2.6	—	—	2.6
Balance, March 31, 2012	<u>\$ 4,348.0</u>	<u>\$ 808.0</u>	<u>\$ (473.0)</u>	<u>\$ 4,683.0</u>
Balance, December 31, 2012	\$ 4,176.9	\$ 1,197.4	\$ (325.0)	\$ 5,049.3
Net income	—	—	11.9	11.9
Change in unrealized appreciation (depreciation) of investments (net of applicable income tax benefit of \$13.8)	—	(27.0)	—	(27.0)
Change in noncredit component of impairment losses on fixed maturities, available for sale (net of applicable income tax expense of \$.2)	—	.3	—	.3
Extinguishment of beneficial conversion feature related to the repurchase of convertible debentures	(12.6)	—	—	(12.6)
Dividends on common stock	—	—	(4.4)	(4.4)
Stock options, restricted stock and performance units	11.1	—	—	11.1
Balance, March 31, 2013	<u>\$ 4,175.4</u>	<u>\$ 1,170.7</u>	<u>\$ (317.5)</u>	<u>\$ 5,028.6</u>

The accompanying notes are an integral part
of the consolidated financial statements.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollars in millions)
(unaudited)

	Three months ended	
	March 31,	
	2013	2012
Cash flows from operating activities:		
Insurance policy income	\$ 622.4	\$ 602.5
Net investment income	314.4	306.7
Fee revenue and other income	6.5	3.9
Insurance policy benefits	(542.4)	(565.3)
Interest expense	(20.1)	(26.5)
Deferrable policy acquisition costs	(53.5)	(46.2)
Other operating costs	(212.0)	(193.2)
Taxes	(.7)	(3.7)
Net cash provided by operating activities	<u>114.6</u>	<u>78.2</u>
Cash flows from investing activities:		
Sales of investments	547.4	670.3
Maturities and redemptions of investments	630.4	417.1
Purchases of investments	(1,656.7)	(1,305.2)
Net sales of trading securities	41.2	7.9
Change in cash and cash equivalents held by variable interest entities	(408.0)	8.6
Other	(7.0)	(9.8)
Net cash used by investing activities	<u>(852.7)</u>	<u>(211.1)</u>
Cash flows from financing activities:		
Payments on notes payable	(72.8)	(59.4)
Expenses related to extinguishment of debt	(54.7)	—
Amount paid to extinguish the beneficial conversion feature associated with repurchase of convertible debentures	(12.6)	—
Issuance of common stock	11.6	.1
Payments to repurchase common stock	—	(18.9)
Common stock dividends paid	(4.4)	—
Amounts received for deposit products	308.5	346.6
Withdrawals from deposit products	(374.1)	(406.3)
Issuance of investment borrowings:		
Federal Home Loan Bank	200.0	—
Related to variable interest entities	376.3	—
Payments on investment borrowings:		
Related to variable interest entities and other	(.1)	(.3)
Investment borrowings - repurchase agreements, net	29.5	8.6
Net cash provided (used) by financing activities	<u>407.2</u>	<u>(129.6)</u>
Net decrease in cash and cash equivalents	(330.9)	(262.5)
Cash and cash equivalents, beginning of period	582.5	436.0
Cash and cash equivalents, end of period	<u>\$ 251.6</u>	<u>\$ 173.5</u>

The accompanying notes are an integral part
of the consolidated financial statements.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
(unaudited)

BUSINESS AND BASIS OF PRESENTATION

The following notes should be read together with the notes to the consolidated financial statements included in our 2012 Annual Report on Form 10-K.

CNO Financial Group, Inc., a Delaware corporation ("CNO"), is a holding company for a group of insurance companies operating throughout the United States that develop, market and administer health insurance, annuity, individual life insurance and other insurance products. CNO became the successor to Conseco, Inc., an Indiana corporation (our "Predecessor"), in connection with our bankruptcy reorganization which became effective on September 10, 2003. The terms "CNO Financial Group, Inc.", the "Company", "we", "us", and "our" as used in these financial statements refer to CNO and its subsidiaries or, when the context requires otherwise, our Predecessor and its subsidiaries. Such terms, when used to describe insurance business and products, refer to the insurance business and products of CNO's insurance subsidiaries.

We focus on serving the senior and middle-income markets, which we believe are attractive, underserved, high growth markets. We sell our products through three distribution channels: career agents, independent producers (some of whom sell one or more of our product lines exclusively) and direct marketing.

Our unaudited consolidated financial statements reflect normal recurring adjustments that, in the opinion of management, are necessary for a fair statement of our financial position, results of operations and cash flows for the periods presented. As permitted by rules and regulations of the Securities and Exchange Commission (the "SEC") applicable to quarterly reports on Form 10-Q, we have condensed or omitted certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). We have reclassified certain amounts from the prior periods to conform to the 2013 presentation. These reclassifications have no effect on net income or shareholders' equity. Results for interim periods are not necessarily indicative of the results that may be expected for a full year.

The balance sheet at December 31, 2012, presented herein, has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements.

When we prepare financial statements in conformity with GAAP, we are required to make estimates and assumptions that significantly affect reported amounts of various assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting periods. For example, we use significant estimates and assumptions to calculate values for deferred acquisition costs, the present value of future profits, fair value measurements of certain investments (including derivatives), other-than-temporary impairments of investments, assets and liabilities related to income taxes, liabilities for insurance products, liabilities related to litigation and guaranty fund assessment accruals. If our future experience differs from these estimates and assumptions, our financial statements would be materially affected.

The accompanying financial statements include the accounts of the Company and its subsidiaries. Our consolidated financial statements exclude the results of material transactions between us and our consolidated affiliates, or among our consolidated affiliates.

OUT-OF-PERIOD ADJUSTMENT

We recorded the net effect of an out-of-period adjustment which increased our insurance policy benefits by \$6.7 million, increased amortization expense by \$2.5 million, decreased tax expense by \$3.2 million and decreased our net income by \$6.0 million (or 2 cents per diluted share) in the three months ended March 31, 2013. We evaluated this error taking into account both qualitative and quantitative factors and considered the impact of this error in relation to the 2013 period, as well as the materiality to the periods in which they originated. The impact of correcting this error in prior years was not significant to any individual period. Management believes this error is immaterial to the consolidated financial statements and all previously issued financial statements.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIESNotes to Consolidated Financial Statements
(unaudited)**INVESTMENTS**

We classify our *fixed maturity securities* into one of two categories: (i) "available for sale" (which we carry at estimated fair value with any unrealized gain or loss, net of tax and related adjustments, recorded as a component of shareholders' equity); or (ii) "trading" (which we carry at estimated fair value with changes in such value recognized as net investment income (classified as investment income from policyholder and reinsurer accounts and other special-purpose portfolios)).

Our trading securities include: (i) investments purchased with the intent of selling in the near term to generate income on price changes; and (ii) investments supporting certain insurance liabilities (including investments backing the market strategies of our multibucket annuity products) and certain reinsurance agreements. The change in fair value of these securities is recognized in income from policyholder and reinsurer accounts and other special-purpose portfolios (a component of net investment income). Investment income from trading securities backing certain insurance liabilities and certain reinsurance agreements is substantially offset by the change in insurance policy benefits related to certain products and agreements. The trading account also includes certain fixed maturity securities containing embedded derivatives for which we have elected the fair value option. The change in value of these securities is recognized in realized investment gain (losses). Our trading securities totaled \$229.8 million and \$266.2 million at March 31, 2013 and December 31, 2012, respectively.

Accumulated other comprehensive income is primarily comprised of the net effect of unrealized appreciation (depreciation) on our investments. These amounts, included in shareholders' equity as of March 31, 2013 and December 31, 2012, were as follows (dollars in millions):

	March 31, 2013	December 31, 2012
Net unrealized appreciation (depreciation) on fixed maturity securities, available for sale, on which an other-than-temporary impairment loss has been recognized	\$ 10.3	\$ 9.8
Net unrealized gains on all other investments	2,787.9	2,986.5
Adjustment to present value of future profits (a)	(184.6)	(193.0)
Adjustment to deferred acquisition costs	(430.2)	(452.9)
Adjustment to insurance liabilities	(364.1)	(489.8)
Unrecognized net loss related to deferred compensation plan	(6.9)	(7.9)
Deferred income tax liabilities	(641.7)	(655.3)
Accumulated other comprehensive income	<u>\$ 1,170.7</u>	<u>\$ 1,197.4</u>

(a) The present value of future profits is the value assigned to the right to receive future cash flows from contracts existing at September 10, 2003 (the date our Predecessor emerged from bankruptcy).

At March 31, 2013, adjustments to the present value of future profits, deferred acquisition costs, insurance liabilities and deferred tax assets included \$(155.9) million, \$(146.7) million, \$(364.1) million and \$240.0 million, respectively, for premium deficiencies that would exist on certain long-term health products if unrealized gains on the assets backing such products had been realized and the proceeds from the sales of such assets were invested at then current yields.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

 Notes to Consolidated Financial Statements
 (unaudited)

At March 31, 2013, the amortized cost, gross unrealized gains and losses, estimated fair value, other-than-temporary impairments in accumulated other comprehensive income of fixed maturities, available for sale, were as follows (dollars in millions):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Other-than- temporary impairments included in accumulated other comprehensive income
Corporate securities	\$ 14,951.6	\$ 2,086.1	\$ (33.6)	\$ 17,004.1	\$ —
United States Treasury securities and obligations of United States government corporations and agencies	93.6	5.2	—	98.8	—
States and political subdivisions	1,883.0	278.4	(4.8)	2,156.6	—
Asset-backed securities	1,460.2	108.2	(3.4)	1,565.0	—
Collateralized debt obligations	338.8	10.1	(.1)	348.8	—
Commercial mortgage-backed securities	1,293.4	146.8	(.5)	1,439.7	—
Mortgage pass-through securities	16.6	1.0	—	17.6	—
Collateralized mortgage obligations	2,077.8	186.6	(.5)	2,263.9	(5.1)
Total fixed maturities, available for sale	\$ 22,115.0	\$ 2,822.4	\$ (42.9)	\$ 24,894.5	\$ (5.1)

The following table sets forth the amortized cost and estimated fair value of fixed maturities, available for sale, at March 31, 2013, by contractual maturity. Actual maturities will differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. In addition, structured securities (such as asset-backed securities, collateralized debt obligations, commercial mortgage-backed securities, mortgage pass-through securities and collateralized mortgage obligations, collectively referred to as "structured securities") frequently include provisions for periodic principal payments and permit periodic unscheduled payments.

	Amortized cost	Estimated fair value
(Dollars in millions)		
Due in one year or less	\$ 201.4	\$ 204.4
Due after one year through five years	1,696.6	1,853.2
Due after five years through ten years	4,302.4	4,854.5
Due after ten years	10,727.8	12,347.4
Subtotal	16,928.2	19,259.5
Structured securities	5,186.8	5,635.0
Total fixed maturities, available for sale	\$ 22,115.0	\$ 24,894.5

Net Realized Investment Gains (Losses)

During the first three months of 2013, we recognized net realized investment gains of \$15.3 million, which were comprised of \$19.8 million of net gains from the sales of investments (primarily fixed maturities) with proceeds of \$.5 billion and the decrease in fair value of certain fixed maturity investments with embedded derivatives of \$4.5 million.

During the first three months of 2012, we recognized net realized investment gains of \$22.9 million, which were comprised of \$27.4 million of net gains from the sales of investments (primarily fixed maturities) with proceeds of \$.7 billion, the increase in fair value of certain fixed maturity investments with embedded derivatives of \$3.4 million, and \$7.9 million of writedowns of investments for other than temporary declines in fair value recognized through net income.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
(unaudited)

At March 31, 2013, fixed maturity securities in default or considered nonperforming had an aggregate amortized cost of \$.4 million and a carrying value of \$.5 million.

Our fixed maturity investments are generally purchased in the context of a long-term strategy to fund insurance liabilities, so we do not generally seek to generate short-term realized gains through the purchase and sale of such securities. In certain circumstances, including those in which securities are selling at prices which exceed our view of their underlying economic value, or when it is possible to reinvest the proceeds to better meet our long-term asset-liability objectives, we may sell certain securities.

During the three months ended March 31, 2013, we sold \$121.3 million of fixed maturity investments which resulted in gross investment losses (before income taxes) of \$2.0 million. We sell securities at a loss for a number of reasons including, but not limited to: (i) changes in the investment environment; (ii) expectation that the market value could deteriorate further; (iii) desire to reduce our exposure to an asset class, an issuer or an industry; (iv) prospective or actual changes in credit quality; or (v) changes in expected cash flows.

We regularly evaluate all of our investments with unrealized losses for possible impairment. Our assessment of whether unrealized losses are "other than temporary" requires significant judgment. Factors considered include: (i) the extent to which fair value is less than the cost basis; (ii) the length of time that the fair value has been less than cost; (iii) whether the unrealized loss is event driven, credit-driven or a result of changes in market interest rates or risk premium; (iv) the near-term prospects for specific events, developments or circumstances likely to affect the value of the investment; (v) the investment's rating and whether the investment is investment-grade and/or has been downgraded since its purchase; (vi) whether the issuer is current on all payments in accordance with the contractual terms of the investment and is expected to meet all of its obligations under the terms of the investment; (vii) whether we intend to sell the investment or it is more likely than not that circumstances will require us to sell the investment before recovery occurs; (viii) the underlying current and prospective asset and enterprise values of the issuer and the extent to which the recoverability of the carrying value of our investment may be affected by changes in such values; (ix) projections of, and unfavorable changes in, cash flows on structured securities including mortgage-backed and asset-backed securities; (x) our best estimate of the value of any collateral; and (xi) other objective and subjective factors.

Future events may occur, or additional information may become available, which may necessitate future realized losses in our portfolio. Significant losses could have a material adverse effect on our consolidated financial statements in future periods.

Impairment losses on equity securities are recognized in net income. The manner in which impairment losses on fixed maturity securities, available for sale, are recognized in the financial statements is dependent on the facts and circumstances related to the specific security. If we intend to sell a security or it is more likely than not that we would be required to sell a security before the recovery of its amortized cost, the security is other-than-temporarily impaired and the full amount of the impairment is recognized as a loss through earnings. If we do not expect to recover the amortized cost basis, we do not plan to sell the security, and if it is not more likely than not that we would be required to sell a security before the recovery of its amortized cost, less any current period credit loss, the recognition of the other-than-temporary impairment is bifurcated. We recognize the credit loss portion in net income and the noncredit loss portion in accumulated other comprehensive income.

We estimate the amount of the credit loss component of a fixed maturity security impairment as the difference between amortized cost and the present value of the expected cash flows of the security. The present value is determined using the best estimate of future cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate of future cash flows vary depending on the type of security.

For most structured securities, cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity, prepayment speeds and structural support, including excess spread, subordination and guarantees. For corporate bonds, cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances. The previous amortized cost basis less the impairment recognized in net income becomes the security's new cost basis. We

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIESNotes to Consolidated Financial Statements
(unaudited)

accrete the new cost basis to the estimated future cash flows over the expected remaining life of the security, except when the security is in default or considered nonperforming.

The remaining noncredit impairment, which is recorded in accumulated other comprehensive income, is the difference between the security's estimated fair value and our best estimate of future cash flows discounted at the effective interest rate prior to impairment. The remaining noncredit impairment typically represents changes in the market interest rates, current market liquidity and risk premiums. As of March 31, 2013, other-than-temporary impairments included in accumulated other comprehensive income of \$5.1 million (before taxes and related amortization) related to structured securities.

The following table summarizes the amount of credit losses recognized in earnings on fixed maturity securities, available for sale, held at the beginning of the period, for which a portion of the other-than-temporary impairment was also recognized in accumulated other comprehensive income for the three months ended March 31, 2013 and 2012 (dollars in millions):

	Three months ended	
	March 31,	
	2013	2012
Credit losses on fixed maturity securities, available for sale, beginning of period	\$ (1.6)	\$ (2.0)
Add: credit losses on other-than-temporary impairments not previously recognized	—	—
Less: credit losses on securities sold	.1	.1
Less: credit losses on securities impaired due to intent to sell (a)	—	—
Add: credit losses on previously impaired securities	—	—
Less: increases in cash flows expected on previously impaired securities	—	—
Credit losses on fixed maturity securities, available for sale, end of period	<u>\$ (1.5)</u>	<u>\$ (1.9)</u>

- (a) Represents securities for which the amount previously recognized in accumulated other comprehensive income was recognized in earnings because we intend to sell the security or we more likely than not will be required to sell the security before recovery of its amortized cost basis.

Gross Unrealized Investment Losses

Our investment strategy is to maximize, over a sustained period and within acceptable parameters of quality and risk, investment income and total investment return through active investment management. Accordingly, we may sell securities at a gain or a loss to enhance the projected total return of the portfolio as market opportunities change, to reflect changing perceptions of risk, or to better match certain characteristics of our investment portfolio with the corresponding characteristics of our insurance liabilities.

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The following table summarizes the gross unrealized losses and fair values of our investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that such securities have been in a continuous unrealized loss position, at March 31, 2013 (dollars in millions):

Description of securities	Less than 12 months		12 months or greater		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
States and political subdivisions	\$ 45.8	\$ (1.6)	\$ 72.1	\$ (3.2)	\$ 117.9	\$ (4.8)
Corporate securities	777.9	(25.8)	131.2	(7.8)	909.1	(33.6)
Asset-backed securities	183.3	(1.2)	70.7	(2.2)	254.0	(3.4)
Collateralized debt obligations	14.7	(.1)	—	—	14.7	(.1)
Commercial mortgage-backed securities	9.1	(.1)	3.7	(.4)	12.8	(.5)
Mortgage pass-through securities	.1	—	1.8	—	1.9	—
Collateralized mortgage obligations	55.9	(.4)	20.5	(.1)	76.4	(.5)
Total fixed maturities, available for sale	\$ 1,086.8	\$ (29.2)	\$ 300.0	\$ (13.7)	\$ 1,386.8	\$ (42.9)
Equity securities	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

The following table summarizes the gross unrealized losses and fair values of our investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that such securities have been in a continuous unrealized loss position, at December 31, 2012 (dollars in millions):

Description of securities	Less than 12 months		12 months or greater		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
States and political subdivisions	\$ 48.3	\$ (1.8)	\$ 68.7	\$ (3.4)	\$ 117.0	\$ (5.2)
Corporate securities	338.1	(11.2)	174.5	(9.0)	512.6	(20.2)
Asset-backed securities	41.7	(.3)	111.6	(4.9)	153.3	(5.2)
Collateralized debt obligations	19.4	(.4)	32.5	(.6)	51.9	(1.0)
Commercial mortgage-backed securities	4.9	(.1)	6.2	(.5)	11.1	(.6)
Mortgage pass-through securities	—	—	1.9	—	1.9	—
Collateralized mortgage obligations	27.0	(.4)	33.8	(.3)	60.8	(.7)
Total fixed maturities, available for sale	\$ 479.4	\$ (14.2)	\$ 429.2	\$ (18.7)	\$ 908.6	\$ (32.9)
Equity securities	\$ 17.8	\$ (1.6)	\$ —	\$ —	\$ 17.8	\$ (1.6)

Based on management's current assessment of investments with unrealized losses at March 31, 2013, the Company believes the issuers of the securities will continue to meet their obligations (or with respect to equity-type securities, the investment value will recover to its cost basis). While we do not have the intent to sell securities with unrealized losses and it is not more likely than not that we will be required to sell securities with unrealized losses prior to their anticipated recovery, our intent on an individual security may change, based upon market or other unforeseen developments. In such instances, if a loss is recognized from a sale subsequent to a balance sheet date due to these unexpected developments, the loss is recognized in the period in which we had the intent to sell the security before its anticipated recovery.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIESNotes to Consolidated Financial Statements
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A reconciliation of net income and shares used to calculate basic and diluted earnings per share is as follows (dollars in millions and shares in thousands):

	Three months ended	
	March 31,	
	2013	2012
Net income for basic earnings per share	\$ 11.9	\$ 59.1
Add: interest expense on 7.0% Convertible Senior Debentures due 2016 (the "7.0% Debentures"), net of income taxes	1.2	3.7
Net income for diluted earnings per share	<u>\$ 13.1</u>	<u>\$ 62.8</u>
Shares:		
Weighted average shares outstanding for basic earnings per share	222,081	240,895
Effect of dilutive securities on weighted average shares:		
7% Debentures	16,591	53,367
Stock options, restricted stock and performance units	2,828	2,582
Warrants	1,967	499
Dilutive potential common shares	21,386	56,448
Weighted average shares outstanding for diluted earnings per share	<u>243,467</u>	<u>297,343</u>

Basic earnings per common share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Restricted shares (including our performance units) are not included in basic earnings per share until vested. Diluted earnings per share reflect the potential dilution that could occur if outstanding stock options and warrants were exercised and restricted stock was vested. The dilution from options, warrants and restricted shares is calculated using the treasury stock method. Under this method, we assume the proceeds from the exercise of the options and warrants (or the unrecognized compensation expense with respect to restricted stock and performance units) will be used to purchase shares of our common stock at the average market price during the period, reducing the dilutive effect of the exercise of the options and warrants (or the vesting of the restricted stock and performance units). Initially, the 7.0% Debentures were convertible into 182.1494 shares of our common stock for each \$1,000 principal amount of 7.0% Debentures, which is equivalent to an initial conversion price of approximately \$5.49 per share. The conversion rate is subject to adjustment following the occurrence of certain events (including the payment of dividends on our common stock) in accordance with the terms of an indenture dated as of October 16, 2009 (the "7.0% Indenture"). At March 31, 2013, the conversion rate was 183.8523 shares of our common stock for each \$1,000 principal amount of 7.0% Debentures outstanding.

BUSINESS SEGMENTS

The Company manages its business through the following operating segments: Bankers Life, Washington National and Colonial Penn, which are defined on the basis of product distribution; Other CNO Business, comprised primarily of products we no longer sell actively; and corporate operations, comprised of holding company activities and certain noninsurance company businesses.

We measure segment performance by excluding realized investment gains (losses), fair value changes in embedded derivative liabilities, equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests and loss on extinguishment of debt because we believe that this performance measure is a better indicator of the ongoing business and trends in our business. Our primary investment focus is on investment income to support our liabilities for insurance products as opposed to the generation of realized investment gains (losses), and a long-term focus is necessary to maintain profitability over the life of the business.

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Realized investment gains (losses), fair value changes in embedded derivative liabilities, equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests and loss on extinguishment of debt depend on market conditions and do not necessarily relate to the underlying business of our segments. Realized investment gains (losses), fair value changes in embedded derivative liabilities, equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests and loss on extinguishment of debt may affect future earnings levels since our underlying business is long-term in nature and changes in our investment portfolio may impact our ability to earn the assumed interest rates needed to maintain the profitability of our business.

Operating information by segment was as follows (dollars in millions):

	Three months ended	
	March 31,	
	2013	2012
Revenues:		
Bankers Life:		
Insurance policy income:		
Annuities	\$ 7.9	\$ 7.2
Health	332.6	334.1
Life	77.5	65.2
Net investment income (a)	261.7	234.9
Fee revenue and other income (a)	3.7	2.9
Total Bankers Life revenues	683.4	644.3
Washington National:		
Insurance policy income:		
Health	144.6	142.4
Life	3.8	4.3
Other	.7	.7
Net investment income (a)	52.0	50.0
Fee revenue and other income (a)	.2	.2
Total Washington National revenues	201.3	197.6
Colonial Penn:		
Insurance policy income:		
Health	1.1	1.4
Life	55.8	52.0
Net investment income (a)	9.9	10.0
Fee revenue and other income (a)	.2	.2
Total Colonial Penn revenues	67.0	63.6
Other CNO Business:		
Insurance policy income:		
Annuities	1.7	2.5
Health	6.2	6.7
Life	59.1	69.6
Other	.2	.2
Net investment income (a)	89.7	92.7
Total Other CNO Business revenues	156.9	171.7
Corporate operations:		
Net investment income	10.1	23.2
Fee and other income	1.7	.6
Total corporate revenues	11.8	23.8
Total revenues	1,120.4	1,101.0

(continued on next page)

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIESNotes to Consolidated Financial Statements
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	Three months ended	
	March 31,	
	2013	2012
Expenses:		
Bankers Life:		
Insurance policy benefits	\$ 470.5	\$ 420.9
Amortization	54.5	56.9
Interest expense on investment borrowings	1.4	1.4
Other operating costs and expenses	94.9	94.6
Total Bankers Life expenses	<u>621.3</u>	<u>573.8</u>
Washington National:		
Insurance policy benefits	118.3	115.7
Amortization	13.7	12.7
Interest expense on investment borrowings	.5	.7
Other operating costs and expenses	39.4	43.8
Total Washington National expenses	<u>171.9</u>	<u>172.9</u>
Colonial Penn:		
Insurance policy benefits	43.0	42.1
Amortization	3.7	3.7
Other operating costs and expenses	25.7	27.6
Total Colonial Penn expenses	<u>72.4</u>	<u>73.4</u>
Other CNO Business:		
Insurance policy benefits	125.4	121.9
Amortization	5.6	7.5
Interest expense on investment borrowings	4.8	5.1
Other operating costs and expenses	17.5	39.5
Total Other CNO Business expenses	<u>153.3</u>	<u>174.0</u>
Corporate operations:		
Interest expense on corporate debt	15.1	17.5
Interest expense on borrowings of variable interest entities	—	4.0
Interest expense on investment borrowings	.1	.1
Other operating costs and expenses	8.7	21.5
Total corporate expenses	<u>23.9</u>	<u>43.1</u>
Total expenses	<u>1,042.8</u>	<u>1,037.2</u>
Income (loss) before net realized investment gains (losses), fair value changes in embedded derivative liabilities (net of related amortization), equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests, loss on extinguishment of debt and income taxes:		
Bankers Life	62.1	70.5
Washington National	29.4	24.7
Colonial Penn	(5.4)	(9.8)
Other CNO Business	3.6	(2.3)
Corporate operations	<u>(12.1)</u>	<u>(19.3)</u>
Income before net realized investment gains (losses), fair value changes in embedded derivative liabilities (net of related amortization), equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests, loss on extinguishment of debt and income taxes	<u>\$ 77.6</u>	<u>\$ 63.8</u>

(a) It is not practicable to provide additional components of revenue by product or services.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIESNotes to Consolidated Financial Statements
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A reconciliation of segment revenues and expenses to consolidated revenues and expenses is as follows (dollars in millions):

	Three months ended	
	March 31,	
	2013	2012
Total segment revenues	\$ 1,120.4	\$ 1,101.0
Net realized investment gains	15.3	22.9
Revenues related to certain non-strategic investments and earnings attributable to non-controlling interests	6.9	—
Consolidated revenues	<u>\$ 1,142.6</u>	<u>\$ 1,123.9</u>
Total segment expenses	\$ 1,042.8	\$ 1,037.2
Insurance policy benefits - fair value changes in embedded derivative liabilities	(3.1)	(11.6)
Amortization related to fair value changes in embedded derivative liabilities	1.0	4.7
Amortization related to net realized investment gains	.8	1.1
Expenses related to certain non-strategic investments and earnings attributable to non-controlling interests	8.8	—
Loss on extinguishment of debt	57.7	.2
Consolidated expenses	<u>\$ 1,108.0</u>	<u>\$ 1,031.6</u>

ACCOUNTING FOR DERIVATIVES

Our fixed index annuity products provide a guaranteed minimum rate of return and a higher potential return that is based on a percentage (the "participation rate") of the amount of increase in the value of a particular index, such as the Standard & Poor's 500 Index, over a specified period. Typically, on each policy anniversary date, a new index period begins. We are generally able to change the participation rate at the beginning of each index period during a policy year, subject to contractual minimums. We typically buy call options (including call spreads) referenced to the applicable indices in an effort to offset or hedge potential increases to policyholder benefits resulting from increases in the particular index to which the policy's return is linked. We reflect changes in the estimated fair value of these options in net investment income (classified as investment income from policyholder and reinsurer accounts and other special-purpose portfolios). Net investment gains (losses) related to fixed index products were \$57.9 million and \$41.4 million in the three months ended March 31, 2013 and 2012, respectively. These amounts were substantially offset by a corresponding change to insurance policy benefits. The estimated fair value of these options was \$110.0 million and \$54.4 million at March 31, 2013 and December 31, 2012, respectively. We classify these instruments as other invested assets.

The Company accounts for the options attributed to the policyholder for the estimated life of the annuity contract as embedded derivatives. The Company purchases options to hedge liabilities for the next policy period approximately on each policy anniversary date and must estimate the fair value of the forward embedded options related to the policies. These accounting requirements often create volatility in the earnings from these products. We record the changes in the fair values of the embedded derivatives in earnings as a component of insurance policy benefits. The fair value of these derivatives, which are classified as "liabilities for interest-sensitive products", was \$794.3 million at March 31, 2013 and \$734.0 million at December 31, 2012. In the first three months of 2013 and 2012, we recognized a reduction to earnings of \$2.1 million and \$6.9 million, respectively, from the volatility caused by the accounting requirements to record embedded options at fair value.

If the counterparties for the call options we hold fail to meet their obligations, we may have to recognize a loss. We limit our exposure to such a loss by diversifying among several counterparties believed to be strong and creditworthy. At March 31, 2013, substantially all of our counterparties were rated "BBB+" or higher by Standard & Poor's Corporation ("S&P").

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Certain of our reinsurance payable balances contain embedded derivatives. Such derivatives had an estimated fair value of \$5.1 million and \$5.5 million at March 31, 2013 and December 31, 2012, respectively. We record the change in the fair value of these derivatives as a component of investment income (classified as investment income from policyholder and reinsurer accounts and other special-purpose portfolios). We maintain the investments related to these agreements in our trading securities account, which we carry at estimated fair value with changes in such value recognized as investment income (also classified as investment income from policyholder and reinsurer accounts and other special-purpose portfolios). The change in value of these trading securities offsets the change in value of the embedded derivatives.

We purchase certain fixed maturity securities that contain embedded derivatives that are required to be bifurcated from the instrument and held at fair value on the consolidated balance sheet. For certain of these securities, we have elected the fair value option to carry the entire security at fair value with changes in fair value reported in net income for operational ease.

REINSURANCE

The cost of reinsurance ceded totaled \$52.0 million and \$57.2 million in the first quarters of 2013 and 2012, respectively. We deduct this cost from insurance policy income. Reinsurance recoveries netted against insurance policy benefits totaled \$53.6 million and \$61.6 million in the first quarters of 2013 and 2012, respectively.

From time-to-time, we assume insurance from other companies. Any costs associated with the assumption of insurance are amortized consistent with the method used to amortize deferred acquisition costs. Reinsurance premiums assumed totaled \$13.7 million and \$15.9 million in the first quarters of 2013 and 2012, respectively. Reinsurance premiums included amounts assumed pursuant to marketing and quota-share agreements with Coventry Health Care ("Coventry") of \$8.9 million and \$10.8 million in the first quarters of 2013 and 2012, respectively.

See the note entitled "Accounting for Derivatives" for a discussion of the derivative embedded in the payable related to certain modified coinsurance agreements.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIESNotes to Consolidated Financial Statements
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The Company's interim tax expense is based upon the estimated annual effective tax rate for the respective period. Under authoritative guidance, certain items are required to be excluded from the estimated annual effective tax rate calculation. Such items include changes in judgment about the realizability of deferred tax assets resulting from changes in projections of income expected to be available in future years, and items deemed to be unusual, infrequent, or that can not be reliably estimated. In these cases, the actual tax expense or benefit applicable to that item is treated discretely and is reported in the same period as the related item. The loss on extinguishment of debt of \$57.7 million was treated as a discrete item in the three month period ended March 31, 2013. The components of income tax expense were as follows (dollars in millions):

	Three months ended	
	March 31,	
	2013	2012
Current tax expense	\$ 2.7	\$ 3.3
Deferred tax expense	31.0	29.9
Income tax expense calculated based on estimated annual effective tax rate	33.7	33.2
Income tax benefit on discrete items:		
Valuation allowance reduction applicable to utilization of capital loss carryforwards	(10.5)	—
Deferred tax benefit related to loss on extinguishment of debt	(.5)	—
Total income tax expense	<u>\$ 22.7</u>	<u>\$ 33.2</u>

A reconciliation of the U.S. statutory corporate tax rate to the estimated annual tax rate, before discrete items, reflected in the consolidated statement of operations is as follows:

	Three months ended	
	March 31,	
	2013	2012
U.S. statutory corporate rate	35.0%	35.0 %
Nondeductible amounts	.1	(.1)
State taxes	1.4	1.1
Estimated annual effective tax rate	<u>36.5%</u>	<u>36.0 %</u>

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The components of the Company's income tax assets and liabilities were as follows (dollars in millions):

	March 31, 2013	December 31, 2012
Deferred tax assets:		
Net federal operating loss carryforwards	\$ 1,309.2	\$ 1,330.2
Net state operating loss carryforwards	16.4	16.2
Tax credits	41.6	39.2
Capital loss carryforwards	285.7	296.2
Deductible temporary differences:		
Insurance liabilities	759.3	746.3
Other	59.0	86.0
Gross deferred tax assets	2,471.2	2,514.1
Deferred tax liabilities:		
Investments	(23.5)	(24.1)
Present value of future profits and deferred acquisition costs	(313.4)	(325.2)
Accumulated other comprehensive income	(641.7)	(655.3)
Gross deferred tax liabilities	(978.6)	(1,004.6)
Net deferred tax assets before valuation allowance	1,492.6	1,509.5
Valuation allowance	(756.4)	(766.9)
Net deferred tax assets	736.2	742.6
Current income taxes accrued	(27.7)	(25.7)
Income tax assets, net	\$ 708.5	\$ 716.9

Our income tax expense includes deferred income taxes arising from temporary differences between the financial reporting and tax bases of assets and liabilities, capital loss carryforwards and net operating loss carryforwards ("NOLs"). Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which temporary differences are expected to be recovered or paid. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in earnings in the period when the changes are enacted.

A reduction of the net carrying amount of deferred tax assets by establishing a valuation allowance is required if, based on the available evidence, it is more likely than not that such assets will not be realized. In assessing the need for a valuation allowance, all available evidence, both positive and negative, shall be considered to determine whether, based on the weight of that evidence, a valuation allowance for deferred tax assets is needed. This assessment requires significant judgment and considers, among other matters, the nature, frequency and severity of current and cumulative losses, forecasts of future profitability, the duration of carryforward periods, our experience with operating loss and tax credit carryforwards expiring unused, and tax planning strategies. We evaluate the need to establish a valuation allowance for our deferred income tax assets on an ongoing basis. The realization of our deferred tax assets depends upon generating sufficient future taxable income during the periods in which our temporary differences become deductible and before our capital loss carryforwards and NOLs expire.

In the first three months of 2013, we reduced our deferred tax valuation allowance by \$10.5 million resulting from the utilization of capital loss carryforwards during the period. We will continue to assess the need for a valuation allowance in the future. If future results are less than projected, a valuation allowance may be required to reduce the deferred tax assets, which could have a material impact on our results of operations in the period in which it is recorded.

Recovery of our deferred tax assets is dependent on achieving the future taxable income used in our deferred tax valuation model and failure to do so would result in an increase in the valuation allowance in a future period. Any future increase in the valuation allowance may result in additional income tax expense and reduce shareholders' equity, and such an increase could have a significant impact upon our earnings in the future. In addition, the use of the Company's NOLs is dependent, in part, on whether the Internal Revenue Service (the "IRS") ultimately agrees with the tax positions we have taken in our tax returns with respect to the allocation of cancellation of indebtedness income ("CODI") resulting from the bankruptcy

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIESNotes to Consolidated Financial Statements
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of our Predecessor and the classification of the loss we recognized as a result of the transfer of the stock of Senior Health Insurance Company of Pennsylvania ("Senior Health") to Senior Health Care Oversight Trust, an independent trust (the "Independent Trust").

The Internal Revenue Code (the "Code") limits the extent to which losses realized by a non-life entity (or entities) may offset income from a life insurance company (or companies) to the lesser of: (i) 35 percent of the income of the life insurance company; or (ii) 35 percent of the total loss of the non-life entities (including NOLs of the non-life entities). There is no similar limitation on the extent to which losses realized by a life insurance entity (or entities) may offset income from a non-life entity (or entities).

Section 382 of the Code imposes limitations on a corporation's ability to use its NOLs when the company undergoes an ownership change. Future transactions and the timing of such transactions could cause an ownership change for Section 382 income tax purposes. Such transactions may include, but are not limited to, additional repurchases under our securities repurchase program, issuances of common stock (including upon conversion of our outstanding 7.0% Debentures), and acquisitions or sales of shares of CNO stock by certain holders of our shares, including persons who have held, currently hold or may accumulate in the future five percent or more of our outstanding common stock for their own account. Many of these transactions are beyond our control. If an additional ownership change were to occur for purposes of Section 382, we would be required to calculate an annual restriction on the use of our NOLs to offset future taxable income. The annual restriction would be calculated based upon the value of CNO's equity at the time of such ownership change, multiplied by a federal long-term tax exempt rate (2.77 percent at March 31, 2013), and the annual restriction could effectively eliminate our ability to use a substantial portion of our NOLs to offset future taxable income. We regularly monitor ownership change (as calculated for purposes of Section 382) and, as of March 31, 2013 , we were below the 50 percent ownership change level that would trigger further impairment of our ability to utilize our NOLs.

As of March 31, 2013 , we had \$3.7 billion of federal NOLs and \$.8 billion of capital loss carryforwards. The following table summarizes the expiration dates of our loss carryforwards assuming the IRS does not ultimately agree with the positions we have taken with respect to the allocation of CODI and the loss on our investment in Senior Health, both as further described below (dollars in millions):

Year of expiration	Net operating loss carryforwards (a)		Capital loss carryforwards	Total loss carryforwards
	Life	Non-life		
2013	\$ —	\$ —	\$ 778.5 (b)	\$ 778.5
2014	—	—	28.6	28.6
2016	—	—	9.1	9.1
2018	400.2 (a)	—	—	400.2
2021	29.5	—	—	29.5
2022	204.1	—	—	204.1
2023	— (b)	2,603.1 (a)	—	2,603.1
2024	—	3.2	—	3.2
2025	—	118.8	—	118.8
2027	—	216.8	—	216.8
2028	—	.5	—	.5
2029	—	148.9	—	148.9
2032	—	.8	—	.8
2033	—	14.7	—	14.7
Total	\$ 633.8	\$ 3,106.8	\$ 816.2	\$ 4,556.8

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- (a) The life/non-life allocation summarized above assumes the IRS does not ultimately agree with the tax position we have taken in our tax returns with respect to the allocation of CODI. If the IRS ultimately agrees with our tax position, approximately \$631 million of the non-life NOLs expiring in 2023 would be characterized as life NOLs expiring in 2018.
- (b) The allocation of the capital loss carryforwards summarized above assumes the IRS does not ultimately agree with the tax position we have taken with respect to our investment in Senior Health, which was worthless when it was transferred to the Independent Trust in 2008. If the IRS ultimately agrees with our tax position of classifying this loss as ordinary, capital loss carryforwards expiring in 2013 would decrease and life NOLs expiring in 2023 would increase by \$742 million .

We had deferred tax assets related to NOLs for state income taxes of \$16.4 million and \$16.2 million at March 31, 2013 and December 31, 2012 , respectively. The related state NOLs are available to offset future state taxable income in certain states through 2019.

In July 2006, the Joint Committee of Taxation accepted the audit and the settlement which characterized \$2.1 billion of the tax losses on our Predecessor's investment in Conseco Finance Corp. as life company losses and the remaining \$3.8 billion as non-life losses prior to the application of the CODI attribute reductions described below.

The Code provides that any income realized as a result of the CODI in bankruptcy must reduce NOLs. We realized \$2.5 billion of CODI when we emerged from bankruptcy. Pursuant to the Company's interpretation of the tax law, the CODI reductions were all used to reduce non-life NOLs and this position has been taken in our tax returns. However, the IRS has issued a proposed adjustment which is not in agreement with our position. We have been granted the opportunity to appeal the IRS proposed adjustment through their early appeals process. Due to uncertainties with respect to the position the IRS may take and limitations on our ability to utilize NOLs based on projected life and non-life income, we have consistently considered the \$631 million of CODI to be a reduction to life NOLs when determining our valuation allowance, pending resolution. If the IRS ultimately agrees with our position that the \$631 million of CODI is a reduction to non-life NOLs, our valuation allowance would be reduced by approximately \$140 million based on the income projection used in determining our valuation allowance. The outcome of this uncertainty cannot be predicted.

We recognized a \$742 million loss on our investment in Senior Health which was worthless when it was transferred to the Independent Trust in 2008. We have treated the loss as a capital loss when determining the deferred tax benefit we may receive. We also established a full valuation allowance as we believe we will not generate capital gains to utilize the benefit. However, due to uncertainties in the Code, we have reflected this loss as an ordinary loss in our tax return, contrary to certain IRS rulings. We are exploring the use of tax planning strategies to utilize this loss, assuming it is ultimately determined to be a capital loss. We have not been able to conclude that the potential strategies we have identified are feasible and/or prudent as of March 31, 2013. If classifying this loss as ordinary is ultimately determined to be correct, our valuation allowance would be reduced by approximately \$135 million based on the income projections used in determining our valuation allowance.

Tax years 2004 and 2008 through 2010 are open to examination by the IRS through September 2014, while tax year 2011 is open through September 2015. The Company's various state income tax returns are generally open for tax years 2009 through 2011 based on the individual state statutes of limitation. Generally, for tax years which generate NOLs, capital losses or tax credit carryforwards, the statute of limitations does not close until the expiration of the statute of limitations for the tax year in which such carryforwards are utilized.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIESNotes to Consolidated Financial Statements
(unaudited)**NOTES PAYABLE - DIRECT CORPORATE OBLIGATIONS**

The following notes payable were direct corporate obligations of the Company as of March 31, 2013 and December 31, 2012 (dollars in millions):

	March 31, 2013	December 31, 2012
Senior Secured Credit Agreement (as defined below)	\$ 631.2	\$ 644.6
6.375% Senior Secured Notes due October 2020 (the "6.375% Notes")	275.0	275.0
7.0% Debentures	33.7	93.0
Unamortized discount on Senior Secured Credit Agreement	(4.7)	(5.0)
Unamortized discount on 7.0% Debentures	(1.0)	(3.4)
Direct corporate obligations	<u>\$ 934.2</u>	<u>\$ 1,004.2</u>

Senior Secured Credit Agreement

On September 28, 2012, the Company entered into a senior secured credit agreement, providing for: (i) a \$425.0 million six-year term loan facility; (ii) a \$250.0 million four-year term loan facility; and (iii) a \$50.0 million three-year revolving credit facility, with JPMorgan Chase Bank, N.A., as administrative agent, and the lenders from time to time party thereto (the "Senior Secured Credit Agreement"). The Senior Secured Credit Agreement is guaranteed by the Subsidiary Guarantors (as defined below) and secured by a first-priority lien (which ranks *pari passu* with the liens securing the 6.375% Notes) on substantially all of the Company's and the Subsidiary Guarantors' assets. As of March 31, 2013, no amounts have been borrowed under the revolving credit facility.

The revolving credit facility includes an uncommitted subfacility for swingline loans of up to \$5.0 million, and up to \$5.0 million of the revolving credit facility is available for the issuance of letters of credit. The six-year term loan facility amortizes in quarterly installments in amounts resulting in an annual amortization of 1% and the four-year term loan facility amortizes in quarterly installments resulting in an annual amortization of 20% during the first and second years and 30% during the third and fourth years. Subject to certain conditions, the Company may incur additional incremental loans under the Senior Secured Credit Agreement in an amount of up to \$250.0 million.

Mandatory prepayments of the Senior Secured Credit Agreement will be required, subject to certain exceptions, in an amount equal to: (i) 100% of the net cash proceeds from certain asset sales or casualty events; (ii) 100% of the net cash proceeds received by the Company or any of its restricted subsidiaries from certain debt issuances; and (iii) 100% of the amount of certain restricted payments made (including any common stock dividends and share repurchases) as defined in the Senior Secured Credit Agreement provided that if, as of the end of the fiscal quarter immediately preceding such restricted payment, the debt to total capitalization ratio is: (x) equal to or less than 22.5%, but greater than 17.5%, the prepayment requirement shall be reduced to 33.33%; or (y) equal to or less than 17.5%, the prepayment requirement shall not apply.

Notwithstanding the foregoing, no mandatory prepayments pursuant to item (i) in the preceding paragraph shall be required if: (x) the debt to total capitalization ratio is equal or less than 20% and (y) either (A) the financial strength rating of certain of the Company's insurance subsidiaries is equal or better than A- (stable) from A.M. Best Company ("A.M. Best") or (B) the Senior Secured Credit Agreement is rated equal or better than BBB- (stable) from S&P and Baa3 (stable) by Moody's Investor Services, Inc. ("Moody's").

In the first three months of 2013, we made a mandatory prepayment of \$1.5 million in an amount equal to 33% of our common stock dividend payments, as required under the terms of our Senior Secured Credit Agreement. We also made an additional payment of \$12.0 million to cover the remaining portion of the scheduled quarterly principal payment due under the Senior Secured Credit Agreement.

The interest rates with respect to loans under: (i) the six-year term loan facility are, at the Company's option, equal to a eurodollar rate, plus 3.75% per annum, or a base rate, plus 2.75% per annum, subject to a eurodollar rate "floor" of 1.25% and a base rate "floor" of 2.25% (such rate was 5.0 percent at March 31, 2013); (ii) the four-year term loan facility are, at the

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

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(unaudited)

Company's option, equal to a eurodollar rate, plus 3.25% per annum, or a base rate, plus 2.25% per annum, subject to a eurodollar rate "floor" of 1.00% and a base rate "floor" of 2.00% (such rate was 4.25 percent at March 31, 2013); and (iii) the revolving credit facility will be, at the Company's option, equal to a eurodollar rate, plus 3.50% per annum, or a base rate, plus 2.50% per annum, in each case, with respect to revolving credit facility borrowings only, subject to certain step-downs based on the debt to total capitalization ratio of the Company.

The Senior Secured Credit Agreement requires the Company to maintain (each as calculated in accordance with the Senior Secured Credit Agreement): (i) a debt to total capitalization ratio of not more than 27.5 percent (such ratio was 20.3 percent at March 31, 2013); (ii) an interest coverage ratio of not less than 2.50 to 1.00 for each rolling four quarters (or, if less, the number of full fiscal quarters commencing after the effective date of the Senior Secured Credit Agreement) (such ratio was 7.51 to 1.00 for the period ended March 31, 2013); (iii) an aggregate ratio of total adjusted capital to company action level risk-based capital for the Company's insurance subsidiaries of not less than 250 percent (such ratio was 366 percent at March 31, 2013); and (iv) a combined statutory capital and surplus for the Company's insurance subsidiaries of at least \$1,300.0 million (combined statutory capital and surplus at March 31, 2013 , was \$1,814.1 million).

6.375% Notes

On September 28, 2012, we issued \$275.0 million in aggregate principal amount of 6.375% Notes pursuant to an Indenture, dated as of September 28, 2012 (the "6.375% Indenture"), among the Company, the subsidiary guarantors party thereto (the "Subsidiary Guarantors") and Wilmington Trust, National Association, as trustee and as collateral agent. The 6.375% Notes mature on October 1, 2020. Interest on the 6.375% Notes accrues at a rate of 6.375% per annum and is payable semiannually in arrears on April 1 and October 1 of each year, commencing on April 1, 2013. The 6.375% Notes and the guarantees thereof (the "Guarantees") are senior secured obligations of the Company and the Subsidiary Guarantors and rank equally in right of payment with all of the Company's and the Subsidiary Guarantors' existing and future senior obligations, and senior to all of the Company's and the Subsidiary Guarantors' future subordinated indebtedness. The 6.375% Notes are secured by a first-priority lien on substantially all of the assets of the Company and the Subsidiary Guarantors, subject to certain exceptions. The 6.375% Notes and the Guarantees are *pari passu* with respect to security and in right of payment with all of the Company's and the Subsidiary Guarantors' existing and future secured indebtedness under the Senior Secured Credit Agreement. The 6.375% Notes are structurally subordinated to all of the liabilities and preferred stock of each of the Company's insurance subsidiaries, which are not guarantors of the 6.375% Notes.

Under the 6.375% Indenture, the Company can make Restricted Payments (as such term is defined in the 6.375% Indenture) up to a calculated limit, provided that the Company's pro forma risk-based capital ratio exceeds 225% after giving effect to the Restricted Payment and certain other conditions are met. Restricted Payments include, among other items, repurchases of common stock and cash dividends on common stock (to the extent such dividends exceed 30 percent in the aggregate in any calendar year). Restricted payments do not include cash paid to purchase our outstanding 7.0% Debentures pursuant to the previously announced tender offer discussed below.

The limit of Restricted Payments permitted under the 6.375% Indenture is the sum of (x) 50% of the Company's "Net Excess Cash Flow" (as defined in the 6.375% Indenture) for the period (taken as one accounting period) from July 1, 2012 to the end of the Company's most recently ended fiscal quarter for which financial statements are available at the time of such Restricted Payment, (y) \$175.0 million and (z) certain other amounts specified in the 6.375% Indenture. Based on the provisions set forth in the 6.375% Indenture and the Company's Net Excess Cash Flow for the period from July 1, 2012 through March 31, 2013, the Company could have made additional Restricted Payments under this 6.375% Indenture covenant of approximately \$246 million as of March 31, 2013 . This limitation on Restricted Payments does not apply if the Debt to Total Capitalization Ratio (as defined in the 6.375% Indenture) as of the last day of the Company's most recently ended fiscal quarter for which financial statements are available that immediately precedes the date of any Restricted Payment, calculated immediately after giving effect to such Restricted Payment and any related transactions on a pro forma basis, is equal to or less than 17.5% .

7.0% Debentures

On March 28, 2013, the Company completed the cash tender offer (the "Offer") for \$59.3 million aggregate principal amount of its 7.0% Debentures for an aggregate purchase price of \$124.8 million . The Offer was conducted as part of our previously announced securities repurchase program.

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Pursuant to the terms of the Offer, holders of the 7.0% Debentures who tendered their 7.0% Debentures prior to the expiration date, received, for each \$1,000 principal amount of such 7.0% Debentures, a cash purchase price (the "Purchase Price") equal to the sum of: (i) the average volume weighted average price of our common stock (as defined in the Offer) (\$11.2393 at the close of trading on March 27, 2013) multiplied by 183.5145 ; plus (ii) a fixed cash amount of \$61.25 . The final purchase price per \$1,000 principal amount of 7.0% Debentures is \$2,123.82 . In addition to the Purchase Price, holders received accrued and unpaid interest on any 7.0% Debentures that were tendered to, but excluding, the settlement date of the Offer.

In the first three months of 2013, we recognized a loss on extinguishment of debt totaling \$57.7 million as a result of the Offer described above, the write-off of unamortized discount and issuance costs associated with the 7.0% Debentures that were repurchased and other transaction costs. Additional paid-in capital was also reduced by \$12.6 million to extinguish the beneficial conversion feature associated with a portion of the 7.0% Debentures that were repurchased. As the Code limits the deduction to taxable income for losses on the redemption of convertible debt, a minimal tax benefit was recognized related to the repurchase of the 7.0% Debentures.

The remaining 7.0% Debentures outstanding will mature on December 30, 2016, unless earlier converted. The 7.0% Debentures are not convertible prior to June 30, 2013, except under limited circumstances. Commencing on June 30, 2013, the 7.0% Debentures may be convertible into shares of our common stock at the option of the holder at any time, subject to certain exceptions and subject to our right to terminate such conversion rights under certain circumstances relating to the sale price of our common stock. If the holders elect to convert their 7.0% Debentures upon the occurrence of certain changes of control of CNO or certain other events, we will be required, under certain circumstances, to increase the conversion rate for such holders of the 7.0% Debentures who convert in connection with such events. Initially, the 7.0% Debentures will be convertible into 182.1494 shares of our common stock for each \$1,000 principal amount of 7.0% Debentures, which is equivalent to an initial conversion price of approximately \$5.49 per share. The conversion rate is subject to adjustment following the occurrence of certain events (including the payment of dividends on our common stock) in accordance with the terms of the 7.0% Indenture. At March 31, 2013, the conversion rate was 183.8523 shares of our common stock for each \$1,000 principal amount of 7.0% Debentures outstanding.

Commencing on June 30, 2013, we have the right to terminate the conversion rights of the holders of the 7.0% Debentures by written notice if the closing price of our common stock remains above \$7.61 (based on the conversion rate at March 31, 2013) for at least 20 trading days in the 30 trading day period ending on the trading day immediately preceding the date of such notice. If we exercise this right, the holders of the 7.0% Debentures would receive an aggregate of approximately 6.2 million shares of our common stock upon conversion of the 7.0% Debentures.

Scheduled Repayment of our Direct Corporate Obligations

The scheduled repayment of our direct corporate obligations was as follows at March 31, 2013 (dollars in millions):

<u>Year ending March 31,</u>		
2014	\$	51.2
2015		66.7
2016		79.3
2017		75.5
2018		4.2
Thereafter		663.0
	\$	<u>939.9</u>

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIESNotes to Consolidated Financial Statements
(unaudited)**INVESTMENT BORROWINGS**

Three of the Company's insurance subsidiaries (Conseco Life Insurance Company ("Conseco Life"), Washington National Insurance Company and Bankers Life and Casualty Company ("Bankers Life")) are members of the Federal Home Loan Bank ("FHLB"). As members of the FHLB, Conseco Life, Washington National Insurance Company and Bankers Life have the ability to borrow on a collateralized basis from the FHLB. Conseco Life, Washington National Insurance Company and Bankers Life are required to hold certain minimum amounts of FHLB common stock as a condition of membership in the FHLB, and additional amounts based on the amount of the borrowings. At March 31, 2013, the carrying value of the FHLB common stock was \$92.5 million. As of March 31, 2013, collateralized borrowings from the FHLB totaled \$1.9 billion and the proceeds were used to purchase fixed maturity securities. The borrowings are classified as investment borrowings in the accompanying consolidated balance sheet. The borrowings are collateralized by investments with an estimated fair value of \$2.3 billion at March 31, 2013, which are maintained in a custodial account for the benefit of the FHLB. Such investments are classified as fixed maturities, available for sale, in our consolidated balance sheet. Interest expense of \$6.7 million and \$7.2 million in the first three months of 2013 and 2012, respectively, was recognized related to the borrowings.

The following summarizes the terms of the borrowings (dollars in millions):

Amount borrowed	Maturity date	Interest rate at March 31, 2013
\$ 67.0	February 2014	Fixed rate – 1.830%
50.0	August 2014	Variable rate – 0.420%
100.0	August 2014	Variable rate – 0.464%
50.0	September 2015	Variable rate – 0.601%
150.0	October 2015	Variable rate – 0.553%
100.0	November 2015	Variable rate – 0.370%
146.0	November 2015	Fixed rate – 5.300%
100.0	December 2015	Fixed rate – 4.710%
100.0	June 2016	Variable rate – 0.644%
75.0	June 2016	Variable rate – 0.471%
100.0	October 2016	Variable rate – 0.486%
50.0	November 2016	Variable rate – 0.554%
50.0	November 2016	Variable rate – 0.674%
100.0	June 2017	Variable rate – 0.724%
100.0	July 2017	Fixed rate – 3.900%
50.0	August 2017	Variable rate – 0.490%
75.0	August 2017	Variable rate – 0.438%
100.0	October 2017	Variable rate – 0.734%
37.0	November 2017	Fixed rate – 3.750%
50.0	January 2018	Variable rate – 0.655%
50.0	January 2018	Variable rate – 0.642%
50.0	February 2018	Variable rate – 0.602%
22.0	February 2018	Variable rate – 0.617%
50.0	July 2018	Variable rate – 0.771%
28.0	March 2023	Fixed rate – 2.160%
<u>\$ 1,850.0</u>		

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The variable rate borrowings are pre-payable on each interest reset date without penalty. The fixed rate borrowings are pre-payable subject to payment of a yield maintenance fee based on current market interest rates. At March 31, 2013, the aggregate fee to prepay all fixed rate borrowings was \$48.9 million.

As part of our investment strategy, we may enter into repurchase agreements to increase our investment return. Pursuant to such agreements, the Company sells securities subject to an obligation to repurchase the same securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. Such borrowings totaled \$29.5 million at March 31, 2013. The borrowings mature as follows: \$22.3 million - within 30 days; and \$7.2 million - between 30 and 90 days.

The primary risks associated with short-term collateralized borrowings are: (i) a substantial decline in the market value of the margined security; and (ii) that a counterparty may be unable to perform under the terms of the contract or be unwilling to extend such financing in future periods especially if the liquidity or value of the margined security has declined. Exposure is limited to any depreciation in value of the related securities.

At March 31, 2013, investment borrowings consisted of: (i) collateralized borrowings from the FHLB of \$1.9 billion; (ii) repurchase agreements of \$29.5 million; and (iii) other borrowings of \$.7 million.

At December 31, 2012, investment borrowings consisted of: (i) collateralized borrowings from the FHLB of \$1.7 billion; and (ii) other borrowings of \$.8 million.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES
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CHANGES IN COMMON STOCK

Changes in the number of shares of common stock outstanding were as follows (shares in thousands):

Balance, December 31, 2012	221,502	
Stock options exercised	1,299	
Restricted and performance stock vested	701	(a)
Balance, March 31, 2013	<u>223,502</u>	

(a) Such amount was reduced by 345 thousand shares which were tendered to the Company for the payment of federal and state taxes owed on the vesting of restricted and performance stock.

In May 2011, the Company announced a common share repurchase program of up to \$100.0 million . In February 2012, June 2012 and December 2012, the Company's Board of Directors approved, in aggregate, an additional \$500.0 million to repurchase the Company's outstanding securities. The Company did not repurchase any shares of its common stock during the quarter ended March 31, 2013 , under its securities repurchase program. However, the purchase of \$59.3 million aggregate principal amount of our 7.0% Debentures in the cash tender offer as further discussed in the note to the consolidated financial statements entitled "Notes Payable - Direct Corporate Obligations" was made pursuant to our securities repurchase program. The Company had remaining repurchase authority of \$225.2 million as of March 31, 2013 .

In May 2012, we initiated a common stock dividend program. In the first quarter of 2013, dividends declared and paid on common stock were \$0.02 per common share totaling \$4.4 million .

SALES INDUCEMENTS

Certain of our annuity products offer sales inducements to contract holders in the form of enhanced crediting rates or bonus payments in the initial period of the contract. Certain of our life insurance products offer persistency bonuses credited to the contract holders balance after the policy has been outstanding for a specified period of time. These enhanced rates and persistency bonuses are considered sales inducements in accordance with GAAP. Such amounts are deferred and amortized in the same manner as deferred acquisition costs. Sales inducements deferred totaled \$1.1 million and \$.9 million during the three months ended March 31, 2013 and 2012 , respectively. Amounts amortized totaled \$5.7 million and \$7.3 million during the three months ended March 31, 2013 and 2012 , respectively. The unamortized balance of deferred sales inducements at March 31, 2013 and December 31, 2012 was \$121.9 million and \$126.5 million , respectively. The balance of insurance liabilities for persistency bonus benefits was \$32.7 million and \$34.6 million at March 31, 2013 and December 31, 2012 , respectively.

ASSETS AND LIABILITIES SUBJECT TO OFFSETTING DISCLOSURE REQUIREMENTS

Call options

As described in the note to the consolidated financial statements entitled "Accounting for Derivatives", we buy call options (including call spreads) referenced to applicable indices in an effort to offset or hedge potential increases to policyholder benefits resulting from increases in the particular index to which the policy's return is linked. We limit our exposure to the counterparties failing to meet their obligation with respect to the call options by diversifying among several counterparties believed to be strong and credit worthy. The call options are free-standing derivatives and are recorded at fair value in the Company's consolidated balance sheet. The Company and its subsidiaries are parties to master netting arrangements with its counterparties related to entering into various derivative contracts. However, the offsetting of assets and liabilities is not applicable to the derivative contracts that were in place at March 31, 2013 or December 31, 2012. The counterparties do not provide collateral to the Company related to their obligations under the call options.

Repurchase agreements

As described in the note to the consolidated financial statements entitled "Investment Borrowings", we may enter into agreements under which we sell securities subject to an obligation to repurchase the same securities. These repurchase

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agreements are accounted for as collateralized financing arrangements and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as investment borrowings in the Company's consolidated balance sheet, while the securities underlying the repurchase agreements remain in the respective investment asset accounts. There is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Company does not currently have any outstanding reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Company be in default (e.g., fails to make an interest payment to the counterparty). If the counterparty were to default (e.g., declare bankruptcy), the Company could cancel the repurchase agreement (i.e., cease payment of principal and interest), and attempt collection on the amount of collateral value in excess of the repurchase agreement fair value. The collateral is held by a third party financial institution in the counterparty's custodial account. The counterparty has the right to sell or repledge the investment securities.

The following tables summarize information related to call options and repurchase agreements as of March 31, 2013 and December 31, 2012 (dollars in millions):

	Gross amounts of recognized assets	Gross amounts offset in the balance sheet	Net amounts of assets presented in the balance sheet	Gross amounts not offset in the balance sheet		
				Financial instruments	Cash collateral received	Net amount
March 31, 2013:						
Call Options	\$ 110.0	\$ —	\$ 110.0	\$ (110.0)	\$ —	\$ —
December 31, 2012:						
Call Options	54.4	—	54.4	(54.4)	—	—

	Gross amounts of recognized liabilities	Gross amounts offset in the balance sheet	Net amounts of liabilities presented in the balance sheet	Gross amounts not offset in the balance sheet		
				Financial instruments	Cash collateral pledged	Net amount
March 31, 2013:						
Repurchase agreements (a)	\$ 29.5	\$ —	\$ 29.5	\$ (29.5)	\$ —	\$ —

- (a) As of March 31, 2013, these agreements were collateralized by investment securities with a fair value of \$38.0 million. There were no repurchase agreements outstanding at December 31, 2012.

RECENTLY ISSUED ACCOUNTING STANDARDS

Adopted Accounting Standards

In December 2011, the FASB issued authoritative guidance regarding disclosures about offsetting assets and liabilities. The guidance requires an entity to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. The guidance is effective for annual and interim reporting periods beginning on or after January 1, 2013, with retrospective disclosures required for all comparative periods presented. In January 2013, the FASB issued authoritative guidance that limits the scope of the new balance sheet offsetting disclosures to derivatives, repurchase

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agreements and securities lending transactions to the extent that they are: (i) offset in the financial statements; or (ii) subject to an enforceable master netting arrangement or similar agreement. Such disclosures are included in the note to the consolidated financial statements entitled "Assets and Liabilities Subject to Offsetting Disclosure Requirements".

LITIGATION AND OTHER LEGAL PROCEEDINGS

Legal Proceedings

The Company and its subsidiaries are involved in various legal actions in the normal course of business, in which claims for compensatory and punitive damages are asserted, some for substantial amounts. We recognize an estimated loss from these loss contingencies when we believe it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. Some of the pending matters have been filed as purported class actions and some actions have been filed in certain jurisdictions that permit punitive damage awards that are disproportionate to the actual damages incurred. The amounts sought in certain of these actions are often large or indeterminate and the ultimate outcome of certain actions is difficult to predict. In the event of an adverse outcome in one or more of these matters, there is a possibility that the ultimate liability may be in excess of the liabilities we have established and could have a material adverse effect on our business, financial condition, results of operations and cash flows. In addition, the resolution of pending or future litigation may involve modifications to the terms of outstanding insurance policies or could impact the timing and amount of rate increases, which could adversely affect the future profitability of the related insurance policies. Based upon information presently available, and in light of legal, factual and other defenses available to the Company and its subsidiaries, the Company does not believe that it is probable that the ultimate liability from either pending or threatened legal actions, after consideration of existing loss provisions, will have a material adverse effect on the Company's consolidated financial condition, operating results or cash flows. However, given the inherent difficulty in predicting the outcome of legal proceedings, there exists the possibility such legal actions could have a material adverse effect on the Company's consolidated financial condition, operating results or cash flows.

In addition to the inherent difficulty of predicting litigation outcomes, particularly those that will be decided by a jury, many of the matters specifically identified below purport to seek substantial or an unspecified amount of damages for unsubstantiated conduct spanning several years based on complex legal theories and damages models. The alleged damages typically are indeterminate or not factually supported in the complaint, and, in any event, the Company's experience indicates that monetary demands for damages often bear little relation to the ultimate loss. In some cases, plaintiffs are seeking to certify classes in the litigation and class certification either has been denied or is pending and we have filed oppositions to class certification or sought to decertify a prior class certification. In addition, for many of these cases: (i) there is uncertainty as to the outcome of pending appeals or motions; (ii) there are significant factual issues to be resolved; and/or (iii) there are novel legal issues presented. Accordingly, the Company can not reasonably estimate the possible loss or range of loss in excess of amounts accrued, if any, or predict the timing of the eventual resolution of these matters. The Company reviews these matters on an ongoing basis. When assessing reasonably possible and probable outcomes, the Company bases its assessment on the expected ultimate outcome following all appeals.

Cost of Insurance Litigation

Valulife/Valuterm Litigation

On March 4, 2008, a complaint was filed in the United States District Court for the Central District of California, Celedonia X. Yue, M. D. on behalf of the class of all others similarly situated, and on behalf of the General Public v. Consec Life Insurance Company, successor to Philadelphia Life Insurance Company and formerly known as Massachusetts General Life Insurance Company, Cause No. CV08-01506 CAS. Plaintiff in this putative class action owns a Valulife universal life policy insuring the life of Ruth S. Yue originally issued by Massachusetts General Life Insurance Company in 1995. Plaintiff is claiming breach of contract on behalf of the proposed national class and seeks injunctive and restitutionary relief pursuant to California Business & Professions Code Section 17200 and declaratory relief. The putative class consists of all owners of Valulife and Valuterm universal life insurance policies issued by either Massachusetts General or Philadelphia Life and that were later acquired and serviced by Consec Life. Plaintiff alleges that members of the class will be damaged by increases in the cost of insurance (a non-guaranteed element ("NGE")) that are set to take place in the twenty first policy year of Valulife and Valuterm policies. At the time plaintiff filed her complaint, no such increases had yet been applied to the subject policies. During 2010, Consec Life voluntarily agreed not to implement the cost of insurance rate increase at issue in this litigation and is following a process with respect to any future cost of insurance rate increases as set forth in the regulatory

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settlement agreement described below under the caption entitled "Regulatory Examinations and Fines". Plaintiff filed a motion for certification of a nationwide class and a California state class. On December 7, 2009, the court granted that motion. On October 8, 2010, the court dismissed the causes of actions alleged in the California state class. On January 19, 2011, the court granted the plaintiff's motion for summary judgment as to the declaratory relief claim and on February 2, 2011, the court issued an advisory opinion, in the form of a declaratory judgment, as to what, in its view, Consec Life could consider in implementing future cost of insurance rate increases related to its Valulife and Valuterm block of policies. Consec Life is appealing the court's January 19, 2011 decision and the plaintiff is appealing the court's decision to dismiss the California causes of action. These appeals are pending. We believe this case is without merit, and intend to defend it vigorously.

On November 15, 2011, a second complaint was filed by Dr. Yue in the United States District Court for the Central District on California, *Celedonia X. Yue, M. D. on behalf of the class of all others similarly situated, and on behalf of the General Public v. Consec Life Insurance Company, Cause No. CV11-9506 AHM (SHx)*, involving the same Valulife universal life policy described in the preceding paragraph. Plaintiff, for herself and on behalf of proposed members of a national class and a California class is claiming breach of contract, injunctive and restitutionary relief pursuant to California Business & Professions Code Section 17200, breach of the covenant of good faith and fair dealing, declaratory relief, and temporary, preliminary, and permanent injunctive relief. The putative class consists of all owners and former owners of Valulife and Valuterm universal life insurance policies issued by either Massachusetts General or Philadelphia Life and that were later acquired and serviced by Consec Life. Plaintiff alleges that members of the classes will be damaged by increases in the cost of insurance (a NGE) that took place on or about November 1, 2011. Plaintiff filed a motion for a preliminary injunction and a motion for certification of a California class. On April 2, 2012, the court granted the plaintiff's motions, which Consec Life is appealing. Pending the outcome of that appeal, Consec Life is preliminarily enjoined from imposing the 2011 increase in the cost of insurance on the members of the California class. Plaintiff also filed a motion on March 20, 2012 for certification of a nationwide class.

Consec Life has agreed to a settlement with the plaintiff in the litigation described in the two preceding paragraphs, which would, upon court approval, resolve those cases as well as the Nicholas litigation described below. On January 25, 2013, the parties filed a stipulation of settlement and joint motion for preliminary approval of proposed nationwide class settlement and certification of settlement classes. On March 6, 2013, the court granted preliminary approval of the settlement. The settlement includes a reduction in the cost of insurance increase implemented by Consec Life in November 2011 and certain policy benefit enhancements. Final approval of the settlement is subject to a court fairness hearing, currently set for June 10, 2013, after notice to the policyholders covered by the settlement, as well as other conditions.

On February 6, 2012, a complaint was filed in the United States District Court for the Northern District of Illinois, *Daniel B. Nicholas, on behalf of himself and all others similarly situated v. Consec Life Insurance Company, Cause No. 12cv845*. Plaintiff in this putative class action owns a Valulife universal life policy insuring Plaintiff's life originally issued by Massachusetts General Life Insurance Company (now Consec Life Insurance Company) in 1991. Plaintiff is claiming breach of contract on behalf of the proposed national class and seeks declaratory, injunctive, and supplemental relief. The putative class consists of all persons who own or have owned one or more universal life policies issued by Consec Life which provide that the cost of insurance rates will be determined based upon expectations as to future mortality experience and who have experienced an increase in the cost of insurance rates. On April 20, 2012, we announced that Consec Life had reached a tentative settlement in the Nicholas case. Venue of this case was subsequently transferred to the United States District Court for the Central District of California. The settlement described in the preceding paragraph would, if approved, resolve the Nicholas case.

In connection with the tentative settlement in the Nicholas litigation, the Company recorded a pre-tax charge of approximately \$20 million in its Other CNO Business segment for the quarter ended March 31, 2012. The Company recorded an additional pre-tax charge of \$21 million in its Other CNO Business segment for the quarter ended September 30, 2012 relating to the settlement agreement described above in the Yue litigation. The liability the Company has established related to these cases includes its best estimates of the costs of implementing the settlement, if finalized and approved by the court. While the Company believes its estimates are adequate to cover these costs, the estimates are subject to significant judgment and it is possible that the estimates will prove insufficient to cover the actual costs.

Lifetrend Litigation

On December 24, 2008, a purported class action was filed in the U.S. District Court for the Northern District of California, *Cedric Brady, et. al. individually and on behalf of all other similarly situated v. Consec, Inc. and Consec Life*

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Insurance Company Case No. 3:08-cv-05746. The plaintiffs allege that Conseco Life and Conseco, Inc. committed breach of contract and insurance bad faith and violated various consumer protection statutes in the administration of various interest sensitive whole life products sold primarily under the name "Lifetrend" by requiring the payment of additional cash amounts to maintain the policies in force and by making changes to certain NGEs in their policies. On April 23, 2009, the plaintiffs filed an amended complaint adding the additional counts of breach of fiduciary duty, fraud, negligent misrepresentation, conversion and declaratory relief. On May 29, 2009, Conseco, Inc. and Conseco Life filed a motion to dismiss the amended complaint. On July 29, 2009, the court granted in part and denied in part the motion to dismiss. The court dismissed the allegations that Conseco Life violated various consumer protection statutes, the breach of fiduciary duty count, and dismissed Conseco, Inc. for lack of personal jurisdiction.

On July 2, 2009, a purported class action was filed in the U.S. District Court for the Middle District of Florida, *Bill W. McFarland, and all those similarly situated v. Conseco Life Insurance Company, Case No. 3:09-cv-598-J-32MCR*. The plaintiff alleges that Conseco Life committed breach of contract and has been unjustly enriched in the administration, including changes to certain NGEs, of various interest sensitive whole life products sold primarily under the name "Lifetrend." The plaintiff seeks declaratory and injunctive relief, compensatory damages, punitive damages and attorney fees.

Conseco Life filed a motion with the Judicial Panel on Multidistrict Litigation ("MDL"), seeking the establishment of an MDL proceeding consolidating the Brady case and the McFarland case into a single action. On February 3, 2010, the Judicial Panel on MDL ordered these cases be consolidated for pretrial proceedings in the Northern District of California Federal Court. On July 7, 2010, plaintiffs filed an amended motion for class certification of a nationwide class and a California state class. On October 6, 2010, the court granted the motion for certification of a nationwide class and denied the motion for certification of a California state class. Conseco Life filed a motion to decertify the nationwide class on July 1, 2011. On December 20, 2011, the court issued an order denying Conseco Life's motion to decertify the class as to current policyholders, but granted the motion to decertify as to former policyholders. On March 5, 2012, the plaintiffs filed a motion for a preliminary injunction requesting that the court enjoin Conseco Life from imposing increased cost of insurance charges until trial with regard to 157 members of the class, and on July 17, 2012, the court granted a preliminary injunction as to 100 members of the class and denied the plaintiff's motion for a preliminary injunction as to the other 57 members. Subsequently, the plaintiffs filed a motion for partial summary judgment on their breach of contract claim, Conseco Life filed a motion to decertify the nationwide class, and Conseco Life filed a motion for summary judgment. On January 29, 2013, the court granted in part and denied in part plaintiffs' motion for partial summary judgment and denied Conseco Life's motions. The parties have reached an agreement in principle on material terms of settlement. Trial has been continued to July 8, 2013 while the parties prepare and file a Stipulation of Settlement with the court.

On October 25, 2012, a purported nationwide class action was filed in the United States District Court for the Central District of California, *William Jeffrey Burnett and Joe H. Camp v. Conseco Life Insurance Company, CNO Financial Group, Inc., CDOC, Inc. and CNO Services, LLC, Case No. EDCV12-01715VAPSPX*. The plaintiffs bring this action under Rule 23(B)(3) on behalf of various Lifetrend policyholders who since October 2008 have surrendered their policies or had them lapse. Such policyholders are no longer members of the class covered by the MDL litigation described in the previous paragraph after the court in the MDL litigation granted Conseco Life's motion to decertify as to former policyholders. Additionally, plaintiffs seek certification of a subclass of various Lifetrend policyholders who accepted optional benefits and signed a release pursuant to the regulatory settlement agreement described below under the caption entitled "Regulatory Examinations and Fines." The plaintiffs allege breach of contract and seek declaratory relief, compensatory damages, attorney fees and costs. On November 30, 2012, Conseco Life and the other defendants filed a motion to dismiss the complaint. We believe this case is without merit and intend to defend it vigorously.

Other Litigation

On December 8, 2008, a purported Florida state class action was filed in the U.S. District Court for the Southern District of Florida, *Sydelle Ruderman individually and on behalf of all other similarly situated v. Washington National Insurance Company, Case No. 08-23401-CIV-Cohn/Selzer*. The plaintiff alleges that the inflation escalation rider on her policy of long-term care insurance operates to increase the policy's lifetime maximum benefit, and that Washington National Insurance Company breached the contract by stopping her benefits when they reached the lifetime maximum. The Company takes the position that the inflation escalator only affects the per day maximum benefit. Additional parties have asked the court to allow them to intervene in the action, and on January 5, 2010, the court granted the motion to intervene and granted the plaintiff's motion for class certification. The court certified a (B) (3) Florida state class alleging damages and a (B) (2) Florida state class alleging injunctive relief. The parties reached a settlement of the (B) (3) class in 2010, which has been implemented. The

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amount recognized in 2010 related to the settlement was not significant to the Company's consolidated financial condition, cash flows or results of operations. The plaintiff filed a motion for summary judgment as to the (B) (2) class which was granted by the court on September 8, 2010. The Company has appealed the court's decision and the appeal is pending. On February 17, 2012, the Eleventh Circuit Court of Appeals referred the case to the Florida Supreme Court, which accepted jurisdiction of the case. On December 5, 2012, the Florida Supreme Court held oral argument and took the matter under advisement. We believe this case is without merit and intend to defend it vigorously.

On January 26, 2009, a purported class action complaint was filed in the United States District Court for the Northern District of Illinois, *Samuel Rowe and Estella Rowe, individually and on behalf of themselves and all others similarly situated v. Bankers Life & Casualty Company and Bankers Life Insurance Company of Illinois, Case No. 09CV491*. The plaintiffs are alleging violation of California Business and Professions Code Sections 17200 et seq. and 17500 et seq., breach of common law fiduciary duty, breach of implied covenant of good faith and fair dealing and violation of California Welfare and Institutions Code Section 15600 on behalf of the proposed national class and seek injunctive relief, compensatory damages, punitive damages and attorney fees. The plaintiffs allege that the defendants used an improper and misleading sales and marketing approach to seniors that fails to disclose all facts, misuses consumers' confidential financial information, uses misleading sales and marketing materials, promotes deferred annuities that are fundamentally inferior and less valuable than readily available alternative investment products and fails to adequately disclose other principal risks including maturity dates, surrender penalties and other restrictions which limit access to annuity proceeds to a date beyond the applicant's actuarial life expectancy. Plaintiffs have amended their complaint attempting to convert this from a California only class action to a national class action. In addition, the amended complaint adds causes of action under the Racketeer Influenced and Corrupt Organization Act ("RICO"); aiding and abetting breach of fiduciary duty and for unjust enrichment. On September 13, 2010, the court dismissed the plaintiff's RICO claims. On October 25, 2010, the plaintiffs filed a second amended complaint re-alleging their RICO claims. On March 29, 2012, the court denied plaintiff's motion for certification of a nationwide class and denied plaintiff's motion for certification of a California class. The court allowed the plaintiff the opportunity to file a renewed motion for a California class, which the plaintiff did on May 21, 2012. On July 24, 2012, Bankers Life filed a motion for summary judgment. On March 26, 2013, the court granted partial summary judgment in favor of Bankers Life and denied the plaintiff's renewed motion for a California class. The case will proceed on an individual basis. We believe this case is without merit and intend to defend it vigorously.

On August 23, 2012, a purported class action was filed in the United States District Court for the District of Massachusetts (Boston), *Fay Glick, on behalf of herself and all others similarly situated, v. Bankers Life & Casualty Company, Case No. 1:12-cv-11579*. The plaintiff is seeking injunctive and declaratory relief and damages arising from Bankers' alleged systematic business practices of delaying and/or denying the payment of claims for benefits provided for under its healthcare insurance policies and recovery of undisclosed interest that Bankers has charged on any policyholders who paid premiums on a monthly or "modal" basis (as opposed to paying premiums on an annual basis). On January 30, 2013, the court dismissed the modal premium related claims. The parties have entered into a confidential settlement on an individual basis. The case has been dismissed.

Regulatory Examinations and Fines

Insurance companies face significant risks related to regulatory investigations and actions. Regulatory investigations generally result from matters related to sales or underwriting practices, payment of contingent or other sales commissions, claim payments and procedures, product design, product disclosure, additional premium charges for premiums paid on a periodic basis, denial or delay of benefits, charging excessive or impermissible fees on products, changing the way cost of insurance charges are calculated for certain life insurance products or recommending unsuitable products to customers. We are, in the ordinary course of our business, subject to various examinations, inquiries and information requests from state, federal and other authorities. The ultimate outcome of these regulatory actions cannot be predicted with certainty. In the event of an unfavorable outcome in one or more of these matters, the ultimate liability may be in excess of liabilities we have established and we could suffer significant reputational harm as a result of these matters, which could also have a material adverse effect on our business, financial condition, results of operations or cash flows.

In August 2011, we were notified of an examination to be done on behalf of a number of states for the purpose of determining compliance with unclaimed property laws by the Company and its subsidiaries. Such examination has included inquiries related to the use of data available on the U.S. Social Security Administration's Death Master File to identify instances where benefits under life insurance policies, annuities and retained asset accounts are payable. We are continuing to provide

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information to the examiners in response to their requests. A total of 38 states and the District of Columbia are currently participating in this examination.

CONSOLIDATED STATEMENT OF CASH FLOWS

The following disclosures supplement our consolidated statement of cash flows.

The following reconciles net income to net cash provided by operating activities (dollars in millions):

	Three months ended	
	March 31,	
	2013	2012
Cash flows from operating activities:		
Net income	\$ 11.9	\$ 59.1
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and depreciation	87.1	91.1
Income taxes	22.1	29.5
Insurance liabilities	142.9	39.9
Accrual and amortization of investment income	(115.2)	(104.1)
Deferral of policy acquisition costs	(53.5)	(46.2)
Net realized investment gains	(15.3)	(22.9)
Loss on extinguishment of debt	57.7	.2
Other	(23.1)	31.6
Net cash provided by operating activities	<u>\$ 114.6</u>	<u>\$ 78.2</u>

Non-cash items not reflected in the investing and financing activities sections of the consolidated statement of cash flows (dollars in millions):

	Three months ended	
	March 31,	
	2013	2012
Stock options, restricted stock and performance units	\$ 3.3	\$ 2.5

INVESTMENTS IN VARIABLE INTEREST ENTITIES

We have concluded that we are the primary beneficiary with respect to certain variable interest entities ("VIEs"), which are consolidated in our financial statements. The following is a description of our significant investments in VIEs:

All of the VIEs are collateralized loan trusts that were established to issue securities and use the proceeds to principally invest in corporate loans and other permitted investments (including a new VIE which was consolidated in the first quarter of 2013). The assets held by the trusts are legally isolated and not available to the Company. The liabilities of the VIEs are expected to be satisfied from the cash flows generated by the underlying loans held by the trusts, not from the assets of the Company. The Company has no further commitments to the VIEs.

Certain of our insurance subsidiaries are noteholders of the VIEs. Another subsidiary of the Company is the investment manager for the VIEs. As such, it has the power to direct the most significant activities of the VIEs which materially impacts the economic performance of the VIEs.

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The following table provides supplemental information about the assets and liabilities of the VIEs which have been consolidated in accordance with authoritative guidance (dollars in millions):

	March 31, 2013		
	VIEs	Eliminations	Net effect on consolidated balance sheet
Assets:			
Investments held by variable interest entities	\$ 1,009.9	\$ —	\$ 1,009.9
Notes receivable of VIEs held by insurance subsidiaries	—	(108.4)	(108.4)
Cash and cash equivalents held by variable interest entities	462.2	—	462.2
Accrued investment income	1.7	—	1.7
Income tax assets, net	2.0	(2.4)	(.4)
Other assets	13.6	(.5)	13.1
Total assets	<u>\$ 1,489.4</u>	<u>\$ (111.3)</u>	<u>\$ 1,378.1</u>
Liabilities:			
Other liabilities	\$ 237.4	\$ (3.4)	\$ 234.0
Borrowings related to variable interest entities	1,143.4	—	1,143.4
Notes payable of VIEs held by insurance subsidiaries	112.4	(112.4)	—
Total liabilities	<u>\$ 1,493.2</u>	<u>\$ (115.8)</u>	<u>\$ 1,377.4</u>
December 31, 2012			
	VIEs	Eliminations	Net effect on consolidated balance sheet
Assets:			
Investments held by variable interest entities	\$ 814.3	\$ —	\$ 814.3
Notes receivable of VIEs held by insurance subsidiaries	—	(78.5)	(78.5)
Cash and cash equivalents held by variable interest entities	54.2	—	54.2
Accrued investment income	1.8	—	1.8
Income tax assets, net	3.3	(2.6)	.7
Other assets	9.6	—	9.6
Total assets	<u>\$ 883.2</u>	<u>\$ (81.1)</u>	<u>\$ 802.1</u>
Liabilities:			
Other liabilities	\$ 39.9	\$ (3.3)	\$ 36.6
Borrowings related to variable interest entities	767.0	—	767.0
Notes payable of VIEs held by insurance subsidiaries	82.5	(82.5)	—
Total liabilities	<u>\$ 889.4</u>	<u>\$ (85.8)</u>	<u>\$ 803.6</u>

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The investment portfolios held by the VIEs are primarily comprised of corporate bank loans which are almost entirely rated below-investment grade. At March 31, 2013, such loans had an amortized cost of \$1,001.6 million; gross unrealized gains of \$9.1 million; gross unrealized losses of \$.8 million; and an estimated fair value of \$1,009.9 million.

The following table sets forth the amortized cost and estimated fair value of the investments held by the VIEs at March 31, 2013, by contractual maturity. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

	Amortized cost	Estimated fair value
	(Dollars in millions)	
Due in one year or less	\$ 4.7	\$ 4.8
Due after one year through five years	437.1	440.6
Due after five years through ten years	559.8	564.5
Total	<u>\$ 1,001.6</u>	<u>\$ 1,009.9</u>

During the first three months of 2013, we recognized net realized investment losses on the VIE investments of \$.1 million. During the first three months of 2012, we recognized net realized investment losses on the VIE investments of \$.5 million, which were comprised of \$.1 million of net losses from the sales of fixed maturities, and \$.4 million of writedowns of investments for other than temporary declines in fair value recognized through net income.

At March 31, 2013, there were no investments held by the VIEs that were in default.

During the first three months of 2013, no investments held by the VIEs were sold which resulted in gross investment losses.

At March 31, 2013, the VIEs held: (i) investments with a fair value of \$132.4 million and gross unrealized losses of \$.6 million that had been in an unrealized loss position for less than twelve months; and (ii) investments with a fair value of \$28.5 million and gross unrealized losses of \$.2 million that had been in an unrealized loss position for greater than twelve months.

The investments held by the VIEs are evaluated for other-than-temporary declines in fair value in a manner that is consistent with the Company's fixed maturities, available for sale.

In addition, the Company, in the normal course of business, makes passive investments in structured securities issued by VIEs for which the Company is not the investment manager. These structured securities include asset-backed securities, collateralized debt obligations, commercial mortgage-backed securities, residential mortgage-backed securities and collateralized mortgage obligations. Our maximum exposure to loss on these securities is limited to our cost basis in the investment. We have determined that we are not the primary beneficiary of these structured securities due to the relative size of our investment in comparison to the total principal amount of the individual structured securities and the level of credit subordination which reduces our obligation to absorb gains or losses.

At March 31, 2013, we hold investments in various limited partnerships, in which we are not the primary beneficiary, totaling \$29.8 million (classified as other invested assets). At March 31, 2013, we had unfunded commitments to these partnerships of \$37.1 million. Our maximum exposure to loss on these investments is limited to the amount of our investment.

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FAIR VALUE MEASUREMENTS

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and, therefore, represents an exit price, not an entry price. We carry certain assets and liabilities at fair value on a recurring basis, including fixed maturities, equity securities, trading securities, investments held by VIEs, derivatives, cash and cash equivalents, separate account assets and embedded derivatives. We carry our company-owned life insurance policy, which is backed by a series of mutual funds, at its cash surrender value and our hedge fund investments at their net asset values; in both cases, we believe these values approximate their fair values. In addition, we disclose fair value for certain financial instruments, including mortgage loans and policy loans, insurance liabilities for interest-sensitive products, investment borrowings, notes payable and borrowings related to VIEs.

The degree of judgment utilized in measuring the fair value of financial instruments is largely dependent on the level to which pricing is based on observable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our view of market assumptions in the absence of observable market information. Financial instruments with readily available active quoted prices would be considered to have fair values based on the highest level of observable inputs, and little judgment would be utilized in measuring fair value. Financial instruments that rarely trade would often have fair value based on a lower level of observable inputs, and more judgment would be utilized in measuring fair value.

Valuation Hierarchy

There is a three-level hierarchy for valuing assets or liabilities at fair value based on whether inputs are observable or unobservable.

- Level 1 – includes assets and liabilities valued using inputs that are unadjusted quoted prices in active markets for identical assets or liabilities. Our Level 1 assets primarily include cash and exchange traded securities.
- Level 2 – includes assets and liabilities valued using inputs that are quoted prices for similar assets in an active market, quoted prices for identical or similar assets in a market that is not active, observable inputs, or observable inputs that can be corroborated by market data. Level 2 assets and liabilities include those financial instruments that are valued by independent pricing services using models or other valuation methodologies. These models are primarily industry-standard models that consider various inputs such as interest rate, credit or issuer spreads, reported trades and other inputs that are observable or derived from observable information in the marketplace or are supported by observable levels at which transactions are executed in the marketplace. Financial assets in this category primarily include: certain public and privately placed corporate fixed maturity securities; certain government or agency securities; certain mortgage and asset-backed securities; certain equity securities; most investments held by our consolidated VIEs; certain mutual fund and hedge fund investments; and most short-term investments; and non-exchange-traded derivatives such as call options to hedge liabilities related to our fixed index annuity products. Financial liabilities in this category include investment borrowings, notes payable and borrowings related to VIEs.
- Level 3 – includes assets and liabilities valued using unobservable inputs that are used in model-based valuations that contain management assumptions. Level 3 assets and liabilities include those financial instruments whose fair value is estimated based on broker/dealer quotes, pricing services or internally developed models or methodologies utilizing significant inputs not based on, or corroborated by, readily available market information. Financial assets in this category include certain corporate securities (primarily certain below-investment grade privately placed securities), certain structured securities, mortgage loans, and other less liquid securities. Financial liabilities in this category include our insurance liabilities for interest-sensitive products, which includes embedded derivatives (including embedded derivatives related to our fixed index annuity products and to a modified coinsurance arrangement) since their values include significant unobservable inputs including actuarial assumptions.

At each reporting date, we classify assets and liabilities into the three input levels based on the lowest level of input that is significant to the measurement of fair value for each asset and liability reported at fair value. This classification is impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established, the characteristics specific to the transaction and overall market conditions. Our assessment of the significance of a particular input to the fair value measurement and the ultimate classification of each asset and liability requires judgment and is subject to change from period to period based on the observability of the valuation inputs. Any transfers between levels are

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reported as having occurred at the beginning of the period. There were no transfers between Level 1 and Level 2 in both the first three months of 2013 and 2012.

The vast majority of our fixed maturity and equity securities, including those held in trading portfolios and those held by consolidated VIEs, short-term and separate account assets use Level 2 inputs for the determination of fair value. These fair values are obtained primarily from independent pricing services, which use Level 2 inputs for the determination of fair value. Substantially all of our Level 2 fixed maturity securities and separate account assets were valued from independent pricing services. Third party pricing services normally derive the security prices through recently reported trades for identical or similar securities making adjustments through the reporting date based upon available market observable information. If there are no recently reported trades, the third party pricing services may use matrix or model processes to develop a security price where future cash flow expectations are developed and discounted at an estimated risk-adjusted market rate. The number of prices obtained for a given security is dependent on the Company's analysis of such prices as further described below.

For securities that are not priced by pricing services and may not be reliably priced using pricing models, we obtain broker quotes. These broker quotes are non-binding and represent an exit price, but assumptions used to establish the fair value may not be observable and therefore represent Level 3 inputs. Approximately 22 percent of our Level 3 fixed maturity securities were valued using unadjusted broker quotes or broker-provided valuation inputs. The remaining Level 3 fixed maturity investments do not have readily determinable market prices and/or observable inputs. For these securities, we use internally developed valuations. Key assumptions used to determine fair value for these securities may include risk-free rates, risk premiums, performance of underlying collateral and other factors involving significant assumptions which may not be reflective of an active market. For certain investments, we use a matrix or model process to develop a security price where future cash flow expectations are developed and discounted at an estimated market rate. The pricing matrix utilizes a spread level to determine the market price for a security. The credit spread generally incorporates the issuer's credit rating and other factors relating to the issuer's industry and the security's maturity. In some instances issuer-specific spread adjustments, which can be positive or negative, are made based upon internal analysis of security specifics such as liquidity, deal size, and time to maturity.

As the Company is responsible for the determination of fair value, we have control processes designed to ensure that the fair values received from third-party pricing sources are reasonable and the valuation techniques and assumptions used appear reasonable and consistent with prevailing market conditions. Additionally, when inputs are provided by third-party pricing sources, we have controls in place to review those inputs for reasonableness. As part of these controls, we perform monthly quantitative and qualitative analysis on the prices received from third parties to determine whether the prices are reasonable estimates of fair value. The Company's analysis includes: (i) a review of the methodology used by third party pricing services; (ii) where available, a comparison of multiple pricing services' valuations for the same security; (iii) a review of month to month price fluctuations; (iv) a review to ensure valuations are not unreasonably stale; and (v) back testing to compare actual purchase and sale transactions with valuations received from third parties. As a result of such procedures, the Company may conclude the prices received from third parties are not reflective of current market conditions. In those instances, we may request additional pricing quotes or apply internally developed valuations. However, the number of instances is insignificant and the aggregate change in value of such investments is not materially different from the original prices received.

The categorization of the fair value measurements of our investments priced by independent pricing services was based upon the Company's judgment of the inputs or methodologies used by the independent pricing services to value different asset classes. Such inputs include: benchmark yields, reported trades, broker dealer quotes, issuer spreads, benchmark securities, bids, offers and reference data. The Company categorizes such fair value measurements based upon asset classes and the underlying observable or unobservable inputs used to value such investments.

The fair value measurements for derivative instruments, including embedded derivatives requiring bifurcation, are determined based on the consideration of several inputs including closing exchange or over-the-counter market price quotations; time value and volatility factors underlying options; market interest rates; and non-performance risk. For certain embedded derivatives, we may use actuarial assumptions in the determination of fair value.

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The categorization of fair value measurements, by input level, for our financial instruments carried at fair value on a recurring basis at March 31, 2013 is as follows (dollars in millions):

	Quoted prices in active markets for identical assets or liabilities (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
Fixed maturities, available for sale:				
Corporate securities	\$ —	\$ 16,647.8	\$ 356.3	\$ 17,004.1
United States Treasury securities and obligations of United States government corporations and agencies	—	98.8	—	98.8
States and political subdivisions	—	2,141.6	15.0	2,156.6
Asset-backed securities	—	1,518.4	46.6	1,565.0
Collateralized debt obligations	—	39.1	309.7	348.8
Commercial mortgage-backed securities	—	1,435.9	3.8	1,439.7
Mortgage pass-through securities	—	15.8	1.8	17.6
Collateralized mortgage obligations	—	2,227.3	36.6	2,263.9
Total fixed maturities, available for sale	—	24,124.7	769.8	24,894.5
Equity securities:				
Corporate securities	63.3	150.4	.1	213.8
Venture capital investments	—	—	3.1	3.1
Total equity securities	63.3	150.4	3.2	216.9
Trading securities:				
Corporate securities	—	46.4	—	46.4
United States Treasury securities and obligations of United States government corporations and agencies	—	4.8	—	4.8
States and political subdivisions	—	14.1	.6	14.7
Asset-backed securities	—	39.7	—	39.7
Commercial mortgage-backed securities	—	87.0	—	87.0
Mortgage pass-through securities	—	.1	—	.1
Collateralized mortgage obligations	—	28.7	5.7	34.4
Equity securities	1.0	1.7	—	2.7
Total trading securities	1.0	222.5	6.3	229.8
Investments held by variable interest entities - corporate securities	—	1,009.9	—	1,009.9
Other invested assets - derivatives	—	110.0	—	110.0
Assets held in separate accounts	—	15.5	—	15.5
Total assets carried at fair value by category	\$ 64.3	\$ 25,633.0	\$ 779.3	\$ 26,476.6
Liabilities:				
Liabilities for insurance products:				
Interest-sensitive products - embedded derivatives associated with fixed index annuity products	\$ —	\$ —	\$ 794.3	\$ 794.3
Interest-sensitive products - embedded derivatives associated with modified coinsurance agreement	—	—	5.1	5.1
Total liabilities for insurance products	—	—	799.4	799.4
Total liabilities carried at fair value by category	\$ —	\$ —	\$ 799.4	\$ 799.4

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For those financial instruments disclosed at fair value, we use the following methods and assumptions to determine the estimated fair values:

Mortgage loans and policy loans. We discount future expected cash flows for loans included in our investment portfolio based on interest rates currently being offered for similar loans to borrowers with similar credit ratings. We aggregate loans with similar characteristics in our calculations. The fair value of policy loans approximates their carrying value.

Company-owned life insurance is backed by a series of mutual funds and is carried at cash surrender value which approximates estimated fair value.

Hedge fund investments are carried at their net asset values which approximates estimated fair value.

Insurance liabilities for interest-sensitive products. We discount future expected cash flows based on interest rates currently being offered for similar contracts with similar maturities.

Cash and cash equivalents include commercial paper, invested cash and other investments purchased with original maturities of less than three months. We carry them at amortized cost, which approximates estimated fair value.

Insurance liabilities for interest-sensitive products. We discount future expected cash flows based on interest rates currently being offered for similar contracts with similar maturities.

Investment borrowings, notes payable and borrowings related to variable interest entities. For publicly traded debt, we use current fair values. For other notes, we use discounted cash flow analyses based on our current incremental borrowing rates for similar types of borrowing arrangements.

The fair value measurements for our financial instruments disclosed at fair value on a recurring basis are as follows (dollars in millions):

	March 31, 2013				
	Quoted prices in active markets for identical assets or liabilities (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total estimated fair value	Total carrying amount
Assets:					
Mortgage loans	\$ —	\$ —	\$ 1,743.4	\$ 1,743.4	\$ 1,639.8
Policy loans	—	271.5	—	271.5	271.5
Other invested assets:					
Company-owned life insurance	—	128.6	—	128.6	128.6
Hedge funds	—	16.3	—	16.3	16.3
Cash and cash equivalents:					
Unrestricted	197.6	54.0	—	251.6	251.6
Held by variable interest entities	462.2	—	—	462.2	462.2
Liabilities:					
Insurance liabilities for interest-sensitive products excluding embedded derivatives (a)	—	—	12,067.7	12,067.7	12,067.7
Investment borrowings	—	1,899.5	—	1,899.5	1,880.2
Borrowings related to variable interest entities	—	1,135.7	—	1,135.7	1,143.4
Notes payable – direct corporate obligations	—	1,000.8	—	1,000.8	934.2

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	December 31, 2012				
	Quoted prices in active markets for identical assets or liabilities (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total estimated fair value	Total carrying amount
Assets:					
Mortgage loans	\$ —	\$ —	\$ 1,682.1	\$ 1,682.1	\$ 1,573.2
Policy loans	—	—	272.0	272.0	272.0
Other invested assets:					
Company-owned life insurance	—	123.0	—	123.0	123.0
Hedge funds	—	16.1	—	16.1	16.1
Cash and cash equivalents:					
Unrestricted	432.3	150.2	—	582.5	582.5
Held by variable interest entities	54.2	—	—	54.2	54.2
Liabilities:					
Insurance liabilities for interest-sensitive products excluding embedded derivatives (a)	—	—	12,153.7	12,153.7	12,153.7
Investment borrowings	—	1,702.0	—	1,702.0	1,650.8
Borrowings related to variable interest entities	—	752.2	—	752.2	767.0
Notes payable – direct corporate obligations	—	1,100.3	—	1,100.3	1,004.2

- (a) The estimated fair value of insurance liabilities for interest-sensitive products was approximately equal to its carrying value at March 31, 2013 and December 31, 2012. This was because interest rates credited on the vast majority of account balances approximate current rates paid on similar products and because these rates are not generally guaranteed beyond one year.

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The categorization of fair value measurements, by input level, for our fixed maturity securities, equity securities, trading securities, certain other invested assets, assets held in separate accounts and embedded derivative instruments included in liabilities for insurance products at December 31, 2012 is as follows (dollars in millions):

	Quoted prices in active markets for identical assets or liabilities (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
Fixed maturities, available for sale:				
Corporate securities	\$ —	\$ 16,498.6	\$ 355.5	\$ 16,854.1
United States Treasury securities and obligations of United States government corporations and agencies	—	99.5	—	99.5
States and political subdivisions	—	2,115.0	13.1	2,128.1
Debt securities issued by foreign governments	—	.8	—	.8
Asset-backed securities	—	1,416.9	44.0	1,460.9
Collateralized debt obligations	—	—	324.0	324.0
Commercial mortgage-backed securities	—	1,471.2	6.2	1,477.4
Mortgage pass-through securities	—	19.9	1.9	21.8
Collateralized mortgage obligations	—	2,230.6	16.9	2,247.5
Total fixed maturities, available for sale	—	23,852.5	761.6	24,614.1
Equity securities:				
Corporate securities	49.7	118.8	.1	168.6
Venture capital investments	—	—	2.8	2.8
Total equity securities	49.7	118.8	2.9	171.4
Trading securities:				
Corporate securities	—	46.6	—	46.6
United States Treasury securities and obligations of United States government corporations and agencies	—	4.8	—	4.8
States and political subdivisions	—	14.0	.6	14.6
Asset-backed securities	—	50.1	—	50.1
Collateralized debt obligations	—	—	7.3	7.3
Commercial mortgage-backed securities	—	93.3	—	93.3
Mortgage pass-through securities	—	.1	—	.1
Collateralized mortgage obligations	—	41.2	5.8	47.0
Equity securities	.9	1.5	—	2.4
Total trading securities	.9	251.6	13.7	266.2
Investments held by variable interest entities - corporate securities	—	814.3	—	814.3
Other invested assets - derivatives	—	54.4	—	54.4
Assets held in separate accounts	—	14.9	—	14.9
Total assets carried at fair value by category	\$ 50.6	\$ 25,106.5	\$ 778.2	\$ 25,935.3
Liabilities:				
Liabilities for insurance products:				
Interest-sensitive products - embedded derivatives associated with fixed index annuity products	\$ —	\$ —	\$ 734.0	\$ 734.0
Interest-sensitive products - embedded derivatives associated with modified coinsurance agreement	—	—	5.5	5.5
Total liabilities for insurance products	—	—	739.5	739.5
Total liabilities carried at fair value by category	\$ —	\$ —	\$ 739.5	\$ 739.5

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The following table presents additional information about assets and liabilities measured at fair value on a recurring basis and for which we have utilized significant unobservable (Level 3) inputs to determine fair value for the three months ended March 31, 2013 (dollars in millions):

	March 31, 2013							Amount of total gains (losses) for the three months ended March 31, 2013 included in our net income relating to assets and liabilities still held as of the reporting date
	Beginning balance as of December 31, 2012	Purchases, sales, issuances and settlements, net (b)	Total realized and unrealized gains (losses) included in net income	Total realized and unrealized gains (losses) included in accumulated other comprehensive income (loss)	Transfers into Level 3	Transfers out of Level 3 (a)	Ending balance as of March 31, 2013	
Assets:								
Fixed maturities, available for sale:								
Corporate securities	\$ 355.5	\$ 17.0	\$ —	\$ (3.8)	\$ —	\$ (12.4)	\$ 356.3	\$ —
States and political subdivisions	13.1	—	—	.6	1.3	—	15.0	—
Asset-backed securities	44.0	6.8	—	(.8)	.6	(4.0)	46.6	—
Collateralized debt obligations	324.0	(19.1)	.2	4.6	—	—	309.7	—
Commercial mortgage-backed securities	6.2	(.2)	—	.1	—	(2.3)	3.8	—
Mortgage pass-through securities	1.9	(.1)	—	—	—	—	1.8	—
Collateralized mortgage obligations	16.9	24.8	—	—	—	(5.1)	36.6	—
Total fixed maturities, available for sale	761.6	29.2	.2	.7	1.9	(23.8)	769.8	—
Equity securities:								
Corporate securities	.1	—	—	—	—	—	.1	—
Venture capital investments	2.8	—	—	.3	—	—	3.1	—
Total equity securities	2.9	—	—	.3	—	—	3.2	—
Trading securities:								
States and political subdivisions	.6	—	—	—	—	—	.6	—
Collateralized debt obligations	7.3	(7.7)	.6	(.2)	—	—	—	—
Collateralized mortgage obligations	5.8	—	—	(.1)	—	—	5.7	—
Total trading securities	13.7	(7.7)	.6	(.3)	—	—	6.3	—
Liabilities:								
Liabilities for insurance products:								
Interest-sensitive products - embedded derivatives associated with fixed index annuity products	(734.0)	(63.1)	2.8	—	—	—	(794.3)	2.8
Interest-sensitive products - embedded derivatives associated with modified coinsurance agreement	(5.5)	.4	—	—	—	—	(5.1)	—
Total liabilities for insurance products	(739.5)	(62.7)	2.8	—	—	—	(799.4)	2.8

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIESNotes to Consolidated Financial Statements
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- (a) For our fixed maturity securities, the majority of our transfers out of Level 3 are the result of obtaining a valuation from an independent pricing service at the end of the period, whereas a broker quote was used as of the beginning of the period.
- (b) Purchases, sales, issuances and settlements, net, represent the activity that occurred during the period that results in a change of the asset or liability but does not represent changes in fair value for the instruments held at the beginning of the period. Such activity primarily consists of purchases and sales of fixed maturity and equity securities and changes to embedded derivative instruments related to insurance products resulting from the issuance of new contracts, or changes to existing contracts. The following summarizes such activity for the three months ended March 31, 2013 (dollars in millions):

	Purchases	Sales	Issuances	Settlements	Purchases, sales, issuances and settlements, net
Assets:					
Fixed maturities, available for sale:					
Corporate securities	\$ 17.0	\$ —	\$ —	\$ —	\$ 17.0
Asset-backed securities	7.6	(.8)	—	—	6.8
Collateralized debt obligations	2.6	(21.7)	—	—	(19.1)
Commercial mortgage-backed securities	—	(.2)	—	—	(.2)
Mortgage pass-through securities	—	(.1)	—	—	(.1)
Collateralized mortgage obligations	24.9	(.1)	—	—	24.8
Total fixed maturities, available for sale	52.1	(22.9)	—	—	29.2
Trading securities - collateralized debt obligations	—	(7.7)	—	—	(7.7)
Liabilities:					
Liabilities for insurance products:					
Interest-sensitive products - embedded derivatives associated with fixed index annuity products	(25.1)	1.4	(50.2)	10.8	(63.1)
Interest-sensitive products - embedded derivatives associated with modified coinsurance agreement	—	.4	—	—	.4
Total liabilities for insurance products	(25.1)	1.8	(50.2)	10.8	(62.7)

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The following table presents additional information about assets and liabilities measured at fair value on a recurring basis and for which we have utilized significant unobservable (Level 3) inputs to determine fair value for the three months ended March 31, 2012 (dollars in millions):

	March 31, 2012							Amount of total gains (losses) for the three months ended March 31, 2012 included in our net income relating to assets and liabilities still held as of the reporting date
	Beginning balance as of December 31, 2011	Purchases, sales, issuances and settlements, net (a)	Total realized and unrealized gains (losses) included in net income	Total realized and unrealized gains (losses) included in other comprehensive income (loss)	Transfers into Level 3	Transfers out of Level 3	Ending balance as of March 31, 2012	
Assets:								
Fixed maturities, available for sale:								
Corporate securities	\$ 278.1	\$ 15.0	\$ —	\$.5	\$ 51.2	\$ (76.8)	\$ 268.0	\$ —
United States Treasury securities and obligations of United States government corporations and agencies	1.6	—	—	—	—	—	1.6	—
States and political subdivisions	2.1	—	—	.1	7.4	—	9.6	—
Asset-backed securities	79.7	(8.2)	(.4)	(1.3)	4.7	(51.8)	22.7	—
Collateralized debt obligations	327.3	(.8)	—	5.9	—	—	332.4	—
Commercial mortgage-backed securities	17.3	—	—	—	—	(17.3)	—	—
Mortgage pass-through securities	2.2	—	—	—	—	—	2.2	—
Collateralized mortgage obligations	124.8	3.5	—	.1	10.9	(124.6)	14.7	—
Total fixed maturities, available for sale	833.1	9.5	(.4)	5.3	74.2	(270.5)	651.2	—
Equity securities:								
Corporate securities	6.4	—	(3.8)	.6	—	—	3.2	(3.8)
Venture capital investments	63.5	—	—	1.7	—	—	65.2	—
Total equity securities	69.9	—	(3.8)	2.3	—	—	68.4	(3.8)
Trading securities:								
Collateralized debt obligations	—	3.2	.4	—	—	—	3.6	.4
Commercial mortgage-backed securities	.4	—	—	—	—	(.4)	—	—
Total trading securities	.4	3.2	.4	—	—	(.4)	3.6	.4
Liabilities:								
Liabilities for insurance products:								
Interest-sensitive products - embedded derivatives associated with fixed index annuity products	(666.3)	(50.4)	12.6	—	—	—	(704.1)	12.6
Interest-sensitive products - embedded derivatives associated with modified coinsurance agreement	(3.5)	(.1)	—	—	—	—	(3.6)	—
Total liabilities for insurance products	(669.8)	(50.5)	12.6	—	—	—	(707.7)	12.6

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- (a) Purchases, sales, issuances and settlements, net, represent the activity that occurred during the period that results in a change of the asset or liability but does not represent changes in fair value for the instruments held at the beginning of the period. Such activity primarily consists of purchases and sales of fixed maturity and equity securities and changes to embedded derivative instruments related to insurance products resulting from the issuance of new contracts, or changes to existing contracts. The following summarizes such activity for the three months ended March 31, 2012 (dollars in millions):

	Purchases	Sales	Issuances	Settlements	Purchases, sales, issuances and settlements, net
Assets:					
Fixed maturities, available for sale:					
Corporate securities	\$ 15.0	\$ —	\$ —	\$ —	\$ 15.0
Asset-backed securities	—	(8.2)	—	—	(8.2)
Collateralized debt obligations	28.3	(29.1)	—	—	(.8)
Collateralized mortgage obligations	14.4	(10.9)	—	—	3.5
Total fixed maturities, available for sale	57.7	(48.2)	—	—	9.5
Trading securities - collateralized debt obligations	3.2	—	—	—	3.2
Liabilities:					
Liabilities for insurance products:					
Interest-sensitive products - embedded derivatives associated with fixed index annuity products	(27.3)	5.0	(38.8)	10.7	(50.4)
Interest-sensitive products - embedded derivatives associated with modified coinsurance agreement	—	—	(.1)	—	(.1)
Total liabilities for insurance products	(27.3)	5.0	(38.9)	10.7	(50.5)

At March 31, 2013, 91 percent of our Level 3 fixed maturities, available for sale, were investment grade and 40 percent and 46 percent of our Level 3 fixed maturities, available for sale, consisted of collateralized debt obligations and corporate securities, respectively.

Realized and unrealized investment gains and losses presented in the preceding tables represent gains and losses during the time the applicable financial instruments were classified as Level 3.

Realized and unrealized gains (losses) on Level 3 assets are primarily reported in either net investment income for policyholder and reinsurer accounts and other special-purpose portfolios, net realized investment gains (losses) or insurance policy benefits within the consolidated statement of operations or accumulated other comprehensive income within shareholders' equity based on the appropriate accounting treatment for the instrument.

The amount presented for gains (losses) included in our net loss for assets and liabilities still held as of the reporting date primarily represents impairments for fixed maturities, available for sale, changes in fair value of trading securities and certain derivatives and changes in fair value of embedded derivative instruments included in liabilities for insurance products that exist as of the reporting date.

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The following table provides additional information about the significant unobservable (Level 3) inputs developed internally by the Company to determine fair value for certain assets and liabilities carried at fair value at March 31, 2013 (dollars in millions):

	Fair value at March 31, 2013	Valuation technique(s)	Unobservable inputs	Range (weighted average)
Assets:				
Corporate securities (a)	\$ 259.8	Discounted cash flow analysis	Discount margins	1.90% - 3.20% (2.71%)
Asset-backed securities (b)	32.4	Discounted cash flow analysis	Discount margins	2.59% - 3.33% (3.02%)
Collateralized debt obligations (c)	307.1	Discounted cash flow analysis	Recoveries	65% - 66% (65.9%)
			Constant prepayment rate	20%
			Discount margins	0.65% - 4.50% (1.36%)
			Annual default rate	1.16% - 5.49% (3.02%)
			Portfolio CCC %	1.88% - 20.63% (12.17%)
Preferred stock (d)	3.1	Market multiples	EBITDA multiple	8.1
			Revenue multiple	1.2
Other assets categorized as Level 3 (e)	176.9	Unadjusted third-party price source	Not applicable	Not applicable
Total	779.3			
Liabilities:				
Interest sensitive products (f)	799.4	Discounted projected embedded derivatives	Projected portfolio yields	5.35% - 5.61% (5.55%)
			Discount rates	0.00 - 3.85% (1.47%)
			Surrender rates	4% - 43% (19%)

- (a) Corporate securities - The significant unobservable input used in the fair value measurement of our corporate securities is discount margin added to a riskless market yield. Significant increases (decreases) in discount margin in isolation would result in a significantly lower (higher) fair value measurement.
- (b) Asset-backed securities - The significant unobservable input used in the fair value measurement of our asset-backed securities is discount margin added to a riskless market yield. Significant increases (decreases) in discount margin in isolation would result in a significantly lower (higher) fair value measurement.
- (c) Collateralized debt obligations - The significant unobservable inputs used in the fair value measurement of our collateralized debt obligations relate to collateral performance, including default rate, recoveries and constant prepayment rate, as well as discount margins of the underlying collateral. Significant increases (decreases) in default rate in isolation would result in a significantly lower (higher) fair value measurement. Generally, a significant increase (decrease) in the constant prepayment rate and recoveries in isolation would result in a significantly higher (lower) fair value measurement. Generally a significant increase (decrease) in discount margin in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the annual default rate is accompanied by a directionally similar change in the assumption used for discount margins and portfolio CCC % and a directionally opposite change in the assumption used for constant prepayment rate and recoveries. A tranche's payment priority and investment cost basis could alter generalized fair value outcomes.
- (d) Preferred stock - The significant unobservable inputs used in the fair value measurement of this preferred stock investment are the EBITDA multiple and revenue multiple. Generally, a significant increase (decrease) in the EBITDA or revenue multiples in isolation would result in a significantly higher (lower) fair value measurement.
- (e) Other assets categorized as Level 3 - For these assets, there were no adjustments to quoted market prices obtained from third-party pricing sources.

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- (f) Interest sensitive products - The significant unobservable inputs used in the fair value measurement of our interest sensitive products are projected portfolio yields, discount rates and surrender rates. Increases (decreases) in projected portfolio yields in isolation would lead to a higher (lower) fair value measurement. The discount rate is based on the Treasury rate adjusted by a margin. Increases (decreases) in the discount rates would lead to a lower (higher) fair value measurement. Assumed surrender rates are used to project how long the contracts remain in force. Generally, the longer the contracts are assumed to be in force the higher the fair value of the embedded derivative.

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

In this section, we review the consolidated financial condition of CNO at March 31, 2013, and the consolidated results of operations for the three months ended March 31, 2013 and 2012, and, where appropriate, factors that may affect future financial performance. Please read this discussion in conjunction with the accompanying consolidated financial statements and notes.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Our statements, trend analyses and other information contained in this report and elsewhere (such as in filings by CNO with the SEC, press releases, presentations by CNO or its management or oral statements) relative to markets for CNO's products and trends in CNO's operations or financial results, as well as other statements, contain forward-looking statements within the meaning of the federal securities laws and the Private Securities Litigation Reform Act of 1995. Forward-looking statements typically are identified by the use of terms such as "anticipate," "believe," "plan," "estimate," "expect," "project," "intend," "may," "will," "would," "contemplate," "possible," "attempt," "seek," "should," "could," "goal," "target," "on track," "comfortable with," "optimistic" and similar words, although some forward-looking statements are expressed differently. You should consider statements that contain these words carefully because they describe our expectations, plans, strategies and goals and our beliefs concerning future business conditions, our results of operations, financial position, and our business outlook or they state other "forward-looking" information based on currently available information. The "Risk Factors" section of our 2012 Annual Report on Form 10-K provides examples of risks, uncertainties and events that could cause our actual results to differ materially from the expectations expressed in our forward-looking statements. Assumptions and other important factors that could cause our actual results to differ materially from those anticipated in our forward-looking statements include, among other things:

- changes in or sustained low interest rates causing reductions in investment income, the margins of our fixed annuity and life insurance businesses, and sales of, and demand for, our products;
- expectations of lower future investment earnings may cause us to accelerate amortization, write down the balance of insurance acquisition costs or establish additional liabilities for insurance products;
- general economic, market and political conditions, including the performance and fluctuations of the financial markets which may affect the value of our investments as well as our ability to raise capital or refinance existing indebtedness and the cost of doing so;
- the ultimate outcome of lawsuits filed against us and other legal and regulatory proceedings to which we are subject;
- our ability to make anticipated changes to certain NGEs of our life insurance products;
- our ability to obtain adequate and timely rate increases on our health products, including our long-term care business;
- the receipt of any required regulatory approvals for dividend and surplus debenture interest payments from our insurance subsidiaries;
- mortality, morbidity, the increased cost and usage of health care services, persistency, the adequacy of our previous reserve estimates and other factors which may affect the profitability of our insurance products;
- changes in our assumptions related to deferred acquisition costs or the present value of future profits;
- the recoverability of our deferred tax assets and the effect of potential ownership changes and tax rate changes on their value;
- our assumption that the positions we take on our tax return filings, including our position that our 7.0% Debentures will not be treated as stock for purposes of Section 382 of the Code and will not trigger an ownership change, will not be successfully challenged by the IRS;
- changes in accounting principles and the interpretation thereof (including changes in principles related to accounting for deferred acquisition costs);

- our ability to continue to satisfy the financial ratio and balance requirements and other covenants of our debt agreements;
- our ability to achieve anticipated expense reductions and levels of operational efficiencies including improvements in claims adjudication and continued automation and rationalization of operating systems;
- performance and valuation of our investments, including the impact of realized losses (including other-than-temporary impairment charges);
- our ability to identify products and markets in which we can compete effectively against competitors with greater market share, higher ratings, greater financial resources and stronger brand recognition;
- our ability to generate sufficient liquidity to meet our debt service obligations and other cash needs;
- our ability to maintain effective controls over financial reporting;
- our ability to continue to recruit and retain productive agents and distribution partners and customer response to new products, distribution channels and marketing initiatives;
- our ability to achieve eventual upgrades of the financial strength ratings of CNO and our insurance company subsidiaries as well as the impact of our ratings on our business, our ability to access capital, and the cost of capital;
- the risk factors or uncertainties listed from time to time in our filings with the SEC;
- regulatory changes or actions, including those relating to regulation of the financial affairs of our insurance companies, such as the payment of dividends and surplus debenture interest to us, regulation of the sale, underwriting and pricing of products, and health care regulation affecting health insurance products; and
- changes in the Federal income tax laws and regulations which may affect or eliminate the relative tax advantages of some of our products or affect the value of our deferred tax assets.

Other factors and assumptions not identified above are also relevant to the forward-looking statements, and if they prove incorrect, could also cause actual results to differ materially from those projected.

All written or oral forward-looking statements attributable to us are expressly qualified in their entirety by the foregoing cautionary statement. Our forward-looking statements speak only as of the date made. We assume no obligation to update or to publicly announce the results of any revisions to any of the forward-looking statements to reflect actual results, future events or developments, changes in assumptions or changes in other factors affecting the forward-looking statements.

The reporting of risk-based capital ("RBC") measures is not intended for the purpose of ranking any insurance company or for use in connection with any marketing, advertising or promotional activities.

OVERVIEW

We are a holding company for a group of insurance companies operating throughout the United States that develop, market and administer health insurance, annuity, individual life insurance and other insurance products. We focus on serving the senior and middle-income markets, which we believe are attractive, underserved, high growth markets. We sell our products through three distribution channels: career agents, independent producers (some of whom sell one or more of our product lines exclusively) and direct marketing.

The Company manages its business through the following operating segments: Bankers Life, Washington National and Colonial Penn, which are defined on the basis of product distribution; Other CNO Business, comprised primarily of products we no longer sell actively; and corporate operations, comprised of holding company activities and certain noninsurance company businesses. The Company's segments are described below:

- **Bankers Life**, which markets and distributes Medicare supplement insurance, interest-sensitive life insurance, traditional life insurance, fixed annuities and long-term care insurance products to the middle-income senior market through a dedicated field force of career agents and sales managers supported by a network of community-based sales

offices. The Bankers Life segment includes primarily the business of Bankers Life and Casualty Company. Bankers Life also markets and distributes Medicare Advantage plans primarily through a distribution arrangement with Humana, Inc. and United HealthCare and Medicare Part D prescription drug plans ("PDP") through a distribution and reinsurance arrangement with Coventry.

- **Washington National**, which markets and distributes supplemental health (including specified disease, accident and hospital indemnity insurance products) and life insurance to middle-income consumers at home and at the worksite. These products are marketed through Performance Matters Associates, Inc. ("PMA"), a wholly owned subsidiary, and through independent marketing organizations and insurance agencies including worksite marketing. The products being marketed are underwritten by Washington National Insurance Company.
- **Colonial Penn**, which markets primarily graded benefit and simplified issue life insurance directly to customers in the senior middle-income market through television advertising, direct mail, the internet and telemarketing. The Colonial Penn segment includes primarily the business of Colonial Penn Life Insurance Company.
- **Other CNO Business**, which consists of blocks of interest-sensitive life insurance, traditional life insurance, annuities, long-term care insurance and other supplemental health products. These blocks of business are not actively marketed and were primarily issued or acquired by Consec Life and Washington National Insurance Company.

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The following summarizes our earnings for the three months ending March 31, 2013 and 2012 (dollars in millions, except per share data):

	Three months ended	
	March 31,	
	2013	2012
Income before net realized investment gains, fair value changes in embedded derivative liabilities, equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests, corporate interest expense, loss on extinguishment of debt and income taxes ("EBIT" a non-GAAP financial measure) (a):		
Bankers Life	\$ 62.1	\$ 70.5
Washington National	29.4	24.7
Colonial Penn	(5.4)	(9.8)
Other CNO Business	3.6	(2.3)
EBIT from business segments	89.7	83.1
Corporate operations, excluding corporate interest expense	3.0	(1.8)
EBIT	92.7	81.3
Corporate interest expense	(15.1)	(17.5)
Income before net realized investment gains, fair value changes in embedded derivative liabilities, equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests, loss on extinguishment of debt and income taxes	77.6	63.8
Tax expense on operating income	27.9	23.2
Net operating income	49.7	40.6
Net realized investment gains (net of related amortization and taxes)	9.4	14.1
Fair value changes in embedded derivative liabilities (net of related amortization and taxes)	1.3	4.5
Equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests (net of taxes)	(1.8)	—
Loss on extinguishment of debt (net of taxes)	(57.2)	(.1)
Net income before valuation allowance for deferred tax assets	1.4	59.1
Valuation allowance for deferred tax assets	10.5	—
Net income	\$ 11.9	\$ 59.1
Per diluted share:		
Net operating income	\$.21	\$.15
Net realized investment gains (net of related amortization and taxes)	.04	.05
Fair value changes in embedded derivative liabilities (net of related amortization and taxes)	.01	.01
Equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests (net of taxes)	(.01)	—
Loss on extinguishment of debt (net of taxes)	(.24)	—
Valuation allowance for deferred tax assets	.04	—
Net income	\$.05	\$.21

- (a) Management believes that an analysis of EBIT provides a clearer comparison of the operating results of the Company from period to period because it excludes: (i) corporate interest expense; (ii) loss on extinguishment of debt; (iii) net realized investment gains; (iv) fair value changes in embedded derivative liabilities that are unrelated to the Company's underlying fundamentals; and (v) equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests. Net realized investment gains or losses include: (i) gains or losses on the sales of investments; (ii) other-than-temporary impairments recognized through net income; and (iii) changes in fair

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

value of certain fixed maturity investments with embedded derivatives. The table above reconciles the non-GAAP measure to the corresponding GAAP measure.

CRITICAL ACCOUNTING POLICIES

Refer to "Critical Accounting Policies" in our 2012 Annual Report on Form 10-K for information on our other accounting policies that we consider critical in preparing our consolidated financial statements.

RESULTS OF OPERATIONS

The following tables and narratives summarize the operating results of our segments for the periods presented (dollars in millions):

	Three months ended	
	March 31,	
	2013	2012
Income (loss) before net realized investment gains (losses), fair value changes in embedded derivative liabilities, net of related amortization, equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests, loss on extinguishment of debt and income taxes (a non-GAAP measure) (a):		
Bankers Life	\$ 62.1	\$ 70.5
Washington National	29.4	24.7
Colonial Penn	(5.4)	(9.8)
Other CNO Business	3.6	(2.3)
Corporate operations	(12.1)	(19.3)
	<u>77.6</u>	<u>63.8</u>
Net realized investment gains (losses), net of related amortization:		
Bankers Life	7.9	9.7
Washington National	1.6	3.1
Colonial Penn	(.3)	2.6
Other CNO Business	4.8	6.5
Corporate operations	.5	(.1)
	<u>14.5</u>	<u>21.8</u>
Fair value changes in embedded derivative liabilities, net of related amortization:		
Bankers Life	2.1	6.8
Other CNO Business	—	.1
	<u>2.1</u>	<u>6.9</u>
Equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests		
Corporate operations	(1.9)	—
Loss on extinguishment of debt:		
Corporate operations	(57.7)	(.2)
Income (loss) before income taxes:		
Bankers Life	72.1	87.0
Washington National	31.0	27.8
Colonial Penn	(5.7)	(7.2)
Other CNO Business	8.4	4.3
Corporate operations	(71.2)	(19.6)
Income before income taxes	<u>\$ 34.6</u>	<u>\$ 92.3</u>

- (a) These non-GAAP measures as presented in the above table and in the following segment financial data and discussions of segment results exclude net realized investment gains (losses), fair value changes in embedded derivative liabilities, net of related amortization, equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests, loss on extinguishment of debt and before income taxes. These are considered non-GAAP financial measures. A non-GAAP measure is a numerical measure of a company's performance, financial position, or cash flows that excludes or includes amounts that are normally excluded or included in the most directly comparable measure calculated and presented in accordance with GAAP.

These non-GAAP financial measures of "income (loss) before net realized investment gains (losses), fair value changes in embedded derivative liabilities, net of related amortization, equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests, loss on extinguishment of debt and before income taxes" differ from "income (loss) before income taxes" as presented in our consolidated statement of operations prepared in accordance with GAAP due to the exclusion of before tax realized investment gains (losses), fair value changes in embedded derivative liabilities, net of related amortization, equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests and loss on extinguishment of debt. We measure segment performance excluding these items because we believe that this performance measure is a better indicator of the ongoing businesses and trends in our business. Our primary investment focus is on investment income to support our liabilities for insurance products as opposed to the generation of realized investment gains (losses), and a long-term focus is necessary to maintain profitability over the life of the business. Realized investment gains (losses), fair value changes in embedded derivative liabilities and equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests depend on market conditions and do not necessarily relate to decisions regarding the underlying business of our segments. However, "income (loss) before net realized investment gains (losses), fair value changes in embedded derivative liabilities, net of related amortization, equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests, loss on extinguishment of debt and before income taxes" does not replace "income (loss) before income taxes" as a measure of overall profitability. We may experience realized investment gains (losses), which will affect future earnings levels since our underlying business is long-term in nature and we need to earn the assumed interest rates on the investments backing our liabilities for insurance products to maintain the profitability of our business. In addition, management uses this non-GAAP financial measure in its budgeting process, financial analysis of segment performance and in assessing the allocation of resources. We believe these non-GAAP financial measures enhance an investor's understanding of our financial performance and allows them to make more informed judgments about the Company as a whole. These measures also highlight operating trends that might not otherwise be transparent. The table above reconciles the non-GAAP measure to the corresponding GAAP measure.

General: CNO is the top tier holding company for a group of insurance companies operating throughout the United States that develop, market and administer health insurance, annuity, individual life insurance and other insurance products. We distribute these products through our Bankers Life segment, which utilizes a career agency force, through our Colonial Penn segment, which utilizes direct response marketing, and through our Washington National segment, which utilizes independent producers.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Bankers Life (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
Premium collections:		
Annuities	\$ 165.6	\$ 184.7
Medicare supplement and other supplemental health	335.1	329.5
Life	89.5	70.1
Total collections	<u>\$ 590.2</u>	<u>\$ 584.3</u>
Average liabilities for insurance products:		
Annuities:		
Mortality based	\$ 229.2	\$ 233.8
Fixed index	3,038.8	2,707.4
Deposit based	4,385.3	4,644.9
Medicare supplement and other supplemental health	5,220.2	4,634.5
Life:		
Interest sensitive	467.6	441.4
Non-interest sensitive	589.5	483.0
Total average liabilities for insurance products, net of reinsurance ceded	<u>\$ 13,930.6</u>	<u>\$ 13,145.0</u>
Revenues:		
Insurance policy income	\$ 418.0	\$ 406.5
Net investment income:		
General account invested assets	212.8	200.3
Fixed index products	48.9	34.6
Fee revenue and other income	3.7	2.9
Total revenues	<u>683.4</u>	<u>644.3</u>
Expenses:		
Insurance policy benefits	375.2	335.2
Amounts added to policyholder account balances:		
Annuity products and interest-sensitive life products other than fixed index products	34.1	38.5
Fixed index products	61.2	47.2
Amortization related to operations	54.5	56.9
Interest expense on investment borrowings	1.4	1.4
Other operating costs and expenses	94.9	94.6
Total benefits and expenses	<u>621.3</u>	<u>573.8</u>
Income before net realized investment gains, net of related amortization, and fair value changes in embedded derivative liabilities, net of related amortization, and income taxes	<u>62.1</u>	<u>70.5</u>
Net realized investment gains	8.6	10.6
Amortization related to net realized investment gains	(.7)	(.9)
Net realized investment gains, net of related amortization	<u>7.9</u>	<u>9.7</u>
Insurance policy benefits - fair value changes in embedded derivative liabilities	3.2	11.0
Amortization related to fair value changes in embedded derivative liabilities	(1.1)	(4.2)
Fair value changes in embedded derivative liabilities, net of related amortization	<u>2.1</u>	<u>6.8</u>
Income before income taxes	<u>\$ 72.1</u>	<u>\$ 87.0</u>

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

	Three months ended	
	March 31,	
	2013	2012
Health benefit ratios:		
All health lines:		
Insurance policy benefits	\$ 310.8	\$ 282.8
Benefit ratio (a)	93.4%	84.6%
Medicare supplement:		
Insurance policy benefits	\$ 129.0	\$ 117.8
Benefit ratio (a)	68.5%	64.5%
PDP:		
Insurance policy benefits	\$ 6.7	\$ 9.2
Benefit ratio (a)	74.9%	85.9%
PFFS:		
Insurance policy benefits	\$ —	\$ (.1)
Benefit ratio (a)	N/A	N/A
Long-term care:		
Insurance policy benefits	\$ 175.1	\$ 155.9
Benefit ratio (a)	129.4%	110.9%
Interest-adjusted benefit ratio (b)	81.7%	65.5%

- (a) We calculate benefit ratios by dividing the related product's insurance policy benefits by insurance policy income.
- (b) We calculate the interest-adjusted benefit ratio (a non-GAAP measure) for Bankers Life's long-term care products by dividing such product's insurance policy benefits less the imputed interest income on the accumulated assets backing the insurance liabilities by policy income. These are considered non-GAAP financial measures. A non-GAAP measure is a numerical measure of a company's performance, financial position, or cash flows that excludes or includes amounts that are normally excluded or included in the most directly comparable measure calculated and presented in accordance with GAAP.

These non-GAAP financial measures of "interest-adjusted benefit ratios" differ from "benefit ratios" due to the deduction of imputed interest income on the accumulated assets backing the insurance liabilities from the product's insurance policy benefits used to determine the ratio. Interest income is an important factor in measuring the performance of health products that are expected to be in force for a longer duration of time, are not subject to unilateral changes in provisions (such as non-cancelable or guaranteed renewable contracts) and require the performance of various functions and services (including insurance protection) for an extended period of time. The net cash flows from long-term care products generally cause an accumulation of amounts in the early years of a policy (accounted for as reserve increases) that will be paid out as benefits in later policy years (accounted for as reserve decreases). Accordingly, as the policies age, the benefit ratio will typically increase, but the increase in benefits will be partially offset by the imputed interest income earned on the accumulated assets. The interest-adjusted benefit ratio reflects the effects of such interest income offset. Since interest income is an important factor in measuring the performance of this product, management believes a benefit ratio that includes the effect of interest income is useful in analyzing product performance. We utilize the interest-adjusted benefit ratio in measuring segment performance because we believe that this performance measure is a better indicator of the ongoing businesses and trends in the business. However, the "interest-adjusted benefit ratio" does not replace the "benefit ratio" as a measure of current period benefits to current period insurance policy income. Accordingly, management reviews both "benefit ratios" and "interest-adjusted benefit ratios" when analyzing the financial results attributable to these products. The imputed investment income earned on the accumulated assets backing Bankers Life's long-term care reserves was \$64.6 million and \$63.8 million in the three months ended March 31, 2013 and 2012, respectively.

Total premium collections were \$590.2 million in the first quarter of 2013, up 1.0 percent from 2012. See "Premium Collections" for further analysis of Bankers Life's premium collections.

Average liabilities for insurance products, net of reinsurance ceded were \$13.9 billion in the first quarter of 2013, up 6 percent from 2012. The increase in such liabilities reflects higher new sales of these products. In addition, such average

insurance liabilities for certain long-term care products were increased by \$427 million in the first quarter of 2013 to reflect the premium deficiencies that would exist if unrealized gains on the assets backing such products had been realized and the proceeds from the sales of such assets were invested at then current yields. Such increase is reflected as a reduction of accumulated other comprehensive income.

Insurance policy income is comprised of premiums earned on policies which provide mortality or morbidity coverage and fees and other charges assessed on other policies.

Net investment income on general account invested assets (which excludes income on policyholder accounts) was \$212.8 million in the first quarter of 2013, up 6.2 percent from 2012. The average balance of general account invested assets was \$14.7 billion and \$14.1 billion in the first quarters of 2013 and 2012, respectively. The average yield on these assets was 5.78 percent and 5.67 percent in the first quarters of 2013 and 2012, respectively. The increase in general account invested assets is primarily due to sales and increased persistency of our annuity and health products in recent periods. The increase in net investment income in the 2013 period reflects the growth in general account invested assets and prepayment income. Prepayment income was \$5.6 million and \$.5 million in the first three months of 2013 and 2012, respectively. Investing in relatively higher yielding investments and reduction to turnover rates to preserve existing higher yielding investments has resulted in maintaining overall yields in this segment when compared to the prior year. However, should current market conditions continue, it is possible that the overall yield may decline in future periods.

Net investment income related to fixed index products represents the change in the estimated fair value of options which are purchased in an effort to offset or hedge certain potential benefits accruing to the policyholders of our fixed index products. Our fixed index products are designed so that investment income spread is expected to be more than adequate to cover the cost of the options and other costs related to these policies. Net investment income (loss) related to fixed index products was \$48.9 million and \$34.6 million in the first quarters of 2013 and 2012, respectively. Such amounts were mostly offset by the corresponding charge (credit) to **amounts added to policyholder account balances for fixed index products**. Such income and related charges fluctuate based on the value of options embedded in the segment's fixed index annuity policyholder account balances subject to this benefit and to the performance of the index to which the returns on such products are linked.

Insurance policy benefits fluctuated as a result of the factors summarized below for benefit ratios. Benefit ratios are calculated by dividing the related insurance product's insurance policy benefits by insurance policy income.

The Medicare supplement business consists of both individual and group policies. Government regulations generally require us to attain and maintain a ratio of total benefits incurred to total premiums earned (excluding changes in policy benefit reserves), after three years from the original issuance of the policy and over the lifetime of the policy, of not less than 65 percent on individual products and not less than 75 percent on group products, as determined in accordance with statutory accounting principles. Since the insurance product liabilities we establish for Medicare supplement business are subject to significant estimates, the ultimate claim liability we incur for a particular period is likely to be different than our initial estimate. Our insurance policy benefits reflected reserve redundancies from prior years of \$11.7 million in the first three months of 2012. Our benefit ratios were 68.5 percent and 64.5 percent in the first three months of 2013 and 2012, respectively. In 2013, we currently expect the benefit ratio on this Medicare supplement business will be approximately 71 percent.

The insurance policy benefits on our PDP business result from our quota-share reinsurance agreement with Coventry. Insurance margins (insurance policy income less insurance policy benefits) on the PDP business were \$2.2 million and \$1.5 million in the first quarters of 2013 and 2012, respectively. In the first three months of 2012, reserves related to the previously terminated Private-Fee-For-Service ("PFFS") business were released due to favorable claim developments resulting in insurance policy benefits of \$(.1) million.

The net cash flows from our long-term care products generally cause an accumulation of amounts in the early years of a policy (accounted for as reserve increases) which will be paid out as benefits in later policy years (accounted for as reserve decreases). Accordingly, as the policies age, the benefit ratio typically increases, but the increase in reserves is partially offset by investment income earned on the accumulated assets. The benefit ratio on our long-term care business in the Bankers Life segment was 129.4 percent and 110.9 percent in the first quarters of 2013 and 2012, respectively. The interest-adjusted benefit ratio on this business was 81.7 percent and 65.5 percent in the first quarters of 2013 and 2012, respectively. Since the insurance product liabilities we establish for long-term care business are subject to significant estimates, the ultimate claim liability we incur for a particular period is likely to be different than our initial estimate. When policies lapse, active life reserves for such lapsed policies are released, resulting in decreased insurance policy benefits (although such decrease is somewhat offset by additional amortization expense). The benefit ratio in 2013 increased due to higher incurred claims as the business continues to age and as new business becomes less of a component of the overall inforce business. In addition, we recognized a \$6.7 million

out-of-period adjustment in the first quarter of 2013 which increased insurance policy benefits. Excluding the out-of-period adjustment, our interest-adjusted benefit ratio would have been 76.7 percent in the first three months of 2013. We currently expect the interest adjusted benefit ratio on this long-term care business will be approximately 75 percent in 2013.

Over the past several years, we have implemented rate increases in the long-term care block in the Bankers Life segment. In the first three months of both 2013 and 2012, the income before income taxes in the Bankers Life segment reflected a reduction in insurance policy benefits partially offset by additional amortization of insurance acquisition costs due to the impacts of recent rate increases. These impacts netted to approximately \$3 million and \$11 million in the first three months of 2013 and 2012, respectively, and include: (i) the reduction in liabilities for policyholders choosing to lapse their policies rather than paying higher rates; (ii) the reduction in liabilities for policyholders choosing to reduce their coverages to achieve a lower cost; offset by (iii) the increase in the liabilities related to waiver of premium benefits to reflect higher premiums after the rate increases; and (iv) increased amortization of insurance acquisition costs resulting from the increase in lapses. The net impacts described above are expected to be lower in future periods as re-rating activity slows given we have completed several rounds of rate actions on underperforming blocks of long-term care business in recent years.

Amounts added to policyholder account balances for annuity products and interest-sensitive life products were \$34.1 million in the first quarter of 2013, down 11 percent from 2012. The weighted average crediting rate for these products was 2.8 percent and 3.0 percent in the first quarters of 2013 and 2012, respectively. The average liabilities of the deposit-based annuity block was \$4.4 billion and \$4.6 billion in the first three months of 2013 and 2012, respectively.

Amounts added to fixed index products based on change in value of the indices will generally fluctuate with the corresponding related investment income accounts described above.

Amortization related to operations includes amortization of deferred acquisition costs and the present value of future profits. Deferred acquisition costs and the present value of future profits are collectively referred to as "insurance acquisition costs." Insurance acquisition costs are generally amortized either: (i) in relation to the estimated gross profits for universal life and investment-type products; or (ii) in relation to actual and expected premium revenue for other products. In addition, for universal life and investment-type products, we are required to adjust the total amortization recorded to date through the statement of operations if actual experience or other evidence suggests that earlier estimates of future gross profits should be revised. Accordingly, amortization for universal life and investment-type products is dependent on the profits realized during the period and on our expectation of future profits. For other products, we amortize insurance acquisition costs in relation to actual and expected premium revenue, and amortization is only adjusted if expected premium revenue changes or if we determine the balance of these costs is not recoverable from future profits. Bankers Life's amortization expense was \$54.5 million and \$56.9 million in the first quarters of 2013 and 2012, respectively.

Interest expense on investment borrowings represents interest expense on collateralized borrowings as further described in the note to the consolidated financial statements entitled "Investment Borrowings".

Other operating costs and expenses in our Bankers Life segment were \$94.9 million in the first quarter of 2013, up .3 percent from 2012. Other operating expenses in first three months of 2012 included a \$10 million settlement with state securities regulators. Other operating costs and expenses include the following (dollars in millions):

	Three months ended March 31,	
	2013	2012
Expenses related to the marketing and quota-share agreements with Coventry	\$ 2.3	\$ 1.9
Commission expense and agent manager benefits	16.2	14.0
Other operating expenses	76.4	78.7
Total	<u>\$ 94.9</u>	<u>\$ 94.6</u>

Net realized investment gains (losses) fluctuate each period. During the first three months of 2013, we recognized \$8.6 million of net gains from the sales of investments (primarily fixed maturities). During the first three months of 2012, net realized investment gains in this segment included \$12.6 million of net gains from the sales of investments (primarily fixed maturities) and \$2.0 million of writedowns of investments for other than temporary declines in fair value recognized through net income.

Amortization related to net realized investment gains is the increase or decrease in the amortization of insurance acquisition costs which results from realized investment gains or losses. When we sell securities which back our universal life and investment-type products at a gain (loss) and reinvest the proceeds at a different yield, we increase (reduce) the amortization of insurance acquisition costs in order to reflect the change in estimated gross profits due to the gains (losses) realized and the resulting effect on estimated future yields. Sales of fixed maturity investments resulted in an increase in the amortization of insurance acquisition costs of \$.7 million and \$.9 million in the first quarters of 2013 and 2012, respectively.

Insurance policy benefits - fair value changes in embedded derivative liabilities represents fair value changes due to fluctuations in the interest rates used to discount embedded derivative liabilities related to our fixed index annuities.

Amortization related to fair value changes in embedded derivative liabilities is the increase or decrease in the amortization of insurance acquisition costs which results from changes in interest rates used to discount embedded derivative liabilities related to our fixed index annuities.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Washington National (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
Premium collections:		
Medicare supplement and other supplemental health	\$ 147.5	\$ 141.7
Life	3.6	4.0
Total collections	<u>\$ 151.1</u>	<u>\$ 145.7</u>
Average liabilities for insurance products:		
Medicare supplement and other supplemental health	\$ 2,421.4	\$ 2,429.6
Non-interest sensitive life	197.2	200.4
Total average liabilities for insurance products, net of reinsurance ceded	<u>\$ 2,618.6</u>	<u>\$ 2,630.0</u>
Revenues:		
Insurance policy income	\$ 149.1	\$ 147.4
Net investment income:		
General account invested assets	52.0	50.0
Trading account income related to reinsurer accounts	—	.1
Change in value of embedded derivatives related to modified coinsurance agreements	—	(.1)
Fee revenue and other income	.2	.2
Total revenues	<u>201.3</u>	<u>197.6</u>
Expenses:		
Insurance policy benefits	118.3	115.7
Amortization related to operations	13.7	12.7
Interest expense on investment borrowings	.5	.7
Other operating costs and expenses	39.4	43.8
Total benefits and expenses	<u>171.9</u>	<u>172.9</u>
Income before net realized investment gains and income taxes	29.4	24.7
Net realized investment gains	1.6	3.1
Income before income taxes	<u>\$ 31.0</u>	<u>\$ 27.8</u>
Health benefit ratios:		
Medicare supplement:		
Insurance policy benefits	\$ 17.4	\$ 20.1
Benefit ratio (a)	65.0%	65.4%
Supplemental health:		
Insurance policy benefits	\$ 93.4	\$ 92.0
Benefit ratio (a)	79.3%	82.4%
Interest-adjusted benefit ratio (b)	53.1%	55.1%

- (a) We calculate benefit ratios by dividing the related product's insurance policy benefits by insurance policy income.
- (b) We calculate the interest-adjusted benefit ratio (a non-GAAP measure) for Washington National's supplemental health products by dividing such product's insurance policy benefits less the imputed interest income on the accumulated assets backing the insurance liabilities by policy income. These are considered non-GAAP financial measures. A non-GAAP measure is a numerical measure of a company's performance, financial position, or cash flows that excludes or includes amounts that are normally excluded or included in the most directly comparable measure calculated and presented in accordance with GAAP.

These non-GAAP financial measures of "interest-adjusted benefit ratios" differ from "benefit ratios" due to the deduction of imputed interest income on the accumulated assets backing the insurance liabilities from the product's insurance policy benefits used to determine the ratio. Interest income is an important factor in measuring the performance of health products that are expected to be in force for a longer duration of time, are not subject to unilateral changes in provisions (such as non-cancelable or guaranteed renewable contracts) and require the performance of various functions and services (including insurance protection) for an extended period of time. The net cash flows from supplemental health products generally cause an accumulation of amounts in the early years of a policy (accounted for as reserve increases) that will be paid out as benefits in later policy years (accounted for as reserve decreases). Accordingly, as the policies age, the benefit ratio will typically increase, but the increase in benefits will be partially offset by the imputed interest income earned on the accumulated assets. The interest-adjusted benefit ratio reflects the effects of such interest income offset. Since interest income is an important factor in measuring the performance of these products, management believes a benefit ratio that includes the effect of interest income is useful in analyzing product performance. We utilize the interest-adjusted benefit ratio in measuring segment performance because we believe that this performance measure is a better indicator of the ongoing businesses and trends in the business. However, the "interest-adjusted benefit ratio" does not replace the "benefit ratio" as a measure of current period benefits to current period insurance policy income. Accordingly, management reviews both "benefit ratios" and "interest-adjusted benefit ratios" when analyzing the financial results attributable to these products. The imputed investment income earned on the accumulated assets backing the supplemental health reserves was \$30.9 million and \$30.5 million in the three months ended March 31, 2013 and 2012, respectively.

Total premium collections were \$151.1 million in the first quarter of 2013, up 3.7 percent from 2012. See "Premium Collections" for further analysis.

Average liabilities for insurance products, net of reinsurance ceded were \$2.6 billion in the first quarter of 2013, down .4 percent from 2012.

Insurance policy income is comprised of premiums earned on traditional insurance policies which provide mortality or morbidity coverage and fees and other charges assessed on other policies. Such income increased slightly during the 2013 period as supplemental health premiums have increased and Medicare supplement premiums have decreased consistent with sales.

Net investment income on general account invested assets (which excludes income on policyholder and reinsurer accounts) was \$52.0 million in the first quarter of 2013, up 4.0 percent from 2012. The average balance of general account invested assets was \$3.8 billion and \$3.7 billion in the first quarters of 2013 and 2012, respectively. The average yield on these assets was 5.53 percent and 5.45 percent in the first quarters of 2013 and 2012, respectively. The average yield reflects slightly higher prepayment income in the 2013 period.

Trading account income related to reinsurer accounts primarily represents the income on trading securities which are held to act as hedges for embedded derivatives related to certain modified coinsurance agreements. The income on our trading account securities is designed to substantially offset the change in value of embedded derivatives related to modified coinsurance agreements described below.

Change in value of embedded derivatives related to modified coinsurance agreements is described in the note to our consolidated financial statements entitled "Accounting for Derivatives." We have transferred the specific block of investments related to these agreements to our trading securities account, which we carry at estimated fair value with changes in such value recognized as trading account income. The change in the value of the embedded derivatives has largely been offset by the change in value of the trading securities.

Insurance policy benefits fluctuated as a result of the factors summarized below for benefit ratios. Benefit ratios are calculated by dividing the related insurance product's insurance policy benefits by insurance policy income.

The benefit ratios on Washington National's Medicare supplement products have been impacted by increases in policyholder lapses following our premium rate increase actions. We establish active life reserves for these policies, which are in addition to amounts required for incurred claims. When policies lapse, active life reserves for such lapsed policies are released, resulting in decreased insurance policy benefits (although such decrease is substantially offset by additional amortization expense). In addition, the insurance product liabilities we establish for our Medicare supplement business are subject to significant estimates and the ultimate claim liability we incur for a particular period is likely to be different than our initial estimate. Government regulations generally require us to attain and maintain a ratio of total benefits incurred to total premiums earned (excluding changes in policy benefit reserves), after three years from the original issuance of the policy and over the lifetime of the policy, of not less than 65 percent on these products, as determined in accordance with statutory accounting principles. Insurance margins (insurance policy income less insurance policy benefits) on these products were \$9.4 million and \$10.7 million in the first quarters of 2013 and 2012, respectively. Such decrease reflects the run-off of this business as we discontinued new sales of Medicare supplement business in this segment in the fourth quarter of 2012.

Washington National's supplemental health products (including specified disease, accident and hospital indemnity products) generally provide fixed or limited benefits. For example, payments under cancer insurance policies are generally made directly to, or at the direction of, the policyholder following diagnosis of, or treatment for, a covered type of cancer. Approximately three-fourths of our supplemental health policies inforce (based on policy count) are sold with return of premium or cash value riders. The return of premium rider generally provides that after a policy has been inforce for a specified number of years or upon the policyholder reaching a specified age, we will pay to the policyholder, or a beneficiary under the policy, the aggregate amount of all premiums paid under the policy, without interest, less the aggregate amount of all claims incurred under the policy. The cash value rider is similar to the return of premium rider, but also provides for payment of a graded portion of the return of premium benefit if the policy terminates before the return of premium benefit is earned. Accordingly, the net cash flows from these products generally result in the accumulation of amounts in the early years of a policy (reflected in our earnings as reserve increases) which will be paid out as benefits in later policy years (reflected in our earnings as reserve decreases which offset the recording of benefit payments). As the policies age, the benefit ratio will typically increase, but the increase in benefits will be partially offset by investment income earned on the accumulated assets. The benefit ratio will fluctuate depending on the claim experience during the year. Insurance margins (insurance policy income less insurance policy benefits) on these products were \$24.3 million and \$19.6 million in the first quarters of 2013 and 2012, respectively. The increase in margin in the 2013 period is primarily related to higher insurance policy income due to the growth in this block of business. The interest adjusted benefit ratio on this supplemental health business was 53.1 percent and 55.1 percent in the first quarters of 2013 and 2012, respectively. In 2013, we currently expect this interest-adjusted benefit ratio will be approximately 50 percent.

Amortization related to operations includes amortization of insurance acquisition costs. Insurance acquisition costs are generally amortized in relation to actual and expected premium revenue, and amortization is only adjusted if expected premium revenue changes or if we determine the balance of these costs is not recoverable from future profits. Such amounts were generally consistent with the related premium revenue. A revision to our current assumptions could result in increases or decreases to amortization expense in future periods.

Interest expense on investment borrowings represents \$.5 million and \$.7 million of interest expense on collateralized borrowings in the three months ended March 31, 2013 and 2012, respectively, as further described in the note to the consolidated financial statements entitled "Investment Borrowings".

Other operating costs and expenses include commission expense of \$16.1 million and \$17.0 million in the first quarters of 2013 and 2012, respectively. The 2013 period reflects lower legal expenses than the comparable period in 2012.

Net realized investment gains (losses) fluctuate each period. During the first three months of 2013, we recognized \$1.6 million of net gains from the sales of investments (primarily fixed maturities). During the first three months of 2012, net realized investment gains included \$5.1 million of net gains from the sales of investments (primarily fixed maturities) and \$2.0 million of writedowns of investments for other than temporary declines in fair value recognized through net income.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Colonial Penn (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
Premium collections:		
Life	\$ 56.1	\$ 52.6
Supplemental health	1.1	1.3
Total collections	<u>\$ 57.2</u>	<u>\$ 53.9</u>
Average liabilities for insurance products:		
Annuities-mortality based	\$ 74.8	\$ 77.0
Supplemental health	14.4	15.4
Life:		
Interest sensitive	17.7	19.9
Non-interest sensitive	618.1	598.4
Total average liabilities for insurance products, net of reinsurance ceded	<u>\$ 725.0</u>	<u>\$ 710.7</u>
Revenues:		
Insurance policy income	\$ 56.9	\$ 53.4
Net investment income:		
General account invested assets	9.9	10.0
Fee revenue and other income	.2	.2
Total revenues	<u>67.0</u>	<u>63.6</u>
Expenses:		
Insurance policy benefits	42.8	41.9
Amounts added to annuity and interest-sensitive life product account balances	.2	.2
Amortization related to operations	3.7	3.7
Other operating costs and expenses	25.7	27.6
Total benefits and expenses	<u>72.4</u>	<u>73.4</u>
Loss before net realized investment gains (losses) and income taxes	(5.4)	(9.8)
Net realized investment gains (losses)	(.3)	2.6
Loss before income taxes	<u>\$ (5.7)</u>	<u>\$ (7.2)</u>

This segment's results are significantly impacted by the adoption of the new accounting standard related to deferred acquisition costs. We are no longer able to defer most of Colonial Penn's direct response advertising costs although such costs generate predictable sales and future inforce profits. In 2013, we plan to continue to invest in this segment's business, including the development of new products and markets. The amount of our investment in new business during a particular period will have a significant impact on this segment's results. We continue to expect this segment to report a loss (before net realized investment gains (losses) and income taxes) in 2013 of between \$5 million and \$10 million.

Total premium collections increased by 6.1 percent, to \$57.2 million, in the first quarter of 2013, as compared to the same period in 2012. See "Premium Collections" for further analysis of Colonial Penn's premium collections.

Insurance policy income is comprised of premiums earned on policies which provide mortality or morbidity coverage and fees and other charges assessed on other policies. The increase in such income reflects the growth in the block of business.

Net investment income on general account invested assets (which excludes income on policyholder and reinsurer accounts) was \$9.9 million in the first quarter of 2013, down 1.0 percent from 2012. The average balance of general account invested assets was \$676.6 million and \$684.0 million in the first quarters of 2013 and 2012, respectively. The average yield on these assets was 5.84 percent and 5.88 percent in the first quarters of 2013 and 2012, respectively.

Insurance policy benefits fluctuated as a result of the growth in this segment.

Amortization related to operations includes amortization of insurance acquisition costs. Insurance acquisition costs in the Colonial Penn segment are amortized in relation to actual and expected premium revenue, and amortization is only adjusted if expected premium revenue changes or if we determine the balance of these costs is not recoverable from future profits. Such amounts were generally consistent with the related premium revenue and gross profits for such periods and the assumptions we made when we established the present value of future profits. A revision to our current assumptions could result in increases or decreases to amortization expense in future periods.

Other operating costs and expenses in our Colonial Penn segment decreased in the 2013 period primarily due to lower marketing expenses.

Net realized investment gains (losses) fluctuate each period. During the first three months of 2013, we recognized \$.3 million of net losses from the sales of investments (primarily fixed maturities). During the first three months of 2012, net realized investment gains in this segment included \$2.7 million of net gains from the sales of investments (primarily fixed maturities) and \$.1 million of writedowns of investments for other than temporary declines in fair value recognized through net income.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Other CNO Business (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
Premium collections:		
Annuities	\$ 1.0	\$.9
Other health	6.5	6.9
Life	41.1	45.3
Total collections	<u>\$ 48.6</u>	<u>\$ 53.1</u>
Average liabilities for insurance products:		
Annuities:		
Mortality based	\$ 214.8	\$ 229.1
Fixed index	474.2	553.8
Deposit based	631.5	638.4
Separate accounts	15.2	15.5
Other health	474.8	481.0
Life:		
Interest sensitive	2,258.9	2,416.9
Non-interest sensitive	809.2	766.5
Total average liabilities for insurance products, net of reinsurance ceded	<u>\$ 4,878.6</u>	<u>\$ 5,101.2</u>
Revenues:		
Insurance policy income	\$ 67.2	\$ 79.0
Net investment income:		
General account invested assets	79.4	84.0
Fixed index products	9.0	6.8
Trading account income related to policyholder accounts	1.3	1.9
Total revenues	<u>156.9</u>	<u>171.7</u>
Expenses:		
Insurance policy benefits	88.1	83.0
Amounts added to policyholder account balances:		
Annuity products and interest-sensitive life products other than fixed index products	28.8	29.7
Fixed index products	8.5	9.2
Amortization related to operations	5.6	7.5
Interest expense on investment borrowings	4.8	5.1
Other operating costs and expenses	17.5	39.5
Total benefits and expenses	<u>153.3</u>	<u>174.0</u>
Income (loss) before net realized investment gains, net of related amortization, and fair value changes in embedded derivative liabilities, net of related amortization, and income taxes	<u>3.6</u>	<u>(2.3)</u>
Net realized investment gains	4.9	6.7
Amortization related to net realized investment gains	(.1)	(.2)
Net realized investment gains, net of related amortization	<u>4.8</u>	<u>6.5</u>
Insurance policy benefits - fair value changes in embedded derivative liabilities	(.1)	.6
Amortization related to fair value changes in embedded derivative liabilities	.1	(.5)
Fair value changes in embedded derivative liabilities, net of related amortization	<u>—</u>	<u>.1</u>
Income before income taxes	<u>\$ 8.4</u>	<u>\$ 4.3</u>

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

	Three months ended	
	March 31,	
	2013	2012
Health benefit ratios:		
Long-term care:		
Insurance policy benefits	\$ 15.6	\$ 15.1
Benefit ratio (a)	252.2%	227.4%
Interest-adjusted benefit ratio (b)	140.7%	122.0%

- (a) We calculate benefit ratios by dividing the related product's insurance policy benefits by insurance policy income.
- (b) We calculate the interest-adjusted benefit ratio (a non-GAAP measure) for Other CNO Business long-term care products by dividing such product's insurance policy benefits less the imputed interest income on the accumulated assets backing the insurance liabilities by policy income. These are considered non-GAAP financial measures. A non-GAAP measure is a numerical measure of a company's performance, financial position, or cash flows that excludes or includes amounts that are normally excluded or included in the most directly comparable measure calculated and presented in accordance with GAAP.

These non-GAAP financial measures of "interest-adjusted benefit ratios" differ from "benefit ratios" due to the deduction of imputed interest income on the accumulated assets backing the insurance liabilities from the product's insurance policy benefits used to determine the ratio. Interest income is an important factor in measuring the performance of health products that are expected to be in force for a longer duration of time, are not subject to unilateral changes in provisions (such as non-cancelable or guaranteed renewable contracts) and require the performance of various functions and services (including insurance protection) for an extended period of time. The net cash flows from long-term care products generally cause an accumulation of amounts in the early years of a policy (accounted for as reserve increases) that will be paid out as benefits in later policy years (accounted for as reserve decreases). Accordingly, as the policies age, the benefit ratio will typically increase, but the increase in benefits will be partially offset by the imputed interest income earned on the accumulated assets. The interest-adjusted benefit ratio reflects the effects of such interest income offset. Since interest income is an important factor in measuring the performance of these products, management believes a benefit ratio that includes the effect of interest income is useful in analyzing product performance. We utilize the interest-adjusted benefit ratio in measuring segment performance because we believe that this performance measure is a better indicator of the ongoing businesses and trends in the business. However, the "interest-adjusted benefit ratio" does not replace the "benefit ratio" as a measure of current period benefits to current period insurance policy income. Accordingly, management reviews both "benefit ratios" and "interest-adjusted benefit ratios" when analyzing the financial results attributable to these products. The imputed investment income earned on the accumulated assets backing the long-term care reserves was \$6.9 million and \$7.0 million in the three months ended March 31, 2013 and 2012, respectively.

This segment's results are significantly impacted by the interest-sensitive life insurance block which is sensitive to interest rates and changes to NGEs. This segment also includes: (i) declining blocks of traditional life and annuity products which generally generate stable earnings; and (ii) a smaller block of long-term care business generating a modest stream of losses with limited rate increase potential. In 2013, we continue to expect this segment to report normalized earnings before net realized investment gains (losses) and fair value changes in embedded derivative liabilities, net of related amortization and taxes of between \$5 million and \$20 million, recognizing this segment's results can be volatile given relatively thin margins and continued litigation activity.

Total premium collections were \$48.6 million in the first quarter of 2013, down 8.5 percent from 2012. The decrease in collected premiums was primarily due to a reduction in policyholder charges on certain interest-sensitive life products consistent with the settlement offered in a class action lawsuit and policyholder redemptions and lapses. See "Premium Collections" for further analysis.

Average liabilities for insurance products, net of reinsurance ceded were \$4.9 billion in the first quarter of 2013, down 4.4 percent from 2012. The decrease in such liabilities was primarily due to policyholder redemptions and lapses.

Insurance policy income is comprised of policyholder charges on our interest-sensitive products and premiums earned on traditional insurance policies which provide mortality or morbidity coverage. The decrease in insurance policy income in the first three months of 2013 is primarily due to a reduction in policyholder charges on certain interest-sensitive life products

consistent with the settlement offered in a class action lawsuit and lower premium revenue due to policyholder redemptions and lapses.

Net investment income on general account invested assets (which excludes income on policyholder and reinsurer accounts) was \$79.4 million in the first quarter of 2013, down 5.5 percent from 2012. The average balance of general account invested assets was \$5.5 billion and \$5.7 billion in the first quarters of 2013 and 2012, respectively. The average yield on these assets was 5.82 percent and 5.86 percent in the first quarters of 2013 and 2012, respectively. The decrease in net investment income is primarily due to the lower invested assets in this segment as the business runs off.

Net investment income related to fixed index products represents the change in the estimated fair value of options which are purchased in an effort to offset or hedge certain potential benefits accruing to the policyholders of our fixed index products. Our fixed index products are designed so that the investment income spread is expected to be more than adequate to cover the cost of the options and other costs related to these policies. Net investment income related to fixed index products was \$9.0 million and \$6.8 million in the first quarters of 2013 and 2012, respectively. Such amounts were mostly offset by the corresponding charge (credit) to **amounts added to policyholder account balances for fixed index products**. Such income and related charges fluctuate based on the value of options embedded in the segment's fixed index annuity policyholder account balances subject to this benefit and to the performance of the index to which the returns on such products are linked.

Trading account income related to policyholder accounts represents the income on investments backing the market strategies of certain annuity products which provide for different rates of cash value growth based on the experience of a particular market strategy. The income on our trading account securities is designed to substantially offset certain amounts included in insurance policy benefits related to the aforementioned annuity products.

Insurance policy benefits were affected by a number of items as summarized below.

The long-term care policies in this segment generally provide for indemnity and non-indemnity benefits on a guaranteed renewable or non-cancellable basis. The benefit ratio on our long-term care policies was 252.2 percent and 227.4 percent in the first quarters of 2013 and 2012, respectively. Benefit ratios are calculated by dividing the product's insurance policy benefits by insurance policy income. Since the insurance product liabilities we establish for long-term care business are subject to significant estimates, the ultimate claim liability we incur for a particular period is likely to be different than our initial estimate.

The net cash flows from long-term care products generally cause an accumulation of amounts in the early years of a policy (reflected in our earnings as reserve increases) which will be paid out as benefits in later policy years (reflected in our earnings as reserve decreases which offset the recording of benefit payments). Accordingly, as the policies age, the benefit ratio will typically increase, but the increase in benefits will be partially offset by investment income earned on the assets which have accumulated. The interest-adjusted benefit ratio on this business was 140.7 percent and 122.0 percent in the first three months of 2013 and 2012, respectively.

In each quarterly period, we calculate our best estimate of claim reserves based on all of the information available to us at that time, which necessarily takes into account new experience emerging during the period. Our actuaries estimate these claim reserves using various generally recognized actuarial methodologies which are based on informed estimates and judgments that are believed to be appropriate. As additional experience emerges and other data become available, these estimates and judgments are reviewed and may be revised. Significant assumptions made in estimating claim reserves for long-term care policies include expectations about the: (i) future duration of existing claims; (ii) cost of care and benefit utilization; (iii) interest rate utilized to discount claim reserves; (iv) claims that have been incurred but not yet reported; (v) claim status on the reporting date; (vi) claims that have been closed but are expected to reopen; and (vii) correspondence that has been received that will ultimately become claims that have payments associated with them.

Amounts added to policyholder account balances for annuity products and interest-sensitive life products were \$28.8 million in the first quarter of 2013, down 3.0 percent from 2012. The decrease was primarily due to a smaller block of interest-sensitive life business in force due to lapses in recent periods. The weighted average crediting rate for these products was 4.0 percent in both the first three months of 2013 and 2012.

Amounts added to fixed index products generally fluctuate with the corresponding related investment income accounts described above.

Amortization related to operations includes amortization of insurance acquisition costs. Insurance acquisition costs are generally amortized either: (i) in relation to the estimated gross profits for universal life and investment-type products; or (ii) in relation to actual and expected premium revenue for other products. In addition, for universal life and investment-type products, we are required to adjust the total amortization recorded to date through the statement of operations if actual experience or other evidence suggests that earlier estimates of future gross profits should be revised. Accordingly, amortization for universal life and investment-type products is dependent on the profits realized during the period and on our expectation of future profits. For other products, we amortize insurance acquisition costs in relation to actual and expected premium revenue, and amortization is only adjusted if expected premium revenue changes. The assumptions we use to estimate our future gross profits and premiums involve significant judgment. A revision to our current assumptions could result in increases or decreases to amortization expense in future periods. Earnings on our universal life products, which comprise a significant part of this block, are subject to volatility since our insurance acquisition costs are equal to the value of future estimated gross profits. Accordingly, the impact of adverse changes in our earlier estimates of future gross profits is generally reflected in earnings in the period such differences occur.

Interest expense on investment borrowings includes \$4.8 million and \$5.1 million of interest expense on collateralized borrowings in the first quarters of 2013 and 2012, respectively, as further described in the note to the consolidated financial statements entitled "Investment Borrowings".

Other operating costs and expenses were \$17.5 million in the first quarter of 2013, down 56 percent from 2012. In the first quarter of 2012, we recognized a charge of \$20.5 million related to pending litigation as more fully described in the note to the consolidated financial statements entitled "Litigation and Other Legal Proceedings - Cost of Insurance Litigation".

Net realized investment gains (losses) fluctuate each period. During the first three months of 2013, we recognized \$4.9 million of net gains from the sales of investments (primarily fixed maturities). During the first three months of 2012, net realized investment gains included \$10.1 million of net gains from the sales of investments (primarily fixed maturities) and \$3.4 million of writedowns of investments for other than temporary declines in fair value recognized through net income.

Amortization related to net realized investment gains is the increase or decrease in the amortization of insurance acquisition costs which results from realized investment gains or losses. When we sell securities which back our universal life and investment-type products at a gain (loss) and reinvest the proceeds at a different yield (or when we have the intent to sell the impaired investments before an anticipated recovery in value occurs), we increase (reduce) the amortization of insurance acquisition costs in order to reflect the change in estimated gross profits due to the gains (losses) realized and the resulting effect on estimated future yields. Sales of fixed maturity investments resulted in an increase in the amortization of insurance acquisition costs of \$.1 million and \$.2 million in the first quarters of 2013 and 2012, respectively.

Insurance policy benefits - fair value changes in embedded derivative liabilities represents fair value changes due to fluctuations in the interest rates used to discount embedded derivative liabilities related to our fixed index annuities.

Amortization related to fair value changes in embedded derivative liabilities is the increase or decrease in the amortization of insurance acquisition costs which results from changes in interest rates used to discount embedded derivative liabilities related to our fixed index annuities.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Corporate Operations (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
Corporate operations:		
Interest expense on corporate debt	\$ (15.1)	\$ (17.5)
Net investment income (loss):		
General investment portfolio	1.1	.9
Other special-purpose portfolios:		
COLI	4.6	6.3
Investments held in a rabbi trust	.4	4.1
Investments in certain hedge funds	.2	(.2)
Other trading account activities	3.8	6.0
Fee revenue and other income	1.7	.4
Net operating results of variable interest entities	—	2.2
Interest expense on investment borrowings	(.1)	(.1)
Other operating costs and expenses	(8.7)	(21.4)
Loss before net realized investment gains (losses), equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests, loss on extinguishment of debt and income taxes	(12.1)	(19.3)
Net realized investment gains (losses)	.5	(.1)
Equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests	(1.9)	—
Loss on extinguishment of debt	(57.7)	(.2)
Loss before income taxes	<u>\$ (71.2)</u>	<u>\$ (19.6)</u>

Interest expense on corporate debt has been primarily impacted by the recapitalization transactions completed in September 2012. Our average corporate debt outstanding was \$1,010.1 million and \$873.0 million during the first three months of 2013 and 2012, respectively. The average interest rate on our debt was 5.4 percent and 7.4 percent during the first three months of 2013 and 2012, respectively.

Net investment income on general investment portfolio fluctuates based on the amount and type of invested assets in the corporate operations segment.

Net investment income on other special-purpose portfolios includes the income (loss) from: (i) investments related to deferred compensation plans held in a rabbi trust (which is offset by amounts included in **other operating costs and expenses** as the investment results are allocated to participants' account balances); (ii) trading account activities; (iii) income (loss) from COLI equal to the difference between the return on these investments and our overall portfolio yield; and (iv) investments in certain hedge funds. COLI is utilized as an investment vehicle to fund Bankers Life's agent deferred compensation plan. For segment reporting, the Bankers Life segment is allocated a return on these investments equivalent to the yield on the Company's overall portfolio, with any difference in the actual COLI return allocated to Corporate Operations.

Net operating results of variable interest entities relates solely to the 2012 period and represents the impact of consolidating the VIEs in accordance with GAAP. These entities were established to issue securities and use the proceeds to invest in loans and other permitted assets. Refer to the note to the consolidated financial statements entitled "Investments in Variable Interest Entities" for more information on the VIEs. Beginning January 1, 2013, the earnings from the VIEs are recognized by our segments as follows: (i) investment income earned on investments in the VIEs made by our insurance segments are recognized in the segment's earnings; (ii) investment income earned on investments in the VIEs made by the Corporate segment are recognized in the Corporate segment earnings; (iii) fee revenue earned for providing investment management services to the VIEs is recognized in fee revenue and other income in the Corporate segment; and (iv) earnings from the non-controlling interests in the VIEs are recognized as "equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests."

Interest expense on investment borrowings represents interest expense on repurchase agreements as further discussed in the note to the consolidated financial statements entitled "Investment Borrowings".

Other operating costs and expenses include general corporate expenses, net of amounts charged to subsidiaries for services provided by the corporate operations. These amounts fluctuate as a result of expenses such as consulting and legal costs which often vary from period to period. In the first quarter of 2012, we recognized a \$6.8 million charge related to the relocation of Bankers Life's primary office.

Net realized investment gains (losses) often fluctuate each period. During the first three months of 2013, we recognized \$.5 million of net gains from the sales of investments (of which, \$.1 million were net gains recognized by VIEs). During the first three months of 2012, net realized investment gains included \$.3 million of net gains from the sales of investments (of which, \$.1 million were losses recognized by VIEs) and \$.4 million of writedowns of investments (all of which were recognized by VIEs) due to other than temporary declines in fair value recognized through net income.

Equity in earnings of certain non-strategic investments and earnings attributable to non-controlling interests include the earnings attributable to non-controlling interests in certain VIEs that we are required to consolidate and certain private companies that were acquired in the commutation of an investment made by our Predecessor, net of affiliated amounts. Such earnings are not indicative and are unrelated to the Company's underlying fundamentals.

Loss on extinguishment of debt in the first three months of 2013 of \$57.7 million resulted from the Offer, the write-off of unamortized discount and issuance costs associated with the 7.0% Debentures that were repurchased and other transaction costs as further discussed in the note to the consolidated financial statements entitled "Notes Payable – Direct Corporate Obligations." The loss on extinguishment of debt in the first three months of 2012 of \$.2 million represents the write-off of unamortized discount and issuance costs associated with repayments of the previous senior secured credit agreement.

EBIT from Business Segments Summarized by In-Force and New Business

Management believes that an analysis of EBIT, separated between in-force and new business provides increased clarity around the value drivers of our business, particularly since the new business results are significantly impacted by the rate of sales, mix of business and the distribution channel through which new sales are made. EBIT from new business includes pre-tax revenues and expenses associated with new sales of our insurance products during the first year after the sale is completed. EBIT from in-force business includes all pre-tax revenues and expenses associated with sales of insurance products that were completed more than one year before the end of the reporting period. The allocation of certain revenues and expenses between new and in-force business is based on estimates, which we believe are reasonable.

The following summarizes our earnings, separated between in-force and new business on a consolidated basis and for each of our operating segments for the three months ended March 31, 2013 and 2012 :

Business segments - total (dollars in millions)

	Three months ended March 31,	
	2013	2012
EBIT from In-Force Business		
Revenues:		
Insurance policy income	\$ 592.2	\$ 597.0
Net investment income and other	406.2	377.8
Total revenues	<u>998.4</u>	<u>974.8</u>
Benefits and expenses:		
Insurance policy benefits	686.3	635.3
Amortization	70.8	73.1
Other expenses	103.1	137.5
Total benefits and expenses	<u>860.2</u>	<u>845.9</u>
EBIT from In-Force Business	<u>\$ 138.2</u>	<u>\$ 128.9</u>
EBIT from New Business		
Revenues:		
Insurance policy income	\$ 99.0	\$ 89.3
Net investment income and other	11.2	13.1
Total revenues	<u>110.2</u>	<u>102.4</u>
Benefits and expenses:		
Insurance policy benefits	70.9	65.3
Amortization	6.7	7.7
Other expenses	81.1	75.2
Total benefits and expenses	<u>158.7</u>	<u>148.2</u>
EBIT from New Business	<u>\$ (48.5)</u>	<u>\$ (45.8)</u>
EBIT from In-Force and New Business		
Revenues:		
Insurance policy income	\$ 691.2	\$ 686.3
Net investment income and other	417.4	390.9
Total revenues	<u>1,108.6</u>	<u>1,077.2</u>
Benefits and expenses:		
Insurance policy benefits	757.2	700.6
Amortization	77.5	80.8
Other expenses	184.2	212.7
Total benefits and expenses	<u>1,018.9</u>	<u>994.1</u>
EBIT from In-Force and New Business	<u>\$ 89.7</u>	<u>\$ 83.1</u>

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Bankers Life (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
EBIT from In-Force Business		
Revenues:		
Insurance policy income	\$ 345.8	\$ 341.8
Net investment income and other	254.2	224.7
Total revenues	600.0	566.5
Benefits and expenses:		
Insurance policy benefits	412.8	367.4
Amortization	48.7	50.0
Other expenses	42.4	52.0
Total benefits and expenses	503.9	469.4
EBIT from In-Force Business	\$ 96.1	\$ 97.1
EBIT from New Business		
Revenues:		
Insurance policy income	\$ 72.2	\$ 64.7
Net investment income and other	11.2	13.1
Total revenues	83.4	77.8
Benefits and expenses:		
Insurance policy benefits	57.7	53.5
Amortization	5.8	6.9
Other expenses	53.9	44.0
Total benefits and expenses	117.4	104.4
EBIT from New Business	\$ (34.0)	\$ (26.6)
EBIT from In-Force and New Business		
Revenues:		
Insurance policy income	\$ 418.0	\$ 406.5
Net investment income and other	265.4	237.8
Total revenues	683.4	644.3
Benefits and expenses:		
Insurance policy benefits	470.5	420.9
Amortization	54.5	56.9
Other expenses	96.3	96.0
Total benefits and expenses	621.3	573.8
EBIT from In-Force and New Business	\$ 62.1	\$ 70.5

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Washington National (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
EBIT from In-Force Business		
Revenues:		
Insurance policy income	\$ 133.6	\$ 133.0
Net investment income and other	52.2	50.2
Total revenues	185.8	183.2
Benefits and expenses:		
Insurance policy benefits	111.6	109.8
Amortization	12.9	12.0
Other expenses	31.6	34.0
Total benefits and expenses	156.1	155.8
EBIT from In-Force Business	\$ 29.7	\$ 27.4
EBIT from New Business		
Revenues:		
Insurance policy income	\$ 15.5	\$ 14.4
Net investment income and other	—	—
Total revenues	15.5	14.4
Benefits and expenses:		
Insurance policy benefits	6.7	5.9
Amortization	.8	.7
Other expenses	8.3	10.5
Total benefits and expenses	15.8	17.1
EBIT from New Business	\$ (.3)	\$ (2.7)
EBIT from In-Force and New Business		
Revenues:		
Insurance policy income	\$ 149.1	\$ 147.4
Net investment income and other	52.2	50.2
Total revenues	201.3	197.6
Benefits and expenses:		
Insurance policy benefits	118.3	115.7
Amortization	13.7	12.7
Other expenses	39.9	44.5
Total benefits and expenses	171.9	172.9
EBIT from In-Force and New Business	\$ 29.4	\$ 24.7

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Colonial Penn (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
EBIT from In-Force Business		
Revenues:		
Insurance policy income	\$ 45.6	\$ 43.2
Net investment income and other	10.1	10.2
Total revenues	55.7	53.4
Benefits and expenses:		
Insurance policy benefits	36.5	36.2
Amortization	3.6	3.6
Other expenses	6.8	6.9
Total benefits and expenses	46.9	46.7
EBIT from In-Force Business	\$ 8.8	\$ 6.7
EBIT from New Business		
Revenues:		
Insurance policy income	\$ 11.3	\$ 10.2
Net investment income and other	—	—
Total revenues	11.3	10.2
Benefits and expenses:		
Insurance policy benefits	6.5	5.9
Amortization	.1	.1
Other expenses	18.9	20.7
Total benefits and expenses	25.5	26.7
EBIT from New Business	\$ (14.2)	\$ (16.5)
EBIT from In-Force and New Business		
Revenues:		
Insurance policy income	\$ 56.9	\$ 53.4
Net investment income and other	10.1	10.2
Total revenues	67.0	63.6
Benefits and expenses:		
Insurance policy benefits	43.0	42.1
Amortization	3.7	3.7
Other expenses	25.7	27.6
Total benefits and expenses	72.4	73.4
EBIT from In-Force and New Business	\$ (5.4)	\$ (9.8)

Other CNO Business (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
EBIT from In-Force Business (a)		
Revenues:		
Insurance policy income	\$ 67.2	\$ 79.0
Net investment income and other	89.7	92.7
Total revenues	156.9	171.7
Benefits and expenses:		
Insurance policy benefits	125.4	121.9
Amortization	5.6	7.5
Other expenses	22.3	44.6
Total benefits and expenses	153.3	174.0
EBIT from In-Force Business	\$ 3.6	\$ (2.3)

(a) All activity in the Other CNO Business segment relates to in-force business.

The above analysis of EBIT, separated between in-force and new business, illustrates how our segments are impacted by the rate of sales, mix of business and distribution channel through which new sales are made. In addition, when the impacts from new business are separated, the value drivers of our in-force business are more apparent.

The **EBIT from in-force business in the Bankers Life segment** was slightly lower in the first three months of 2013 primarily due to favorable reserve developments in the Medicare supplement and long-term care blocks in the 2012 period and a \$9.2 million out-of-period adjustment that resulted in decreased earnings in 2013.

The **EBIT from in-force business in the Washington National segment** in the 2013 period reflects lower expenses.

The **EBIT from new business in the Colonial Penn segment** in the 2013 period reflects lower marketing expenses.

We are not investing in new business in the **Other CNO Business segment**.

PREMIUM COLLECTIONS

In accordance with GAAP, insurance policy income in our consolidated statement of operations consists of premiums earned for traditional insurance policies that have life contingencies or morbidity features. For annuity and universal life contracts, premiums collected are not reported as revenues, but as deposits to insurance liabilities. We recognize revenues for these products over time in the form of investment income and surrender or other charges.

Our insurance segments sell products through three primary distribution channels - career agents (our Bankers Life segment), direct marketing (our Colonial Penn segment) and independent producers (our Washington National segment). Our career agency force in the Bankers Life segment sells primarily Medicare supplement and long-term care insurance policies, PDP contracts, life insurance and annuities. These agents visit the customer's home, which permits one-on-one contact with potential policyholders and promotes strong personal relationships with existing policyholders. Our direct marketing distribution channel in the Colonial Penn segment is engaged primarily in the sale of graded benefit life and simplified issue life insurance policies which are sold directly to the policyholder. Our Washington National segment sells primarily supplemental health and life insurance. These products are marketed through PMA, a subsidiary that specializes in marketing and distributing health products, and through independent marketing organizations and insurance agencies, including worksite marketing.

Agents, insurance brokers and marketing companies who market our products and prospective purchasers of our products use the financial strength ratings of our insurance subsidiaries as an important factor in determining whether to market or purchase. Ratings have the most impact on our annuity, interest-sensitive life insurance and long-term care products. The current financial strength ratings of our primary insurance subsidiaries (except Consec Life) from A.M. Best, S&P, Moody's and Fitch Ratings ("Fitch") are "B++", "BB+", "Baa3" and "BBB", respectively. The current financial strength ratings of Consec Life from A.M. Best, S&P, Moody's and Fitch are "B-", "B+", "Ba1" and "BB+", respectively. For a description of these ratings and additional information on our ratings, see "Financial Strength Ratings of our Insurance Subsidiaries."

We set premium rates on our health insurance policies based on facts and circumstances known at the time we issue the policies using assumptions about numerous variables, including the actuarial probability of a policyholder incurring a claim, the probable size of the claim, and the interest rate earned on our investment of premiums. We also consider historical claims information, industry statistics, the rates of our competitors and other factors. If our actual claims experience is less favorable than we anticipated and we are unable to raise our premium rates, our financial results may be adversely affected. We generally cannot raise our health insurance premiums in any state until we obtain the approval of the state insurance regulator. We review the adequacy of our premium rates regularly and file for rate increases on our products when we believe such rates are too low. It is likely that we will not be able to obtain approval for all requested premium rate increases. If such requests are denied in one or more states, our net income may decrease. If such requests are approved, increased premium rates may reduce the volume of our new sales and may cause existing policyholders to lapse their policies. If the healthier policyholders allow their policies to lapse, this would reduce our premium income and profitability in the future.

Total premium collections by segment were as follows:

Bankers Life (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
Premiums collected by product:		
Annuities:		
Fixed index (first-year)	\$ 126.6	\$ 134.9
Other fixed rate (first-year)	37.2	47.8
Other fixed rate (renewal)	1.8	2.0
Subtotal - other fixed rate annuities	39.0	49.8
Total annuities	165.6	184.7
Health:		
Medicare supplement (first-year)	22.7	23.8
Medicare supplement (renewal)	162.5	151.1
Subtotal - Medicare supplement	185.2	174.9
Long-term care (first-year)	5.7	5.5
Long-term care (renewal)	129.7	131.2
Subtotal - long-term care	135.4	136.7
PDP (first year)	.1	.3
PDP (renewal)	10.1	15.0
Subtotal - PDP	10.2	15.3
Other health (first-year)	1.9	.4
Other health (renewal)	2.4	2.2
Subtotal - other health	4.3	2.6
Total health	335.1	329.5
Life insurance:		
First-year	42.4	32.8
Renewal	47.1	37.3
Total life insurance	89.5	70.1
Collections on insurance products:		
Total first-year premium collections on insurance products	236.6	245.5
Total renewal premium collections on insurance products	353.6	338.8
Total collections on insurance products	\$ 590.2	\$ 584.3

Annuities in this segment include fixed index and other fixed annuities sold to the senior market. Annuity collections in this segment decreased 10 percent, to \$165.6 million, in the first quarter of 2013, as compared to the same period in 2012. Premium collections from Bankers Life's fixed annuity products have decreased in recent periods as low new money interest rates negatively impacted our sales and the overall sales in the fixed annuity market.

Health products include Medicare supplement, PDP contracts, long-term care and other insurance products. Our profits on health policies depend on the overall level of sales, the length of time the business remains inforce, investment yields, claims experience and expense management.

Collected premiums on Medicare supplement policies in the Bankers Life segment increased 5.9 percent, to \$185.2 million, in the first quarter of 2013, as compared to the same period in the prior year.

Premiums collected on Bankers Life's long-term care policies in the first quarter of 2013 were comparable to the same period in 2012.

Premiums collected on other health products in the first three months of 2013 include \$1.6 million related to a new critical illness product that was introduced in 2012. There were no such premiums collected in the first three months of 2012.

Premiums collected on PDP business relate to our quota-share reinsurance agreements with Coventry.

Life products in this segment include traditional and interest-sensitive life products. Life premiums collected in this segment increased 28 percent, to \$89.5 million, in the first quarter of 2013, as compared to the same period in 2012, reflecting higher sales in this segment (including increased sales of single premium whole life products).

Washington National (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
Premiums collected by product:		
Health:		
Medicare supplement (first-year)	\$.2	\$.3
Medicare supplement (renewal)	26.4	27.8
Subtotal - Medicare supplement	26.6	28.1
Supplemental health (first-year)	15.6	14.1
Supplemental health (renewal)	104.7	98.8
Subtotal – supplemental health	120.3	112.9
Other health (all renewal)	.6	.7
Total health	147.5	141.7
Life insurance:		
First-year	.2	.2
Renewal	3.4	3.8
Total life insurance	3.6	4.0
Collections on insurance products:		
Total first-year premium collections on insurance products	16.0	14.6
Total renewal premium collections on insurance products	135.1	131.1
Total collections on insurance products	\$ 151.1	\$ 145.7

Health products in the Washington National segment include Medicare supplement, supplemental health and other insurance products. Our profits on health policies depend on the overall level of sales, the length of time the business remains inforce, investment yields, claim experience and expense management.

Collected premiums on Medicare supplement policies in the Washington National segment decreased 5.3 percent, to \$26.6 million, in the first quarter of 2013, as compared to the same period in 2012. We discontinued new sales of Medicare supplement policies in this segment in the fourth quarter of 2012.

Premiums collected on supplemental health products (including specified disease, accident and hospital indemnity insurance products) increased 6.6 percent, to \$120.3 million, in the first quarter of 2013, as compared to the same period in 2012. Such increases are due to higher new sales in recent periods and an improvement in persistency.

Life products in the Washington National segment are primarily traditional life products. Life premiums collected in this segment have declined in recent periods.

Colonial Penn (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
Premiums collected by product:		
Life insurance:		
First-year	\$ 11.4	\$ 10.4
Renewal	44.7	42.2
Total life insurance	56.1	52.6
Health (all renewal):		
Medicare supplement	1.0	1.2
Other health	.1	.1
Total health	1.1	1.3
Collections on insurance products:		
Total first-year premium collections on insurance products	11.4	10.4
Total renewal premium collections on insurance products	45.8	43.5
Total collections on insurance products	\$ 57.2	\$ 53.9

Life products in this segment are sold primarily to the senior market. Life premiums collected in this segment increased 6.7 percent, to \$56.1 million, in the first quarter of 2013, as compared to the same period in 2012. Graded benefit life products sold through our direct response marketing channel accounted for \$55.5 million and \$51.8 million of our total collected premiums in the first quarters of 2013 and 2012, respectively.

Health products include Medicare supplement and other insurance products. Our profits on health policies depend on the overall level of sales, the length of time the business remains inforce, investment yields, claims experience and expense management. Premiums collected on these products have decreased as we do not currently market these products through this segment.

Other CNO Business (dollars in millions)

	Three months ended	
	March 31,	
	2013	2012
Premiums collected by product:		
Annuities:		
Fixed index (first-year)	\$.2	\$ —
Fixed index (renewal)	.6	.7
Subtotal - fixed index annuities	.8	.7
Other fixed rate (all renewal)	.2	.2
Total annuities	1.0	.9
Health:		
Long-term care (all renewal)	6.3	6.7
Other health (all renewal)	.2	.2
Total health	6.5	6.9
Life insurance:		
First-year	1.0	.6
Renewal	40.1	44.7
Total life insurance	41.1	45.3
Collections on insurance products:		
Total first-year premium collections on insurance products	1.2	.6
Total renewal premium collections on insurance products	47.4	52.5
Total collections on insurance products	\$ 48.6	\$ 53.1

Annuities in this segment include fixed index and other fixed annuities. We are no longer actively pursuing sales of annuity products in this segment.

Health products in the Other CNO Business segment include long-term care and other health insurance products. Our profits on health policies depend on the length of time the business remains inforce, investment yields, claim experience and expense management.

The long-term care premiums in this segment relate to blocks of business that we no longer market or underwrite. As a result, we expect this segment's long-term care premiums to continue to decline, reflecting additional policy lapses in the future.

Life products in the Other CNO Business segment include primarily universal life products. Life premiums collected in this segment decreased 9.3 percent, to \$41.1 million, in the first quarter of 2013, as compared to the same period in 2012. The decrease in collected premiums was primarily due to a reduction in policyholder charges on certain interest-sensitive life products consistent with the settlement offered in a class action lawsuit and policyholder redemptions and lapses. New sales of life products in this segment are insignificant and we expect premiums to continue to decline.

LIQUIDITY AND CAPITAL RESOURCES

Our capital structure as of March 31, 2013 , and December 31, 2012 , was as follows (dollars in millions):

	March 31, 2013	December 31, 2012
Total capital:		
Corporate notes payable	\$ 934.2	\$ 1,004.2
Shareholders' equity:		
Common stock	2.2	2.2
Additional paid-in capital	4,173.2	4,174.7
Accumulated other comprehensive income	1,170.7	1,197.4
Accumulated deficit	(317.5)	(325.0)
Total shareholders' equity	5,028.6	5,049.3
Total capital	\$ 5,962.8	\$ 6,053.5

The following table summarizes certain financial ratios as of and for the three months ended March 31, 2013 , and as of and for the year ended December 31, 2012 :

	March 31, 2013	December 31, 2012
Book value per common share	\$ 22.50	\$ 22.80
Book value per common share, excluding accumulated other comprehensive income (a)	17.26	17.39
Ratio of earnings to fixed charges	1.37X	1.40X
Debt to total capital ratios:		
Corporate debt to total capital	15.7%	16.6%
Corporate debt to total capital, excluding accumulated other comprehensive income (a)	19.5%	20.7%

- (a) This non-GAAP measure differs from the corresponding GAAP measure presented immediately above, because accumulated other comprehensive income has been excluded from the value of capital used to determine this measure. Management believes this non-GAAP measure is useful because it removes the volatility that arises from changes in accumulated other comprehensive income. Such volatility is often caused by changes in the estimated fair value of our investment portfolio resulting from changes in general market interest rates rather than the business decisions made by management. However, this measure does not replace the corresponding GAAP measure.

Liquidity for Insurance Operations

Our insurance companies generally receive adequate cash flows from premium collections and investment income to meet their obligations. Life insurance, long-term care insurance and annuity liabilities are generally long-term in nature. Life and annuity policyholders may, however, withdraw funds or surrender their policies, subject to any applicable penalty provisions; there are generally no withdrawal or surrender benefits for long-term care insurance. We seek to balance the duration of our invested assets with the estimated duration of benefit payments arising from contract liabilities.

Three of the Company's insurance subsidiaries (Conseco Life, Washington National Insurance Company and Bankers Life) are members of the FHLB. As members of the FHLB, Conseco Life, Washington National Insurance Company and Bankers Life have the ability to borrow on a collateralized basis from the FHLB. Conseco Life, Washington National Insurance Company and Bankers Life are required to hold certain minimum amounts of FHLB common stock as a condition of membership in the FHLB, and additional amounts based on the amount of the borrowings. At March 31, 2013 , the carrying value of the FHLB common stock was \$92.5 million . As of March 31, 2013 , collateralized borrowings from the FHLB totaled \$1.9 billion and the proceeds were used to purchase fixed maturity securities. The borrowings are classified as investment

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

borrowings in the accompanying consolidated balance sheet. The borrowings are collateralized by investments with an estimated fair value of \$2.3 billion at March 31, 2013, which are maintained in a custodial account for the benefit of the FHLB. The following summarizes the terms of the borrowings (dollars in millions):

Amount borrowed	Maturity date	Interest rate at March 31, 2013
\$ 67.0	February 2014	Fixed rate – 1.830%
50.0	August 2014	Variable rate – 0.420%
100.0	August 2014	Variable rate – 0.464%
50.0	September 2015	Variable rate – 0.601%
150.0	October 2015	Variable rate – 0.553%
100.0	November 2015	Variable rate – 0.370%
146.0	November 2015	Fixed rate – 5.300%
100.0	December 2015	Fixed rate – 4.710%
100.0	June 2016	Variable rate – 0.644%
75.0	June 2016	Variable rate – 0.471%
100.0	October 2016	Variable rate – 0.486%
50.0	November 2016	Variable rate – 0.554%
50.0	November 2016	Variable rate – 0.674%
100.0	June 2017	Variable rate – 0.724%
100.0	July 2017	Fixed rate – 3.900%
50.0	August 2017	Variable rate – 0.490%
75.0	August 2017	Variable rate – 0.438%
100.0	October 2017	Variable rate – 0.734%
37.0	November 2017	Fixed rate – 3.750%
50.0	January 2018	Variable rate – 0.655%
50.0	January 2018	Variable rate – 0.642%
50.0	February 2018	Variable rate – 0.602%
22.0	February 2018	Variable rate – 0.617%
50.0	July 2018	Variable rate – 0.771%
28.0	March 2023	Fixed rate – 2.160%
<u>\$ 1,850.0</u>		

State laws generally give state insurance regulatory agencies broad authority to protect policyholders in their jurisdictions. Regulators have used this authority in the past to restrict the ability of our insurance subsidiaries to pay any dividends or other amounts without prior approval. We cannot be assured that the regulators will not seek to assert greater supervision and control over our insurance subsidiaries' businesses and financial affairs.

The 2012 statutory annual statements filed with the state insurance regulators of each of our insurance subsidiaries reflected total adjusted capital in excess of the levels subjecting the subsidiaries to any regulatory action. However, the RBC ratio of Consec Life, which has experienced significant losses primarily related to pending legal settlements, was near the level at which it would have been required to submit a comprehensive plan to insurance regulators proposing corrective actions aimed at improving its capital position. Consec Life's domestic state is expected to adopt new RBC requirements which would increase the RBC level required to avoid regulatory action, effective December 31, 2013. If those increased requirements had been in effect at December 31, 2012, the RBC ratio of Consec Life at that date would have been at a level that would require Consec Life to submit a comprehensive plan to the state regulatory authority proposing corrective actions aimed at improving its capital position. No assurances can be given that capital will be contributed or otherwise made available to Consec Life or the other insurance subsidiaries.

Our consolidated statutory risk-based capital ratio of 366% at March 31, 2013, reflects consolidated statutory operating earnings of \$112.5 million and the payment of dividends to the holding company of \$81 million during the first quarter of 2013. Statutory earnings will often fluctuate on a quarterly basis due to the application of statutory accounting principles. For example, statutory pre-tax income for the first quarter of 2013 benefited by approximately \$10 million due to the statutory accounting requirements related to fixed index annuity products and we do not expect such benefits to continue in future quarters.

In addition to the RBC requirements, certain states have established minimum capital requirements for insurance companies licensed to do business in their state. These regulators have the discretionary authority, in connection with the continual licensing of the Company's insurance subsidiaries, to limit or prohibit writing new business within its jurisdiction when, in the state's judgment, the insurance subsidiary is not maintaining adequate statutory surplus or capital or that the insurance subsidiary's further transaction of business would be hazardous to policyholders. The state insurance department rules provide several standards for the regulators to use in identifying companies which may be deemed to be in hazardous financial condition. One of the standards defines hazardous conditions as existing if an insurer's operating loss in the last twelve months or any shorter period of time, (including, but not limited to: (A) net capital gain or loss; (B) change in nonadmitted assets; and (C) cash dividends paid to shareholders), is greater than fifty percent of the insurer's remaining surplus. One of the Company's subsidiaries, Consec Life, reported statutory financial results in 2012 that indicated a surplus deficiency under this standard. We have been in contact with Consec Life's domestic state insurance department regarding this matter following the significant loss Consec Life recognized in 2012, primarily related to a pending legal settlement. Based on our discussions with the state insurance regulator, we do not expect any actions to be taken against Consec Life that would have a material adverse effect on the financial position or results of operations of CNO. Subject to the completion and filing of the March 31, 2013 statutory filing, we believe the calculation based on Consec Life's operating loss for the twelve months ended March 31, 2013, will not indicate a surplus deficiency under this standard.

Financial Strength Ratings of our Insurance Subsidiaries

Financial strength ratings provided by A.M. Best, S&P, Moody's and Fitch are the rating agency's opinions of the ability of our insurance subsidiaries to pay policyholder claims and obligations when due.

On September 4, 2012, A.M. Best upgraded the financial strength ratings of our primary insurance subsidiaries, except Consec Life, to "B++" from "B+". A.M. Best also affirmed the financial strength rating of "B-" of Consec Life. The outlook for all ratings is stable. A "stable" designation means that there is a low likelihood of a rating change due to stable financial market trends. The "B++" rating is assigned to companies that have a good ability, in A.M. Best's opinion, to meet their ongoing obligations to policyholders. A "B-" rating is assigned to companies that have a fair ability, in A.M. Best's opinion, to meet their current obligations to policyholders, but are financially vulnerable to adverse changes in underwriting and economic conditions. A.M. Best ratings for the industry currently range from "A++ (Superior)" to "F (In Liquidation)" and some companies are not rated. An "A++" rating indicates a superior ability to meet ongoing obligations to policyholders. A.M. Best has sixteen possible ratings. There are four ratings above the "B++" rating of our primary insurance subsidiaries, other than Consec Life, and eleven ratings that are below that rating. There are seven ratings above the "B-" rating of Consec Life and eight ratings that are below that rating.

On August 3, 2012, S&P affirmed the financial strength ratings of "BB+" of our primary insurance subsidiaries, except Consec Life, and revised the outlook for such ratings to positive from stable. S&P also downgraded the financial strength rating of Consec Life to "B+" from "BB+" and the outlook for such rating is stable. On August 4, 2011, S&P upgraded the financial strength ratings of our primary insurance subsidiaries to "BB+" from "BB". A "positive" outlook means that a rating may be raised. A "stable" outlook means that a rating is not likely to change. S&P financial strength ratings range from "AAA" to "R" and some companies are not rated. An insurer rated "BB" or lower is regarded as having vulnerable characteristics that may outweigh its strengths. A "BB" rating indicates the least degree of vulnerability within the range; a "CC" rating indicates the highest degree of vulnerability. Pluses and minuses show the relative standing within a category. In S&P's view, an insurer rated "BB" has marginal financial security characteristics and although positive attributes exist, adverse business conditions could lead to an insufficient ability to meet financial commitments. In S&P's view, an insurer rated "B" has weak financial security characteristics and adverse business conditions will likely impair its ability to meet financial commitments. S&P has twenty-one possible ratings. There are ten ratings above the "BB+" rating of our primary insurance subsidiaries, other than Consec Life, and ten ratings that are below that rating. There are thirteen ratings above the "B+" rating of Consec Life and seven ratings that are below that rating.

On August 29, 2012, Moody's upgraded the financial strength ratings of our primary insurance subsidiaries, except Consec Life, to "Baa3" from "Ba1". Moody's also affirmed the financial strength rating of "Ba1" of Consec Life. The

outlook for all ratings is stable. A "stable" designation means that a rating is not likely to change. Moody's financial strength ratings range from "Aaa" to "C". These ratings may be supplemented with numbers "1", "2", or "3" to show relative standing within a category. In Moody's view, an insurer rated "Baa" offers adequate financial security, however, certain protective elements may be lacking or may be characteristically unreliable over any great length of time. In Moody's view, an insurer rated "Ba" offers questionable financial security and, often, the ability of these companies to meet policyholders' obligations may be very moderate and thereby not well safeguarded in the future. Moody's has twenty-one possible ratings. There are nine ratings above the "Baa3" rating of our primary insurance subsidiaries, other than Consec Life, and eleven ratings that are below the rating. There are ten ratings above the "Ba1" rating of Consec Life and ten ratings that are below that rating.

On September 5, 2012, Fitch affirmed the financial strength ratings of "BBB" of our primary insurance subsidiaries as well as the "BB+" rating of Consec Life and the outlook for all of these ratings is stable. On February 3, 2012, Fitch upgraded the financial strength ratings of our primary insurance subsidiaries, except Consec Life, to "BBB" (from "BBB-" or "BB+" depending on the company). Fitch also affirmed the financial strength rating of "BB+" of Consec Life. A "BBB" rating, in Fitch's opinion, indicates that there is currently a low expectation of ceased or interrupted payments. The capacity to meet policyholder and contract obligations on a timely basis is considered adequate, but adverse changes in circumstances and economic conditions are more likely to impact this capacity. A "BB" rating, in Fitch's opinion, indicates that there is an elevated vulnerability to ceased or interrupted payments, particularly as the result of adverse economic or market changes over time. However, business or financial alternatives may be available to allow for policyholder and contract obligations to be met in a timely manner. Fitch ratings for the industry range from "AAA Exceptionally Strong" to "C Distressed" and some companies are not rated. Pluses and minuses show the relative standing within a category. Fitch has nineteen possible ratings. There are eight ratings above the "BBB" rating of our primary insurance subsidiaries, other than Consec Life, and ten ratings that are below that rating. There are ten ratings above the "BB+" rating of Consec Life and eight ratings that are below that rating.

Rating agencies have increased the frequency and scope of their credit reviews and requested additional information from the companies that they rate, including us. They may also adjust upward the capital and other requirements employed in the rating agency models for maintenance of certain ratings levels. We cannot predict what actions rating agencies may take, or what actions we may take in response. Accordingly, downgrades and outlook revisions related to us or the life insurance industry may occur in the future at any time and without notice by any rating agency. These could increase policy surrenders and withdrawals, adversely affect relationships with our distribution channels, reduce new sales, reduce our ability to borrow and increase our future borrowing costs.

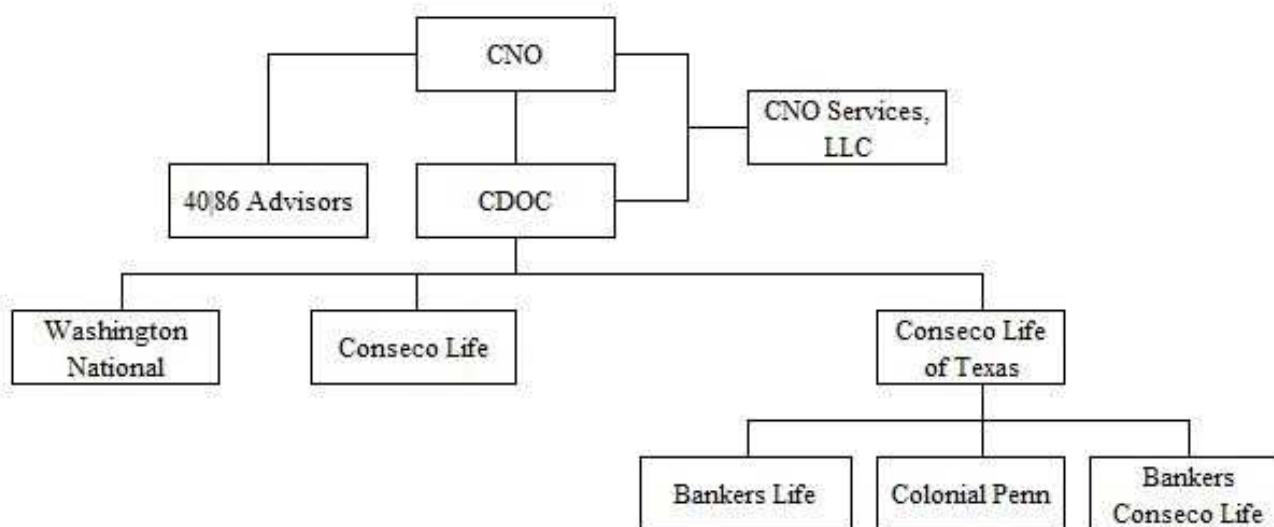
Liquidity of the Holding Companies

Availability and Sources and Uses of Holding Company Liquidity; Limitations on Ability of Insurance Subsidiaries to Make Dividend and Surplus Debenture Interest Payments to the Holding Companies

At March 31, 2013, CNO, CDOC, Inc. ("CDOC") (our wholly owned subsidiary and a guarantor under the Senior Secured Credit Agreement) and our other non-insurance subsidiaries held: (i) unrestricted cash and cash equivalents of \$102.2 million; (ii) fixed income investments of \$64.0 million; and (iii) equity securities and other invested assets totaling \$77.9 million. CNO and CDOC are holding companies with no business operations of their own; they depend on their operating subsidiaries for cash to make principal and interest payments on debt, and to pay administrative expenses and income taxes. CNO and CDOC receive cash from insurance subsidiaries, consisting of dividends and distributions, interest payments on surplus debentures and tax-sharing payments, as well as cash from non-insurance subsidiaries consisting of dividends, distributions, loans and advances. The principal non-insurance subsidiaries that provide cash to CNO and CDOC are 40|86 Advisors, Inc. ("40|86 Advisors"), which receives fees from the insurance subsidiaries for investment services, and CNO Services, LLC which receives fees from the insurance subsidiaries for providing administrative services. The agreements between our insurance subsidiaries and CNO Services, LLC and 40|86 Advisors, respectively, were previously approved by the domestic insurance regulator for each insurance company, and any payments thereunder do not require further regulatory approval.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

The following summarizes the current legal ownership structure of CNO's primary subsidiaries:



The ability of our insurance subsidiaries to pay dividends is subject to state insurance department regulations and is based on the financial statements of our insurance subsidiaries prepared in accordance with statutory accounting practices prescribed or permitted by regulatory authorities, which differ from GAAP. These regulations generally permit dividends to be paid from statutory earned surplus of the insurance company for any 12-month period in amounts equal to the greater of (or in a few states, the lesser of): (i) statutory net gain from operations or net income for the prior year; or (ii) 10 percent of statutory capital and surplus as of the end of the preceding year. This type of dividend is referred to as an "ordinary dividend". Any dividend in excess of these levels or from an insurance company that has negative earned surplus requires the approval of the director or commissioner of the applicable state insurance department and is referred to as an "extraordinary dividend". Each of the direct insurance subsidiaries of CDOC has significant negative earned surplus and any dividend payments from the subsidiaries of CDOC would be considered extraordinary dividends and, therefore, require the approval of the director or commissioner of the applicable state insurance department. In the first three months of 2013, our insurance subsidiaries paid extraordinary dividends to CDOC totaling \$81.0 million. Based on our continued expectation to generate strong statutory earnings and excess capital, we expect to make total dividend payments to the holding company of \$250 million to \$300 million during 2013. We expect to receive regulatory approval for future dividends from our subsidiaries, but there can be no assurance that such payments will be approved or that the financial condition of our insurance subsidiaries will not change, making future approvals less likely.

We generally maintain capital and surplus levels in our insurance subsidiaries in an amount that is sufficient to maintain a minimum consolidated RBC ratio of 350 percent and will typically seek to have our insurance subsidiaries pay ordinary dividends or request regulatory approval for extraordinary dividends when the consolidated RBC ratio exceeds such level and we have concluded the capital level in each of our insurance subsidiaries is adequate to support their business and projected growth. The consolidated RBC ratio of our insurance subsidiaries was 366 percent at March 31, 2013.

CDOC holds surplus debentures from Conseco Life Insurance Company of Texas ("Conseco Life of Texas") with an aggregate principal amount of \$749.6 million. Interest payments on those surplus debentures do not require additional approval provided the RBC ratio of Conseco Life of Texas exceeds 100 percent (but do require prior written notice to the Texas state insurance department). The RBC ratio of Conseco Life of Texas was 309 percent at March 31, 2013. CDOC also holds a surplus debenture from Colonial Penn Life Insurance Company with an outstanding principal balance of \$160.0 million. Interest payments on that surplus debenture require prior approval by the Pennsylvania state insurance department. Dividends and other payments from our non-insurance subsidiaries, including 4086 Advisors and CNO Services, LLC, to CNO or CDOC do not require approval by any regulatory authority or other third party. However, insurance regulators may prohibit payments by our insurance subsidiaries to parent companies if they determine that such payments could be adverse to our policyholders or contractholders.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

The insurance subsidiaries of CDOC receive funds to pay dividends primarily from: (i) the earnings of their direct businesses; (ii) tax sharing payments received from subsidiaries (if applicable); and (iii) with respect to Conseco Life of Texas, dividends received from subsidiaries. At March 31, 2013, the subsidiaries of Conseco Life of Texas had earned surplus (deficit) as summarized below (dollars in millions):

Subsidiary of CDOC	Earned surplus (deficit)	Additional information
Subsidiaries of Conseco Life of Texas:		
Bankers Life	\$ 315.9	(a)
Colonial Penn Life Insurance Company	(244.9)	(b)

- (a) Bankers Life paid ordinary dividends of \$30.0 million to Conseco Life of Texas in the first three months of 2013.
- (b) The deficit is primarily due to transactions which occurred several years ago, including a tax planning transaction and the fee paid to recapture a block of business previously ceded to an unaffiliated insurer.

A significant deterioration in the financial condition, earnings or cash flow of the material subsidiaries of CNO or CDOC for any reason could hinder such subsidiaries' ability to pay cash dividends or other disbursements to CNO and/or CDOC, which, in turn, could limit CNO's ability to meet debt service requirements and satisfy other financial obligations. In addition, we may choose to retain capital in our insurance subsidiaries or to contribute additional capital to our insurance subsidiaries to strengthen their surplus, and these decisions could limit the amount available at our top tier insurance subsidiaries to pay dividends to the holding companies. In the past, we have made capital contributions to our insurance subsidiaries to meet debt covenants and minimum capital levels required by certain regulators and it is possible we will be required to do so in the future. We made no capital contributions to our insurance subsidiaries in the first three months of 2013.

On March 28, 2013, the Company completed the Offer for \$59.3 million aggregate principal amount of its 7.0% Debentures for an aggregate purchase price of \$124.8 million. The Offer was conducted as part of our previously announced securities repurchase program.

Pursuant to the terms of the Offer, holders of the 7.0% Debentures who tendered their 7.0% Debentures prior to the expiration date, received, for each \$1,000 principal amount of such 7.0% Debentures, a Purchase Price equal to the sum of: (i) the average volume weighted average price of our common stock (as defined in the Offer) (\$11.2393 at the close of trading on March 27, 2013) multiplied by 183.5145; plus (ii) a fixed cash amount of \$61.25. The final purchase price per \$1,000 principal amount of 7.0% Debentures is \$2,123.82. In addition to the Purchase Price, holders received accrued and unpaid interest on any 7.0% Debentures that were tendered to, but excluding, the settlement date of the Offer.

The remaining 7.0% Debentures outstanding will mature on December 30, 2016, unless earlier converted. The 7.0% Debentures are not convertible prior to June 30, 2013, except under limited circumstances. Commencing on June 30, 2013, the 7.0% Debentures will be convertible into shares of our common stock at the option of the holder at any time, subject to certain exceptions and subject to our right to terminate such conversion rights under certain circumstances relating to the sale price of our common stock. If the holders elect to convert their 7.0% Debentures upon the occurrence of certain changes of control of CNO or certain other events, we will be required, under certain circumstances, to increase the conversion rate for such holders of the 7.0% Debentures who convert in connection with such events. Initially, the 7.0% Debentures will be convertible into 182.1494 shares of our common stock for each \$1,000 principal amount of 7.0% Debentures, which is equivalent to an initial conversion price of approximately \$5.49 per share. The conversion rate is subject to adjustment following the occurrence of certain events (including the payment of dividends on our common stock) in accordance with the terms of the 7.0% Indenture. At March 31, 2013, the conversion rate was 183.8523 shares of our common stock for each \$1,000 principal amount of 7.0% Debentures outstanding.

Commencing on June 30, 2013, we have the right to terminate the conversion rights of the holders of the 7.0% Debentures by written notice if the closing price of our common stock remains above \$7.61 (based on the conversion rate at March 31, 2013) for at least 20 trading days in the 30 trading day period ending on the trading day immediately preceding the date of such notice. If we exercise this right, the holders of the 7.0% Debentures would receive an aggregate of approximately 6.2 million shares of our common stock upon conversion of the 7.0% Debentures. We currently expect to exercise such right in the third quarter of 2013 to the extent the remaining 7.0% Debentures have not otherwise been repurchased or converted by the holder.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

The Company did not repurchase any shares of its common stock during the quarter ended March 31, 2013, under its securities repurchase program. However, the purchase of \$59.3 million aggregate principal amount of our 7.0% Debentures in the cash tender offer as further discussed above was made pursuant to our securities repurchase program. The Company had remaining repurchase authority of \$225.2 million as of March 31, 2013. We currently anticipate repurchasing an additional \$125 million to \$175 million of our securities in 2013.

In the first quarter of 2013, dividends declared and paid on common stock were \$0.02 per common share totaling \$4.4 million.

In the first three months of 2013, we made a mandatory prepayment of \$1.5 million in an amount equal to 33% of our common stock dividend payments, as required under the terms of our Senior Secured Credit Agreement. We also made an additional payment of \$12.0 million to cover the remaining portion of the scheduled quarterly principal payment due under the Senior Secured Credit Agreement.

The scheduled principal payments on our direct corporate obligations are as follows at March 31, 2013 (dollars in millions):

<u>Year ending March 31,</u>	<u>Principal</u>
2014	\$ 51.2
2015	66.7
2016	79.3
2017	75.5
2018	4.2
Thereafter	663.0
	<u>\$ 939.9</u>

Mandatory prepayments of the Senior Secured Credit Agreement will be required, subject to certain exceptions, in an amount equal to: (i) 100% of the net cash proceeds from certain asset sales or casualty events; (ii) 100% of the net cash proceeds received by the Company or any of its restricted subsidiaries from certain debt issuances; and (iii) 100% of the amount of certain restricted payments made (including any common stock dividends and share repurchases) as defined in the Senior Secured Credit Agreement provided that if, as of the end of the fiscal quarter immediately preceding such restricted payment, the debt to total capitalization ratio is: (x) equal to or less than 22.5%, but greater than 17.5%, the prepayment requirement shall be reduced to 33.33%; or (y) equal to or less than 17.5%, the prepayment requirement shall not apply.

Notwithstanding the foregoing, no mandatory prepayments pursuant to item (i) in the preceding paragraph shall be required if: (x) the debt to total capitalization ratio is equal or less than 20% and (y) either (A) the financial strength rating of certain of the Company's insurance subsidiaries is equal or better than A- (stable) from A.M. Best or (B) the Senior Secured Credit Agreement is rated equal or better than BBB- (stable) from S&P and Baa3 (stable) by Moody's.

The Senior Secured Credit Agreement requires the Company to maintain (each as calculated in accordance with the Senior Secured Credit Agreement): (i) a debt to total capitalization ratio of not more than 27.5 percent (such ratio was 20.3 percent at March 31, 2013); (ii) an interest coverage ratio of not less than 2.50 to 1.00 for each rolling four quarters (or, if less, the number of full fiscal quarters commencing after the effective date of the Senior Secured Credit Agreement) (such ratio was 7.51 to 1.00 for the period ended March 31, 2013); (iii) an aggregate ratio of total adjusted capital to company action level risk-based capital for the Company's insurance subsidiaries of not less than 250 percent (such ratio was 366 percent at March 31, 2013); and (iv) a combined statutory capital and surplus for the Company's insurance subsidiaries of at least \$1,300.0 million (combined statutory capital and surplus at March 31, 2013, was \$1,814.1 million).

Under the 6.375% Indenture, the Company can make Restricted Payments (as such term is defined in the 6.375% Indenture) up to a calculated limit, provided that the Company's pro forma risk-based capital ratio exceeds 225% after giving effect to the Restricted Payment and certain other conditions are met. Restricted Payments include, among other items, repurchases of common stock and cash dividends on common stock (to the extent such dividends exceed \$30 million in the aggregate in any calendar year). Restricted payments do not include cash paid to purchase our outstanding 7.0% Debentures pursuant to the previously announced tender offer discussed below.

The limit of Restricted Payments permitted under the 6.375% Indenture is the sum of (x) 50% of the Company's "Net Excess Cash Flow" (as defined in the 6.375% Indenture) for the period (taken as one accounting period) from July 1, 2012 to the end of the Company's most recently ended fiscal quarter for which financial statements are available at the time of such Restricted Payment, (y) \$175.0 million and (z) certain other amounts specified in the 6.375% Indenture. Based on the provisions set forth in the 6.375% Indenture and the Company's Net Excess Cash Flow for the period from July 1, 2012 through March 31, 2013, the Company could have made additional Restricted Payments under this 6.375% Indenture covenant of approximately \$246 million as of March 31, 2013. This limitation on Restricted Payments does not apply if the Debt to Total Capitalization Ratio (as defined in the 6.375% Indenture) as of the last day of the Company's most recently ended fiscal quarter for which financial statements are available that immediately precedes the date of any Restricted Payment, calculated immediately after giving effect to such Restricted Payment and any related transactions on a pro forma basis, is equal to or less than 17.5%.

As part of our investment strategy for the holding company, we may enter into repurchase agreements to increase our investment return. We account for these transactions as collateralized borrowings, where the amount borrowed is equal to the sales price of the underlying securities. Repurchase agreements involve a sale of securities and an agreement to repurchase the same securities at a later date at an agreed-upon price. Such borrowings totaled \$29.5 million at March 31, 2013. The borrowings mature as follows: \$22.3 million - within 30 days; and \$7.2 million - between 30 and 90 days. These borrowings were collateralized by investment securities (primarily collateralized mortgage obligations) with fair values approximately equal to the loan value. The primary risks associated with short-term collateralized borrowings are: (i) a substantial decline in the market value of the margined security; and (ii) that a counterparty will be unable to perform under the terms of the contract or be unwilling to extend such related financing in future periods especially if the liquidity or value of the margined security has declined. Exposure is limited to any depreciation in value of the related securities.

We believe that the existing cash available to the holding company, the cash flows to be generated from operations and other transactions will be sufficient to allow us to meet our debt service obligations, pay corporate expenses and satisfy other financial obligations. However, our cash flow is affected by a variety of factors, many of which are outside of our control, including insurance regulatory issues, competition, financial markets and other general business conditions. We cannot provide assurance that we will possess sufficient income and liquidity to meet all of our debt service requirements and other holding company obligations.

INVESTMENTS

At March 31, 2013, the amortized cost, gross unrealized gains and losses and estimated fair value of fixed maturities, available for sale, and equity securities were as follows (dollars in millions):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Investment grade (a):				
Corporate securities	\$ 13,750.3	\$ 2,015.5	\$ (27.1)	\$ 15,738.7
United States Treasury securities and obligations of United States government corporations and agencies	93.6	5.2	—	98.8
States and political subdivisions	1,867.7	278.4	(4.0)	2,142.1
Asset-backed securities	961.9	67.9	(2.4)	1,027.4
Collateralized debt obligations	322.7	10.0	—	332.7
Commercial mortgage-backed securities	1,293.4	146.8	(.5)	1,439.7
Mortgage pass-through securities	16.6	1.0	—	17.6
Collateralized mortgage obligations	1,184.1	100.4	(.4)	1,284.1
Total investment grade fixed maturities, available for sale	19,490.3	2,625.2	(34.4)	22,081.1
Below-investment grade (a):				
Corporate securities	1,201.3	70.6	(6.5)	1,265.4
States and political subdivisions	15.3	—	(.8)	14.5
Asset-backed securities	498.3	40.3	(1.0)	537.6
Collateralized debt obligations	16.1	.1	(.1)	16.1
Collateralized mortgage obligations	893.7	86.2	(.1)	979.8
Total below-investment grade fixed maturities, available for sale	2,624.7	197.2	(8.5)	2,813.4
Total fixed maturities, available for sale	\$ 22,115.0	\$ 2,822.4	\$ (42.9)	\$ 24,894.5
Equity securities	\$ 206.0	\$ 10.9	\$ —	\$ 216.9

(a) Investment ratings – Investment ratings are assigned the second lowest rating by Nationally Recognized Statistical Rating Organizations ("NRSROs") (Moody's, S&P or Fitch), or if not rated by such firms, the rating assigned by the National Association of Insurance Commissioners (the "NAIC"). NAIC designations of "1" or "2" include fixed maturities generally rated investment grade (rated "Baa3" or higher by Moody's or rated "BBB-" or higher by S&P and Fitch). NAIC designations of "3" through "6" are referred to as below-investment grade (which generally are rated "Ba1" or lower by Moody's or rated "BB+" or lower by S&P and Fitch). References to investment grade or below-investment grade throughout our consolidated financial statements are determined as described above.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

The NAIC evaluates the fixed maturity investments of insurers for regulatory and capital assessment purposes and assigns securities to one of six credit quality categories called NAIC designations, which are used by insurers when preparing their annual statements based on statutory accounting principles. The NAIC designations are generally similar to the credit quality designations of the NRSROs for marketable fixed maturity securities, except for certain structured securities as described below. The following summarizes the NAIC designations and NRSRO equivalent ratings:

<u>NAIC Designation</u>	<u>NRSRO Equivalent Rating</u>
1	AAA/AA/A
2	BBB
3	BB
4	B
5	CCC and lower
6	In or near default

The NAIC adopted revised rating methodologies for non-agency residential mortgage-backed securities that became effective December 31, 2009 and for commercial mortgage-backed traded securities and other asset-backed securities that became effective December 31, 2010. The NAIC's objective with the revised ratings was to increase the accuracy in assessing potential losses, and to use the improved assessment to determine a more appropriate capital requirement for such structured securities. Accordingly, certain structured securities rated below investment grade by the NRSROs could be assigned as NAIC 1 or NAIC 2 securities dependent on the cost basis of the holder relative to estimated recoverable amounts as determined by the NAIC.

A summary of our fixed maturity securities, available for sale, by NAIC designations (or for fixed maturity securities held by non-regulated entities, based on NRSRO ratings) as of March 31, 2013 is as follows (dollars in millions):

NAIC designation	Amortized cost	Estimated fair value	Percentage of total estimated fair value
1	\$ 10,396.4	\$ 11,818.1	47.5%
2	10,391.5	11,675.4	46.9
3	952.4	1,013.1	4.1
4	343.2	358.8	1.4
5	28.5	26.1	.1
6	3.0	3.0	—
	<u>\$ 22,115.0</u>	<u>\$ 24,894.5</u>	<u>100.0%</u>

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Concentration of Fixed Maturity Securities, Available for Sale

The following table summarizes the carrying values and gross unrealized losses of our fixed maturity securities, available for sale, by category as of March 31, 2013 (dollars in millions):

	Carrying value	Percent of fixed maturities	Gross unrealized losses	Percent of gross unrealized losses
Energy/pipelines	\$ 2,645.1	10.6%	\$.8	1.9%
Collateralized mortgage obligations	2,263.9	9.1	.5	1.1
States and political subdivisions	2,156.6	8.7	4.8	11.1
Utilities	1,929.4	7.7	.3	.7
Insurance	1,653.5	6.6	.5	1.2
Asset-backed securities	1,565.0	6.3	3.4	7.9
Commercial mortgage-backed securities	1,439.7	5.8	.5	1.2
Healthcare/pharmaceuticals	1,252.4	5.0	4.1	9.5
Food/beverage	1,131.1	4.5	2.5	5.8
Cable/media	962.3	3.9	7.0	16.3
Banks	916.5	3.7	1.1	2.5
Real estate/REITs	902.5	3.6	—	—
Capital goods	692.8	2.8	—	—
Transportation	560.9	2.3	.2	.6
Telecom	512.7	2.1	2.9	6.8
Aerospace/defense	479.1	1.9	—	—
Building materials	397.5	1.6	1.3	3.0
Chemicals	396.6	1.6	1.6	3.7
Metals and mining	393.3	1.6	2.1	4.9
Collateralized debt obligations	348.8	1.4	.1	.2
Paper	343.7	1.4	.1	.1
Technology	284.4	1.1	—	—
Brokerage	276.7	1.1	—	—
Consumer products	243.5	1.0	.1	.3
Other	1,146.5	4.6	9.0	21.2
Total fixed maturities, available for sale	\$ 24,894.5	100.0%	\$ 42.9	100.0%

Below-Investment Grade Securities

At March 31, 2013, the amortized cost of the Company's below-investment grade fixed maturity securities was \$2,624.7 million, or 12 percent of the Company's fixed maturity portfolio. The estimated fair value of the below-investment grade portfolio was \$2,813.4 million, or 107 percent of the amortized cost.

Below-investment grade corporate debt securities typically have different characteristics than investment grade corporate debt securities. Based on historical performance, probability of default by the borrower is significantly greater for below-investment grade corporate debt securities and in many cases severity of loss is relatively greater as such securities are generally unsecured and often subordinated to other indebtedness of the issuer. Also, issuers of below-investment grade corporate debt securities frequently have higher levels of debt relative to investment-grade issuers, hence, all other things being equal, are generally more sensitive to adverse economic conditions. The Company attempts to reduce the overall risk related to its investment in below-investment grade securities, as in all investments, through careful credit analysis, strict investment policy guidelines, and diversification by issuer and/or guarantor and by industry.

Net Realized Investment Gains (Losses)

The following table sets forth the net realized investment gains (losses) for the periods indicated (dollars in millions):

	Three months ended	
	March 31,	
	2013	2012
Fixed maturity securities, available for sale:		
Realized gains on sale	\$ 16.6	\$ 28.7
Realized losses on sale	(2.0)	(2.3)
Impairments:		
Total other-than-temporary impairment losses	—	(.4)
Other-than-temporary impairment losses recognized in accumulated other comprehensive income (loss)	—	—
Net impairment losses recognized	—	(.4)
Net realized investment gains from fixed maturities	14.6	26.0
Commercial mortgage loans	.7	.5
Impairments of mortgage loans and other investments	—	(7.5)
Other	—	3.9
Net realized investment gains	<u>\$ 15.3</u>	<u>\$ 22.9</u>

During the first three months of 2013, we recognized net realized investment gains of \$15.3 million, which were comprised of \$19.8 million of net gains from the sales of investments (primarily fixed maturities) with proceeds of \$.5 billion and the decrease in fair value of certain fixed maturity investments with embedded derivatives of \$4.5 million.

During the first three months of 2012, we recognized net realized investment gains of \$22.9 million, which were comprised of \$27.4 million of net gains from the sales of investments (primarily fixed maturities), the increase in fair value of certain fixed maturity investments with embedded derivatives of \$3.4 million, and \$7.9 million of writedowns of investments for other than temporary declines in fair value recognized through net income.

At March 31, 2013, fixed maturity securities in default or considered nonperforming had an aggregate amortized cost of \$.4 million and a carrying value of \$.5 million.

During the first three months of 2013, the \$2.0 million of realized losses on sales of \$121.3 million of fixed maturity securities, available for sale, included: (i) \$.5 million of losses related to the sales of mortgage-backed securities and asset-backed securities; and (ii) \$1.5 million of additional losses primarily related to various corporate securities. Securities are generally sold at a loss following unforeseen issue-specific events or conditions or shifts in perceived risks. These reasons include but are not limited to: (i) changes in the investment environment; (ii) expectation that the fair value could deteriorate further; (iii) desire to reduce our exposure to an asset class, an issuer or an industry; (iv) prospective or actual changes in credit quality; or (v) related to structured securities, changes in expected cash flows.

During the first three months of 2012, the \$7.9 million of other-than-temporary impairments we recorded in earnings included: (i) \$3.2 million of losses related to certain commercial mortgage loans; (ii) \$3.9 million of losses related to equity securities; and (iii) \$.8 million of additional losses following unforeseen issue-specific events or conditions.

During the first three months of 2012, the \$2.3 million of realized losses on sales of \$147.6 million of fixed maturity securities, available for sale, included: (i) \$.7 million of losses related to the sales of mortgage-backed securities and asset-backed securities; and (ii) \$1.6 million of additional losses primarily related to various corporate securities.

Our fixed maturity investments are generally purchased in the context of a long-term strategy to fund insurance liabilities, so we do not generally seek to generate short-term realized gains through the purchase and sale of such securities. In certain circumstances, including those in which securities are selling at prices which exceed our view of their underlying

economic value, or when it is possible to reinvest the proceeds to better meet our long-term asset-liability objectives, we may sell certain securities.

We regularly evaluate all of our investments with unrealized losses for possible impairment. Our assessment of whether unrealized losses are "other than temporary" requires significant judgment. Factors considered include: (i) the extent to which fair value is less than the cost basis; (ii) the length of time that the fair value has been less than cost; (iii) whether the unrealized loss is event driven, credit-driven or a result of changes in market interest rates or risk premium; (iv) the near-term prospects for specific events, developments or circumstances likely to affect the value of the investment; (v) the investment's rating and whether the investment is investment-grade and/or has been downgraded since its purchase; (vi) whether the issuer is current on all payments in accordance with the contractual terms of the investment and is expected to meet all of its obligations under the terms of the investment; (vii) whether we intend to sell the investment or it is more likely than not that circumstances will require us to sell the investment before recovery occurs; (viii) the underlying current and prospective asset and enterprise values of the issuer and the extent to which the recoverability of the carrying value of our investment may be affected by changes in such values; (ix) projections of, and unfavorable changes in, cash flows on structured securities including mortgage-backed and asset-backed securities; (x) our best estimate of the value of any collateral; and (xi) other objective and subjective factors.

Future events may occur, or additional information may become available, which may necessitate future realized losses in our portfolio. Significant losses could have a material adverse effect on our consolidated financial statements in future periods.

The following table sets forth the amortized cost and estimated fair value of those fixed maturities, available for sale, with unrealized losses at March 31, 2013, by contractual maturity. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties. Structured securities frequently include provisions for periodic principal payments and permit periodic unscheduled payments.

	Amortized cost	Estimated fair value
(Dollars in millions)		
Due in one year or less	\$ 15.6	\$ 15.6
Due after one year through five years	53.7	51.2
Due after five years through ten years	108.4	106.7
Due after ten years	887.7	853.5
Subtotal	1,065.4	1,027.0
Structured securities	364.3	359.8
Total	\$ 1,429.7	\$ 1,386.8

There were no investments in our portfolio rated below-investment grade which have been continuously in an unrealized loss position exceeding 20 percent of the cost basis at March 31, 2013.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

The following table summarizes the gross unrealized losses of our fixed maturity securities, available for sale, by category and ratings category as of March 31, 2013 (dollars in millions):

	Investment grade		Below investment grade		Total gross unrealized losses
	AAA/AA/A	BBB	BB	B+ and below	
Cable/media	\$ —	\$ 3.8	\$.8	\$ 2.4	\$ 7.0
States and political subdivisions	1.8	2.2	.8	—	4.8
Healthcare/pharmaceuticals	—	4.1	—	—	4.1
Business services	—	4.0	—	—	4.0
Asset-backed securities	.5	1.9	.1	.9	3.4
Telecom	.1	2.7	.1	—	2.9
Food/beverage	.5	2.0	—	—	2.5
Metals and mining	—	2.1	—	—	2.1
Chemicals	—	.8	—	.8	1.6
Building materials	—	.1	1.2	—	1.3
Autos	—	1.1	—	—	1.1
Banks	—	.1	1.0	—	1.1
Energy/pipelines	—	.7	—	.1	.8
Commercial mortgage-backed securities	.5	—	—	—	.5
Collateralized mortgage obligations	.4	—	.1	—	.5
Insurance	—	.5	—	—	.5
Finance - other	.3	—	—	—	.3
Utilities	—	.3	—	—	.3
Transportation	—	.2	—	—	.2
Consumer products	—	.1	—	—	.1
Collateralized debt obligations	—	—	—	.1	.1
Paper	—	.1	—	—	.1
Other	—	3.5	.1	—	3.6
Total fixed maturities, available for sale	\$ 4.1	\$ 30.3	\$ 4.2	\$ 4.3	\$ 42.9

Our investment strategy is to maximize, over a sustained period and within acceptable parameters of quality and risk, investment income and total investment return through active investment management. Accordingly, we may sell securities at a gain or a loss to enhance the projected total return of the portfolio as market opportunities change, to reflect changing perceptions of risk, or to better match certain characteristics of our investment portfolio with the corresponding characteristics of our insurance liabilities.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

The following table summarizes the gross unrealized losses and fair values of our investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that such securities had been in a continuous unrealized loss position, at March 31, 2013 (dollars in millions):

Description of securities	Less than 12 months		12 months or greater		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
States and political subdivisions	\$ 45.8	\$ (1.6)	72.1	\$ (3.2)	\$ 117.9	\$ (4.8)
Corporate securities	777.9	(25.8)	131.2	(7.8)	909.1	(33.6)
Asset-backed securities	183.3	(1.2)	70.7	(2.2)	254.0	(3.4)
Collateralized debt obligations	14.7	(.1)	—	—	14.7	(.1)
Commercial mortgage-backed securities	9.1	(.1)	3.7	(.4)	12.8	(.5)
Mortgage pass-through securities	.1	—	1.8	—	1.9	—
Collateralized mortgage obligations	55.9	(.4)	20.5	(.1)	76.4	(.5)
Total fixed maturities, available for sale	\$ 1,086.8	\$ (29.2)	\$ 300.0	\$ (13.7)	\$ 1,386.8	\$ (42.9)
Equity securities	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

Based on management's current assessment of investments with unrealized losses at March 31, 2013, the Company believes the issuers of the securities will continue to meet their obligations (or with respect to equity-type securities, the investment value will recover to its cost basis). While we do not have the intent to sell securities with unrealized losses and it is not more likely than not that we will be required to sell securities with unrealized losses prior to their anticipated recovery, our intent on an individual security may change, based upon market or other unforeseen developments. In such instances, if a loss is recognized from a sale subsequent to a balance sheet date due to these unexpected developments, the loss is recognized in the period in which we had the intent to sell the security before its anticipated recovery.

Structured Securities

At March 31, 2013 fixed maturity investments included structured securities with an estimated fair value of \$5.6 billion (or 23 percent of all fixed maturity securities). The yield characteristics of structured securities generally differ in some respects from those of traditional corporate fixed-income securities or government securities. For example, interest and principal payments on structured securities may occur more frequently, often monthly. In many instances, we are subject to the risk that the amount and timing of principal and interest payments may vary from expectations. For example, in many cases, partial prepayments may occur at the option of the issuer and prepayment rates are influenced by a number of factors that cannot be predicted with certainty, including: the relative sensitivity of prepayments on the underlying assets backing the security to changes in interest rates; a variety of economic, geographic and other factors; the timing, pace and proceeds of liquidations of defaulted collateral; and various security-specific structural considerations (for example, the repayment priority of a given security in a securitization structure). In addition, the total amount of payments for non-agency structured securities may be affected by changes to cumulative default rates or loss severities of the related collateral.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

The following table sets forth the par value, amortized cost and estimated fair value of structured securities, summarized by interest rates on the underlying collateral, at March 31, 2013 (dollars in millions):

	Par value	Amortized cost	Estimated fair value
Below 4 percent	\$ 766.6	\$ 712.7	\$ 735.2
4 percent – 5 percent	892.8	850.5	923.3
5 percent – 6 percent	2,726.4	2,557.0	2,804.3
6 percent – 7 percent	864.7	806.9	897.1
7 percent – 8 percent	143.2	146.7	160.2
8 percent and above	111.8	113.0	114.9
Total structured securities	\$ 5,505.5	\$ 5,186.8	\$ 5,635.0

The amortized cost and estimated fair value of structured securities at March 31, 2013, summarized by type of security, were as follows (dollars in millions):

Type	Amortized cost	Estimated fair value	
		Amount	Percent of fixed maturities
Pass-throughs, sequential and equivalent securities	\$ 1,395.4	\$ 1,511.2	6.0%
Planned amortization classes, target amortization classes and accretion-directed securities	674.1	741.8	3.0
Commercial mortgage-backed securities	1,293.4	1,439.7	5.8
Asset-backed securities	1,460.2	1,565.0	6.3
Collateralized debt obligations	338.8	348.8	1.4
Other	24.9	28.5	.1
Total structured securities	\$ 5,186.8	\$ 5,635.0	22.6%

Pass-throughs, sequentials and equivalent securities have unique prepayment variability characteristics. Pass-through securities typically return principal to the holders based on cash payments from the underlying mortgage obligations. Sequential securities return principal to tranche holders in a detailed hierarchy. Planned amortization classes, targeted amortization classes and accretion-directed bonds adhere to fixed schedules of principal payments as long as the underlying mortgage loans experience prepayments within certain estimated ranges. In most circumstances, changes in prepayment rates are first absorbed by support or companion classes insulating the timing of receipt of cash flows from the consequences of both faster prepayments (average life shortening) and slower prepayments (average life extension).

Commercial mortgage-backed securities are secured by commercial real estate mortgages, generally income producing properties that are managed for profit. Property types include multi-family dwellings including apartments, retail centers, hotels, restaurants, hospitals, nursing homes, warehouses, and office buildings. Most commercial mortgage-backed securities have call protection features whereby underlying borrowers may not prepay their mortgages for stated periods of time without incurring prepayment penalties.

Commercial Mortgage Loans

The following table provides the carrying value and estimated fair value of our outstanding mortgage loans and the underlying collateral as of March 31, 2013, summarized by loan-to-value ratios (dollars in millions):

Loan-to-value ratio (a)	Carrying value	Estimated fair value	
		Mortgage loans	Collateral
Less than 60%	\$ 790.5	\$ 866.4	\$ 2,280.3
60% to 70%	306.1	323.0	466.1
Greater than 70% to 80%	317.4	327.0	431.9
Greater than 80% to 90%	154.9	163.5	184.6
Greater than 90%	70.9	63.5	76.4
Total	<u>\$ 1,639.8</u>	<u>\$ 1,743.4</u>	<u>\$ 3,439.3</u>

(a) Loan-to-value ratios are calculated as the ratio of: (i) the carrying value of the commercial mortgage loans; to (ii) the estimated fair value of the underlying collateral.

INVESTMENT IN VARIABLE INTEREST ENTITIES

The following table provides supplemental information about the revenues and expenses of the VIEs which have been consolidated in accordance with authoritative guidance, after giving effect to the elimination of our investment in the VIEs and investment management fees earned by a subsidiary of the Company (dollars in millions):

	Three months ended	
	March 31,	
	2013	2012
Revenues:		
Net investment income – policyholder and reinsurer accounts and other special-purpose portfolios	\$ 9.5	\$ 6.1
Fee revenue and other income	.8	.2
Total revenues	<u>10.3</u>	<u>6.3</u>
Expenses:		
Interest expense	5.4	4.0
Other operating expenses	.1	.1
Total expenses	<u>5.5</u>	<u>4.1</u>
Income before net realized investment gains (losses) and income taxes	4.8	2.2
Net realized investment gains (losses)	.1	(.5)
Income before income taxes	<u>\$ 4.9</u>	<u>\$ 1.7</u>

During the first three months of 2013, we recognized net realized investment gains of \$.1 million from the sales of investments. During the first three months of 2012, net realized investment losses included: (i) \$.1 million of net losses from the sales of investments; and (ii) \$.4 million of writedowns of investments held by VIEs as a result of our intent to sell such investments.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Supplemental Information on Investments Held by VIEs

The following table summarizes the carrying values of the investments held by the VIEs by category as of March 31, 2013 (dollars in millions):

	Carrying value	Percent of fixed maturities	Gross unrealized losses	Percent of gross unrealized losses
Healthcare/pharmaceuticals	\$ 132.2	13.1%	\$.1	11.1%
Cable/media	124.7	12.4	.1	15.8
Technology	109.1	10.8	.1	9.9
Food/beverage	63.6	6.3	.1	10.3
Autos	62.5	6.2	—	3.0
Brokerage	59.0	5.8	.1	9.4
Gaming	40.6	4.0	—	1.9
Consumer products	40.6	4.0	—	3.7
Insurance	40.2	4.0	—	—
Retail	29.7	2.9	—	3.5
Aerospace/defense	29.6	2.9	—	—
Entertainment/hotels	29.5	2.9	.1	4.4
Building materials	24.9	2.5	—	.4
Energy/pipelines	23.6	2.3	—	2.3
Capital goods	23.2	2.3	—	3.6
Utilities	22.1	2.2	.1	3.8
Real estate/REITs	21.4	2.1	.1	5.5
Metals and mining	19.8	2.0	—	.2
Business services	14.0	1.4	—	2.1
Chemicals	13.9	1.4	—	.7
Paper	10.9	1.0	—	3.4
Telecom	8.9	.9	—	—
Textiles	6.1	.6	—	2.0
Transportation	1.7	.2	—	.1
Other	58.1	5.8	—	2.9
Total	<u>\$ 1,009.9</u>	<u>100.0%</u>	<u>\$.8</u>	<u>100.0%</u>

The following table sets forth the amortized cost and estimated fair value of those investments held by the VIEs with unrealized losses at March 31, 2013, by contractual maturity. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

	Amortized cost	Estimated fair value
(Dollars in millions)		
Due in one year or less	\$ 1.0	\$ 1.0
Due after one year through five years	61.1	60.6
Due after five years through ten years	99.6	99.3
Total	<u>\$ 161.7</u>	<u>\$ 160.9</u>

There were no investments held by the VIEs rated below-investment grade which had been continuously in an unrealized loss position exceeding 20 percent of the cost basis as of March 31, 2013 .

NEW ACCOUNTING STANDARDS

See "Recently Issued Accounting Standards" in the notes to consolidated financial statements for a discussion of recently issued accounting standards.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Our market risks, and the ways we manage them, are summarized in "Management's Discussion and Analysis of Financial Condition and Results of Operations", included in our Annual Report on Form 10-K for the year ended December 31, 2012. There have been no material changes in the first three months of 2013 to such risks or our management of such risks.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures . CNO's management, under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of CNO's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based on its evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2013 , CNO's disclosure controls and procedures were effective to ensure that information required to be disclosed by CNO in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures are also designed to reasonably assure that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes to Internal Control Over Financial Reporting. There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) during the three months ended March 31, 2013 , that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Information required for Part II, Item 1 is incorporated by reference to the discussion under the heading "Litigation and Other Legal Proceedings" in the footnotes to our consolidated financial statements included in Part I, Item 1 of this Form 10-Q.

ITEM 1A. RISK FACTORS.

CNO and its businesses are subject to a number of risks including general business and financial risk factors. Any or all of such factors could have a material adverse effect on the business, financial condition or results of operations of CNO. Refer to "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2012, for further discussion of such risk factors. There have been no material changes from such previously disclosed risk factors.

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

Issuer Purchases of Equity Securities

Period	Total number of shares (or units)	Average price paid per share (or unit)	Total number of shares (or units) purchased as part of publicly announced plans or programs	Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs (a) (dollars in millions)
January 1 through January 31	—	\$ —	—	\$ 350.0
February 1 through February 28	215,445	10.88	—	350.0
March 1 through March 31	129,933	11.47	—	225.2 (b)
Total	<u>345,378</u>	<u>11.10</u>	<u>—</u>	<u>225.2</u>

(a) In May 2011, the Company announced a common share repurchase program of up to \$100.0 million. In February 2012, June 2012 and December 2012, the Company's Board of Directors approved, in aggregate, an additional \$500.0 million to repurchase the Company's outstanding securities.

(b) On March 28, 2013, the Company completed the Offer for \$59.3 million aggregate principal amount of its 7.0% Debentures for an aggregate purchase price of \$124.8 million. The Offer was part of our previously announced securities repurchase program.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

12.1 Computation of Ratio of Earnings to Fixed Charges.

31.1 Certification Pursuant to the Securities Exchange Act Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification Pursuant to the Securities Exchange Act Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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

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

101.INS XBRL Instance Document.

101.SCH XBRL Taxonomy Extension Schema Document.

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.

101.DEF XBRL Taxonomy Extension Definition Linkbase Document.

101.LAB XBRL Taxonomy Extension Label Linkbase Document.

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

SIGNATURE

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.

CNO FINANCIAL GROUP, INC.

Dated: April 29, 2013

By: /s/ Frederick J. Crawford

Frederick J. Crawford
Executive Vice President and Chief Financial Officer
(authorized officer and principal financial officer)

CNO FINANCIAL GROUP, INC. AND SUBSIDIARIES

Computation of Ratio of Earnings to Fixed Charges

(Dollars in millions)

	Three months ended March 31, 2013	Year ended December 31, 2012
Pretax income from operations:		
Net income	\$ 11.9	\$ 221.0
Add income tax expense (benefit)	22.7	(65.3)
Pretax income from operations	34.6	155.7
Add fixed charges:		
Interest expense on corporate debt	15.1	66.2
Interest expense on investment borrowings and borrowings related to variable interest entities	12.2	48.4
Interest added to policyholder account balances	63.1	260.5
Portion of rental (a)	3.2	14.6
Fixed charges	93.6	389.7
Adjusted earnings	\$ 128.2	\$ 545.4
Ratio of earnings to fixed charges	1.37X	1.40X

(a) Interest portion of rental is estimated to be 33 percent.

CERTIFICATION

I, Edward J. Bonach, certify that:

1. I have reviewed this quarterly report on Form 10-Q of CNO Financial Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the period presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 29, 2013

/s/ Edward J. Bonach
Edward J. Bonach
Chief Executive Officer

CERTIFICATION

I, Frederick J. Crawford, certify that:

1. I have reviewed this quarterly report on Form 10-Q of CNO Financial Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the period presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 29, 2013

/s/ Frederick J. Crawford
Frederick J. Crawford
Executive Vice President
and Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of CNO Financial Group, Inc. (the "Company") on Form 10-Q for the period ending March 31, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Edward J. Bonach, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my actual knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Edward J. Bonach

Edward J. Bonach
Chief Executive Officer

April 29, 2013

A signed original of this written statement required by Section 906 has been provided to CNO Financial Group, Inc. and will be retained by CNO Financial Group, Inc. and furnished to the Securities and Exchange Commission upon request.

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of CNO Financial Group, Inc. (the "Company") on Form 10-Q for the period ending March 31, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Frederick J. Crawford, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my actual knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Frederick J. Crawford
Frederick J. Crawford
Executive Vice President
and Chief Financial Officer

April 29, 2013

A signed original of this written statement required by Section 906 has been provided to CNO Financial Group, Inc. and will be retained by CNO Financial Group, Inc. and furnished to the Securities and Exchange Commission upon request.