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DELPHI FINANCIAL GROUP INC/DE  
Form 10-K  
March 15, 2006

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

FORM 10-K

(Mark One)

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

For the Fiscal Year Ended December 31, 2005

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-11462

DELPHI FINANCIAL GROUP, INC.  
(Exact name of registrant as specified in its charter)

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

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

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

Class A Common Stock, \$.01 par value	New York Stock Exchange
-----	-----
(Title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes X No  
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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes      No    X  
    ---    ---

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to filing requirements for the past 90 days.

Yes    X    No  
    ---    ---

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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

Large accelerated filer    X    Accelerated filer      Non-accelerated filer  
                                  ---                                    ---                                    ---

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes      No    X  
    ---    ---

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of June 30, 2005 was \$1,240,110,056.

As of March 1, 2006, the Registrant had 28,616,435 shares of Class A Common Stock and 3,781,163 shares of Class B Common Stock outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Registrant's 2006 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

This document contains certain forward-looking statements as defined in the Securities Exchange Act of 1934, some of which may be identified by the use of terms such as "expects," "believes," "anticipates," "intends," "judgment," "outlook" or other similar expressions. These statements are subject to various uncertainties and contingencies, which could cause actual results to differ materially from those expressed in such statements. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward-Looking Statements and Cautionary Statements Regarding Certain Factors That May Affect Future Results."

### PART I

#### ITEM 1. BUSINESS

Delphi Financial Group, Inc. (the "Company," which term includes the Company and

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its consolidated subsidiaries unless the context indicates otherwise), is a holding company whose subsidiaries provide integrated employee benefit services. The Company was organized as a Delaware corporation in 1987 and completed the initial public offering of its Class A common stock in 1990. The Company manages all aspects of employee absence to enhance the productivity of its clients and provides the related insurance coverages: long-term and short-term disability, excess and primary workers' compensation, group life, travel accident and dental. The Company's asset accumulation business emphasizes individual fixed annuity products. The Company offers its products and services in all fifty states and the District of Columbia. The Company's two reportable segments are group employee benefit products and asset accumulation products. See Notes A and R to the Consolidated Financial Statements included in this Form 10-K for additional information regarding the Company's segments.

The Company makes available free of charge on its website at [www.delphifin.com](http://www.delphifin.com) its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to these reports as soon as reasonably possible after such material has been filed with or furnished to the Securities and Exchange Commission.

### OPERATING STRATEGY

The Company's operating strategy is to offer financial products and services which have the potential for significant growth, which require specialized expertise to meet the individual needs of its customers and which provide the Company the opportunity to achieve superior operating earnings growth and returns on capital.

The Company has concentrated its efforts within certain niche insurance markets, primarily group employee benefits for small to mid-sized employers, where data from the Bureau of Labor Statistics indicate nearly all of the employment growth in the American economy has occurred in recent years. The Company also markets its group employee benefit products and services to large employers, emphasizing unique programs that integrate both employee benefit insurance coverages and absence management services. The Company also operates an asset accumulation business that focuses primarily on offering fixed annuities to individuals planning for retirement.

The Company's primary operating subsidiaries are as follows:

Reliance Standard Life Insurance Company ("RSLIC"), founded in 1907 and having administrative offices in Philadelphia, Pennsylvania, and its subsidiary, First Reliance Standard Life Insurance Company ("FRSLIC"), underwrite a diverse portfolio of group life, disability and accident insurance products targeted principally to the employee benefits market. RSLIC also markets asset accumulation products, primarily fixed annuities, to individuals and groups. The financial strength rating of RSLIC as of February 2006 as assigned by A.M. Best was A (Excellent). Financial strength ratings are based upon factors relevant to policyholders and are not directed toward protection of investors. The Company, through Reliance Standard Life Insurance Company of Texas ("RSLIC-Texas"), acquired RSLIC and FRSLIC in November 1987.

Safety National Casualty Corporation ("SNCC") focuses primarily on providing excess workers' compensation insurance to the self-insured market. Founded in 1942 and located in St. Louis, Missouri, SNCC is one of the oldest continuous writers of excess workers' compensation insurance in the United States. The financial strength rating of SNCC as of February 2006 as assigned by A.M. Best was A (Excellent). The Company, through SIG Holdings, Inc. ("SIG"), acquired SNCC in March 1996. In 2001, SNCC formed an insurance subsidiary, Safety First Insurance Company, which also focuses on selling excess workers' compensation products to the self-insured market.

Matrix Absence Management, Inc. ("Matrix"), founded in 1987, provides integrated disability and absence management services to the employee benefits market across the United States. Headquartered in San Jose, California, Matrix was acquired by the Company in June 1998.

GROUP EMPLOYEE BENEFIT PRODUCTS

The Company is a leading provider of group life, disability and excess workers' compensation insurance products to small and mid-sized employers, with more than 20,000 policies in force. The Company also offers travel accident, voluntary accidental death and dismemberment and group dental insurance. The Company markets its group products to employer-employee groups and associations in a variety of industries. The Company insures groups ranging from 2 to more than 5,000 individuals, although the size of an insured group generally ranges from 10 to 1,000 individuals. The Company markets its employee benefit products on an unbundled basis and as part of an Integrated Employee Benefit program that combines employee benefit insurance coverages and absence management services. The Integrated Employee Benefit program, which the Company believes helps to differentiate itself from competitors by offering clients improved productivity from reduced employee absence, has enhanced the Company's ability to market its group employee benefit products to large employers. In 2003, the Company introduced a suite of voluntary group life, disability and accidental death and dismemberment products that are sold to employees at their worksite. This suite of voluntary benefits allows the employees of the Company's clients to choose the type and amount of benefit. In underwriting its group employee benefit products, the Company attempts to avoid concentrations of business in any particular industry segment or geographic area.

The Company's group employee benefit products are sold to employer groups primarily through independent brokers and agents. The Company's products are marketed to brokers and agents by 129 sales representatives and managers. RSLIC had 117 sales representatives and managers located in 26 sales offices nationwide at December 31, 2005, up 9% from 107 sales representatives and managers at the end of 2004. At December 31, 2005, SNCC had 11 sales representatives and managers. The Company's three administrative offices and 26 sales offices also service existing business.

The following table sets forth for the periods indicated selected financial data concerning the Company's group employee benefit products:

	Year Ended December 31,				
	2005		2004		2003
	(dollars in thousands)				
Insurance premiums:					
Core Products:					
Disability income .....	\$392,959	42.0%	\$290,743	37.0%	\$233,437
Life .....	281,915	30.1	261,797	33.4	241,902
Excess workers' compensation .....	220,312	23.5	190,794	24.3	151,522
Travel accident, dental and other .....	41,058	4.4	41,656	5.3	46,792
	-----	-----	-----	-----	-----
	\$936,244	100.0%	\$784,990	100.0%	\$673,653
	=====	=====	=====	=====	=====

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Non-Core Products:					
Loss portfolio transfers .....	10,377		5,300		--
Other .....	14,541		10,766		14,908
	-----		-----		-----
	24,918		16,066		14,908
	-----		-----		-----
Total insurance premiums .....	\$961,162		\$801,056		\$688,561
	=====		=====		=====
Sales (new annualized gross premiums):					
Core Products:					
Disability income .....	\$103,515	42.4%	\$ 95,799	45.8%	\$ 84,920
Life .....	72,814	29.8	64,555	30.8	68,200
Excess workers' compensation .....	46,044	18.9	28,408	13.6	45,058
Travel accident, dental and other .....	21,728	8.9	20,547	9.8	21,933
	-----		-----		-----
	\$244,101	100.0%	\$209,309	100.0%	\$220,111
	=====	=====	=====	=====	=====
Non-Core Products:					
Loss portfolio transfers .....	10,377		5,300		--
Other .....	9,448		7,069		8,337
	-----		-----		-----
	19,825		12,369		8,337
	-----		-----		-----
Total sales .....	\$263,926		\$221,678		\$228,448
	=====		=====		=====

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The profitability of group employee benefit products is affected by, among other things, differences between actual and projected claims experience, the retention of existing customers, product mix and the Company's ability to attract new customers, change premium rates and contract terms and control administrative expenses. The Company transfers its exposure to some group employee benefit risks through reinsurance ceded arrangements with other insurance and reinsurance companies. Under these arrangements, another insurer assumes a specified portion of the Company's losses and loss adjustment expenses in exchange for a specified portion of policy premiums. See "Reinsurance." Accordingly, the profitability of group employee benefit products is affected by the amount, cost and terms of reinsurance obtained by the Company. Profitability of certain group employee benefit products is also affected by the difference between the yield achieved on invested assets and the discount rate used to calculate the related reserves.

The table below shows the loss and expense ratios as a percent of premium income for the Company's group employee benefit products for the periods indicated.

	Year Ended December 31,		
	-----	-----	-----
	2005	2004	2003
	----	----	----
Loss ratio .....	70.1%	70.3%	68.9%
Expense ratio .....	24.0	24.7	26.1
	----	----	----
Combined ratio ..	94.1%	95.0%	95.0%
	=====	=====	=====

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The loss and expense ratios are affected by, among other things, claims development related to prior years and the results with respect to the Company's non-core group employee benefit products. Such ratios can also be affected by changes in the Company's mix of products, such as the level of premium from loss portfolio transfers ("LPTs"), from year to year. LPTs, which are classified as a non-core product due to the episodic nature of sales, carry a higher loss ratio and a significantly lower expense ratio as compared to the Company's other group employee benefit products.

Group disability products offered by the Company, principally long-term disability insurance, generally provide a specified level of periodic benefits for a specified period to persons who, because of sickness or injury, are unable to work. The Company's group long-term disability coverages are spread across many industries. Typically, long-term disability benefits are paid monthly and are limited for any one employee to two-thirds of the employee's earned income up to a specified maximum benefit. Long-term disability benefits are usually offset by income the claimant receives from other sources, primarily Social Security disability benefits. The Company actively manages its disability claims, working with claimants to help them return to work as quickly as possible. When claimants' disabilities prevent them from returning to their original occupations, the Company, in appropriate cases, may provide assistance in developing new productive skills for an alternative career. Premiums are generally determined annually for disability insurance and are based upon expected morbidity and the insured group's emerging experience, as well as assumptions regarding operating expenses and future interest rates. Effective October 1, 2003 for new policies and, for policies that were in effect on such date, the earlier of the next policy anniversary date or October 1, 2004, the Company reinsures risks in excess of \$7,500 (compared to \$2,500 previously) in long-term disability benefits per individual per month. See "Reinsurance" and "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Reinsurance."

The Company's group life insurance products provide for the payment of a stated amount upon the death of a member of the insured group. Policy terms are generally one year. Accidental death and dismemberment insurance, which provides for the payment of a stated amount upon the accidental death or dismemberment of a member of the insured group, is frequently sold in conjunction with group life policies and is included in premiums charged for group life insurance. The Company reinsures risks in excess of \$150,000 per individual and type of coverage for employer-provided group life insurance policies and \$100,000 per individual for voluntary group term life policies. See "Reinsurance."

Excess workers' compensation insurance products provide coverage to employers and groups who self-insure their workers' compensation risks. The coverage applies to losses in excess of the applicable self-insured retentions ("SIRs" or deductibles) of employers and groups, whose workers' compensation claims are generally handled by third-party administrators ("TPAs"). These products are principally targeted to mid-sized companies and other employers, particularly small municipalities, hospitals and schools. These employers are believed to be less prone to catastrophic workers' compensation exposures and less price sensitive than larger account business. Because excess workers' compensation claim payments do not begin until after the self-insured's total loss payments equal the SIR, the period from when the claim is incurred to the time the Company's claim payments begin averages 15 years. At that point, the payments are primarily for wage replacement, similar to the benefit provided under long-term disability coverage, and any medical payments tend to be stable and predictable. This family of products also includes large deductible workers' compensation insurance, which provides coverage similar to excess workers' compensation insurance, and a complementary product, workers' compensation self-insurance bonds.

The pricing environment and demand for excess workers' compensation insurance has improved substantially since 2000 due to high primary workers' compensation rates and disruption in the excess workers' compensation marketplace resulting from difficulties experienced by some competitors, particularly during 2000. These trends accelerated during the second half of 2001 as sharply higher primary workers' compensation rates and rising reinsurance costs due to the September 11th terrorist attacks increased the demand for alternatives to primary workers' compensation. As a result, the demand for excess workers' compensation products and the rates for such products continued to increase. SNCC was able to obtain significant price increases in connection with its renewals of insurance coverage during 2003 and 2004, with average increases of 15% and 9%, respectively, on a substantial portion of such renewals. SNCC was able to maintain its pricing in its renewals of insurance coverage during 2005 while also obtaining significant improvements in contract terms, in particular higher SIR levels, in these renewals. On average, SIRs increased 13% in 2003, 8% in 2004 and 8% in 2005. SNCC has continued to maintain its pricing on its 2006 renewals and SIR levels on average are up 9% in these renewals. New business production, which represents the amount of new annualized premium sold, for excess workers' compensation products was \$45.1 million in 2003, \$28.4 million in 2004 and \$46.0 million in 2005 and the retention of existing customers remains strong. Excess workers' compensation new business production for the important January renewal season increased 129% to \$20.4 million in 2006 from \$8.9 million in 2005. New business production for 2005 and 2006 benefited from a renewal rights agreement that SNCC entered into in July 2005. Under the agreement, SNCC acquired, among other things, the right to offer renewal quotes to expiring excess workers' compensation policies of a former competitor. During 2003, the Company replaced certain of its existing reinsurance arrangements for its excess workers' compensation products. Under the replacement arrangements, the Company reinsures excess workers' compensation risks between \$5.0 million (compared to \$3.0 million previously) and \$50.0 million, and a substantial majority in proportionate amount of the risks between \$50.0 million and \$100.0 million, per policy per occurrence. In addition, during 2005, the Company entered into a reinsurance arrangement under which the Company cedes 30% of its excess workers' compensation risks between \$100.0 million and \$150.0 million, per policy per occurrence. See "Reinsurance" and "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Reinsurance."

As a result of the September 11th terrorist attacks, a number of the Company's reinsurers have excluded coverage for losses resulting from terrorism. In November 2002, the Terrorism Risk Insurance Act of 2002 (the "Terrorism Act") was enacted. The Terrorism Act established a program under which the federal government will share with the insurance industry the risk of loss from covered acts of international terrorism. In December 2005, Congress passed the Terrorism Risk Insurance Extension Act of 2005 extending, with certain modifications, the Terrorism Act, which otherwise would have expired at the end of 2005, for an additional two-year term through December 31, 2007. The Terrorism Act applies to lines of property and casualty insurance directly written by SNCC, including excess workers' compensation. SNCC's surety line of business will not be covered under the Terrorism Act after December 31, 2005. The federal government would pay 90% of each covered loss in 2006 and 85% of each covered loss in 2007 and the insurer would pay the remaining 10% and 15%, respectively. Each insurer has a separate deductible before federal assistance becomes available for a covered act of terrorism. The deductible is based on a percentage of the insurer's direct earned premiums from the previous calendar year. Such percentage will be 17.5% in 2006 and 20.0% in 2007. The maximum

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after-tax loss to the Company for 2006 within the Terrorism Act deductible from property and casualty products is approximately 2.6% of the Company's shareholders' equity as of December 31, 2005. Any payments made by the government under the Terrorism Act would be subject to recoupment via surcharges to policyholders when future premiums are billed. The Terrorism Act does not apply to the lines of insurance written by the Company's life insurance subsidiaries.

Business travel accident as well as voluntary accidental death and dismemberment insurance policies pay a stated amount based on a predetermined schedule in the event of the accidental death or dismemberment of a member of the insured group. The Company reinsures risks in excess of \$150,000 per individual and type of coverage. Group dental insurance provides coverage for preventive, restorative and specialized dentistry up to a stated maximum benefit per individual per year. Under a reinsurance arrangement, the Company ceded 50% of its risk under dental policies with effective dates prior to 2003, ceded 100% of its risk under dental policies with effective dates in 2003 through June 30, 2004 and cedes 75% of its risk under dental policies with effective dates after June 30, 2004. See "Reinsurance."

The Company's suite of voluntary group life, disability and accidental death and dismemberment products are sold to employees at the worksite. Trends in the U.S. employment market, particularly the increasing cost of employer-provided medical benefits, are leading an increasing number of employers to offer new or additional benefits on a voluntary basis. The Company's suite of voluntary products allows the employees of the Company's clients to choose the type and amount of benefit, the premiums for which are paid through payroll deductions. Because these products are convenient to purchase and maintain, the Company believes that they are appealing to employees who might have little opportunity or inclination to purchase similar coverage on an individual basis. The Company believes that these voluntary products complement the Company's core group employee benefit products and represent a significant growth opportunity.

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Non-core group employee benefit products include certain products that have been discontinued, such as reinsurance facilities and excess casualty insurance, newer products which have not demonstrated their financial potential, products which are not expected to comprise a significant percentage of earned premiums and products for which sales are episodic in nature, such as LPTs. Pursuant to an LPT, the Company, in exchange for a specified one-time payment, assumes responsibility for an existing block of disability or self-insured workers' compensation claims that are in the course of being paid over time. These products are typically marketed to the same types of clients who have historically purchased the Company's disability and excess workers' compensation products. Non-core group employee benefit products also include primary workers' compensation for which the Company primarily receives fee income since a significant portion of the risk is reinsured. Excess casualty insurance consists of a discontinued excess umbrella liability program. This program entails exposure to excess of loss liability claims from past years, including environmental and asbestos-related claims. Net incurred losses and loss adjustment expenses relating to this program totaled \$6.5 million, \$8.0 million and \$4.4 million in 2005, 2004 and 2003, respectively. In addition, non-core group employee benefit products include bail bond insurance and workers' compensation reinsurance. See "Reinsurance."

### ASSET ACCUMULATION PRODUCTS

The Company's asset accumulation products consist of fixed annuities, primarily



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single premium deferred annuities ("SPDAs") and flexible premium annuities ("FPAs"). An SPDA provides for a single payment by an annuity holder to the Company and the crediting of interest by the Company on the annuity contract at the applicable crediting rate. An FPA provides for periodic payments by an annuity holder to the Company, the timing and amount of which are at the discretion of the annuity holder, and the crediting of interest by the Company on the annuity contract at the applicable crediting rate. Interest credited on SPDAs and FPAs is not paid currently to the annuity holder but instead accumulates and is added to the annuity contract's account value. This accumulation is tax deferred. The crediting rate may be increased or decreased by the Company subject to specified guaranteed minimum crediting rates, which currently range from 2.3% to 5.5%. For most of the Company's annuity products, the crediting rate may be reset by the Company annually, typically on the policy anniversary. The Company's annuity products also include multi-year interest guarantee products, in which the crediting rate is fixed at a stated rate for a specified period of years, such periods ranging from three to eight years. At December 31, 2005, the weighted average crediting rate on the Company's annuity products as a group was 4.41%, which includes the effects of the first year crediting rate bonus on certain newly issued products. Withdrawals may be made by the annuity holder at any time, but some withdrawals may result in the assessment of surrender charges, taxes, and/or tax penalties on the withdrawn amount. In addition, for annuity products containing a market value adjustment ("MVA") provision, the accumulated value of the annuity may be increased or decreased under such provision if it is surrendered during the surrender charge period. Under this provision, the accumulated value is guaranteed to be at least equal to the annuity premium paid, plus credited interest at the specified minimum guaranteed crediting rate. The Company does not market variable annuity products.

These fixed annuity products are sold predominantly to individuals through networks of independent agents. In 2005, the Company's SPDA products accounted for \$82.2 million of asset accumulation product deposits, of which \$65.7 million was attributable to the MVA annuity product, and \$5.4 million was attributable to FPA products, of which \$5.3 million had an MVA feature. Three networks of independent agents accounted for approximately 40% of the deposits from these SPDA and FPA products during 2005, with no other network of independent agents accounting for more than 10% of these deposits. The Company believes that it has a good relationship with these networks.

The following table sets forth for the periods indicated selected financial data concerning the Company's asset accumulation products:

	Year Ended December 31,		
	2005	2004	2003
	(dollars in thousands)		
Asset accumulation product deposits (sales)...	\$ 95,021	\$133,096	\$100,636
Funds under management (at period end).....	1,008,787	993,346	929,922

At December 31, 2005, funds under management consisted of \$874.1 million of SPDA liabilities and \$134.7 million of FPA liabilities. Of these liabilities, \$677.6 million were subject to surrender charges averaging 6.26% at December 31, 2005. Annuity liabilities not subject to surrender charges have been in force, on average, for 20 years.

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The Company prices its annuity products based on assumptions concerning prevailing and expected interest rates and other factors to achieve a positive spread between its expected return on investments and the crediting rate. The Company attempts to achieve this spread by active portfolio management focusing on matching invested assets and related liabilities to minimize the exposure to fluctuations in market interest rates and by the adjustment of the crediting rate on its annuity products. In response to changes in interest rates, the Company increases or decreases the crediting rates on its annuity products.

In light of the annuity holder's ability to withdraw funds and the volatility of market interest rates, it is difficult to predict the timing of the Company's payment obligations under its SPDAs and FPAs. Consequently, the Company maintains a portfolio of investments which are readily marketable and expected to be sufficient to satisfy liquidity requirements. See "Investments."

### OTHER PRODUCTS AND SERVICES

The Company provides integrated disability and absence management services on a nationwide basis through Matrix, which was acquired in June 1998.

The Company's comprehensive disability and absence management services are designed to assist clients in identifying and minimizing lost productivity and benefit payment costs resulting from employee absence due to illness, injury or personal leave. The Company offers services including event reporting, leave of absence management, claims and case management and return to work management. These services' goal is to enhance employee productivity and provide more efficient benefit delivery and enhanced cost containment. The Company provides these services on an unbundled basis or in a unique Integrated Employee Benefit program that combines these services with various group employee benefit insurance coverages. The Company believes that these integrated disability and absence management services complement the Company's core group employee benefit products, enhancing the Company's ability to market these core products and providing the Company with a competitive advantage in the market for these products.

In 1991, the Company introduced a variable flexible premium universal life insurance policy under which the related assets are segregated in a separate account not subject to claims of general creditors of the Company. Policyholders may elect to deposit amounts in the account from time to time, subject to underwriting limits and a minimum initial deposit of \$1.0 million. Both the cash values and death benefits of these policies fluctuate according to the investment experience of the assets in the separate account; accordingly, the investment risk with respect to these assets is borne by the policyholders. The Company earns fee income from the separate account in the form of charges for management and other administrative fees. The Company is not presently actively marketing this product. The Company reinsures risks in excess of \$200,000 per individual under indemnity reinsurance arrangements with various reinsurance companies. See "Reinsurance."

### UNDERWRITING PROCEDURES

Premiums charged on insurance products are based in part on assumptions about the incidence, severity and timing of insurance claims. The Company has adopted and follows detailed underwriting procedures designed to assess and qualify insurance risks before issuing its policies. To implement these procedures, the Company employs a professional underwriting staff.

In underwriting group coverage, the Company focuses on the overall risk characteristics of the group to be insured and the geographic concentration of its new and renewal business. A prospective group client is evaluated with

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particular attention paid to the claims experience of the group with prior carriers, the occupations of the insureds, the nature of the business of the client, the current economic outlook of the client in relation to others in its industry and of the industry as a whole, the appropriateness of the benefits or SIR applied for and income from other sources during disability. The Company's products generally afford it the flexibility to seek, on an annual basis, to adjust premiums charged to its policyholders in order to reflect emerging mortality or morbidity experience.

### INVESTMENTS

The Company's management of its investment portfolio is an important component of its profitability since a substantial portion of its operating income is generated from the difference between the yield achieved on invested assets and, in the case of asset accumulation products, the interest credited on policyholder funds and, in the case of certain of the

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Company's other products, the discount rate used to calculate the related reserves. The Company's overall investment strategy to achieve its objectives of safety and liquidity, while seeking the best available return, focuses on, among other things, matching of the Company's interest-sensitive assets and liabilities and seeking to minimize the Company's exposure to fluctuations in interest rates.

For information regarding the composition and diversification of the Company's investment portfolio and asset/liability management, see "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" and Notes A, B and I to the Consolidated Financial Statements.

The following table sets forth for the periods indicated the Company's pretax investment results:

	Year Ended December 31,		
	2005	2004	2003
(dollars in thousands)			
Average invested assets (1).....	\$3,621,608	\$3,272,978	\$2,948,150
Net investment income (2).....	223,569	202,444	186,337
Tax equivalent weighted average annual yield (3)...	6.4%	6.4%	6.5%

- (1) Average invested assets are computed by dividing the total of invested assets as reported on the balance sheet at the beginning of each year plus the individual quarter-end balances by five and deducting one-half of net investment income.
- (2) Consists principally of interest and dividend income less investment expenses.
- (3) The tax equivalent weighted average annual yield on the Company's investment portfolio for each period is computed by dividing net investment income, increased to reflect tax exempt interest income and similar tax

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savings, by average invested assets for the period. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Results of Operations."

### REINSURANCE

The Company participates in various reinsurance arrangements both as the ceding insurer and as the assuming insurer. Arrangements in which the Company is the ceding insurer afford various levels of protection against excessive loss by assisting the Company in diversifying its risks and by limiting its maximum loss on risks that exceed retention limits. Under indemnity reinsurance transactions in which the Company is the ceding insurer, the Company remains liable for policy claims if the assuming company fails to meet its obligations. To limit this risk, the Company monitors the financial position of its reinsurers, including, among other things, the companies' financial ratings, and in certain cases receives collateral security from the reinsurer. Also, certain of the Company's reinsurance agreements require the reinsurer to set up security arrangements for the Company's benefit in the event of certain ratings downgrades. In addition, the U.S. federal government presently provides certain protections for insurers who issue certain property and casualty insurance coverages, including SNCC. See "Business - Group Employee Benefit Products."

The Company cedes portions of the risks relating to its group employee benefit and variable life insurance products under indemnity reinsurance agreements with various unaffiliated reinsurers. The terms of these agreements, which management believes are typical for agreements of this type, provide, among other things, for the automatic acceptance by the reinsurer of ceded risks in excess of the Company's retention limits stated in the agreements. The Company pays reinsurance premiums to these reinsurers which are, in general, based upon percentages of premiums received by the Company on the business reinsured less, in certain cases, ceding commissions and experience refunds paid by the reinsurer to the Company. These agreements are generally terminable as to new risks by either the Company or the reinsurer on appropriate notice; however, termination does not affect risks ceded during the term of the agreement, for which the reinsurer generally remains liable. See "Business - Group Employee Benefit Products" and Note P to the Consolidated Financial Statements. As a result of the terrorist attacks on the World Trade Center, a number of the Company's reinsurers have excluded coverage for losses resulting from terrorism. See "The Company's ability to reduce its exposure to risks depends on the availability and cost of reinsurance" in Item 1A, Risk Factors. The Company assumes certain workers' compensation risks through reinsurance. In these arrangements, the Company provides coverage for losses in excess of specified amounts, subject to specified maximums. Coverage for losses as a result of terrorism is generally excluded from these reinsurance treaties. The attachment points for workers' compensation reinsurance range from \$250,000 to \$1.6 billion, with an average attachment point of \$64 million. Aggregate exposures assumed under individual workers' compensation treaties generally range from \$500,000 to \$5 million, with the highest net exposure pursuant to any such treaty equal to \$5 million. The Company underwrites workers' compensation reinsurance assumed pursuant to procedures similar to those utilized in connection with its excess workers' compensation products.

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During the fourth quarter of 2005, the Company decided to exit its non-core property catastrophe reinsurance business, due to the volatility associated with such business and other strategic considerations, and has not thereafter entered into or renewed any assumed property reinsurance contracts. A substantial majority of these reinsurance contracts expired on or before December 31, 2005 and all of the remaining contracts will expire prior to the end of the third

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quarter of 2006. The Company has classified the operating results of this business as discontinued operations. See "Other Transactions" and Note S to the Consolidated Financial Statements.

In the fourth quarter of 2004, the Company entered into an indemnity reinsurance arrangement under which it assumes certain newly issued group disability insurance policies on an ongoing basis. Under this arrangement, the Company is responsible for underwriting and claims management with respect to the reinsured business. The Company provides coverage primarily on a quota share basis up to a maximum Company share of \$7,500 in benefits per individual per month. The Company did not recognize any premium income or incurred losses from this arrangement in 2004. Premium income and incurred losses from this arrangement were \$37.9 million and \$32.3 million, respectively, in 2005.

The Company had in the past participated as an assuming insurer in a number of reinsurance facilities. These reinsurance facilities generally are administered by TPAs or managing underwriters who underwrite risks, coordinate premiums charged and process claims. During 1999 and 2000, the Company terminated, on a prospective basis, its participations in all of these reinsurance facilities. However, the terms of such facilities provide for the continued assumption of risks by, and payments of premiums to, facility participants with respect to business written in the periods during which they participated in such facilities. The Company has been and is currently a party to certain arbitration proceedings arising out of such facilities. See "Legal Proceedings." Premium income from all reinsurance facilities was \$0.3 million, \$0.1 million and \$0.3 million in 2005, 2004 and 2003, respectively, and incurred losses from these facilities were \$3.8 million, \$5.5 million and \$5.1 million in 2005, 2004 and 2003, respectively.

### LIFE, ANNUITY, DISABILITY AND ACCIDENT RESERVES

The Company carries as liabilities actuarially determined reserves for its life, annuity, disability and accident policy and contract obligations. These reserves, together with premiums to be received on policies in force and interest thereon at certain assumed rates, are calculated and established at levels believed to be sufficient to satisfy policy and contract obligations. The Company performs periodic studies to compare current experience for mortality, morbidity, interest and lapse rates with the experience reflected in the reserve assumptions to determine future policy benefit reserves for these products. Reserves for future policy benefits and unpaid claims and claim expenses are estimated based on individual loss data, historical loss data and industry averages and indices and include amounts determined on the basis of individual and actuarially determined estimates of future losses. Therefore, the ultimate liability could deviate from the amounts of the reserves currently reflected in the Consolidated Financial Statements. Under United States generally accepted accounting principles ("GAAP") these policy and claim reserves are permitted to be discounted to reflect the time value of money. Such reserve discounting, which is common industry practice, is based on interest rate assumptions reflecting projected portfolio yield rates for the assets supporting the liabilities. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates" and Note A to the Consolidated Financial Statements for certain additional information regarding reserve assumptions under GAAP. The assets selected to support these liabilities produce cash flows that are intended to match the timing and amount of anticipated claim and claim expense payments. Differences between actual and expected claims experience are reflected currently in earnings for each period. The Company does not believe it has experienced significant adverse deviations from its assumptions.

The life, annuity, disability and accident reserves carried in the Consolidated Financial Statements are calculated based on GAAP and differ from those reported by the Company for statutory financial statement purposes. These differences

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arise from, among other things, the use of different mortality and morbidity tables and interest assumptions, the introduction of lapse assumptions into the reserve calculation and the use of the net level method on all insurance business.

### PROPERTY AND CASUALTY INSURANCE RESERVES

The Company carries as liabilities actuarially determined reserves for anticipated claims and claim expenses for its excess workers' compensation insurance and other casualty and property insurance products. Reserves for claim expenses represent the estimated probable costs of investigating those claims and, when necessary, defending lawsuits in connection with those claims. Reserves for claims and claim expenses are estimated based on individual loss data, historical loss data and industry averages and indices and include amounts determined on the basis of individual and actuarially determined

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estimates of future losses. Therefore, the ultimate liability could deviate from the amounts of the reserves currently reflected in the Consolidated Financial Statements.

Reserving practices under GAAP allow discounting of claim reserves related to excess workers' compensation losses to reflect the time value of money. Reserve discounting for these types of claims is common industry practice, and the discount factors used are less than the annual tax-equivalent investment yield earned by the Company on its invested assets. The discount factors are based on the expected duration and payment pattern of the claims at the time the claims are settled and the risk-free rate of return for U.S. government securities with a comparable duration. Reserves for claim expenses are not discounted.

The following table provides a reconciliation of beginning and ending unpaid claims and claim expenses for the periods indicated:

	Year Ended December 31,		
	2005	2004	2003
(dollars in thousands)			
Unpaid claims and claim expenses, net of reinsurance,			
beginning of period .....	\$541,682	\$479,660	\$439,660
Add provision for claims and claim expenses incurred, net of reinsurance, occurring during:			
Current year .....	141,785	103,444	82,444
Prior years .....	56,698	30,868	20,868
Incurred claims and claim expenses, net of reinsurance, during the current year .....	198,483	134,312	102,444
Deduct claims and claim expenses paid, net of reinsurance, occurring during:			
Current year .....	14,853	8,120	5,120
Prior years .....	81,847	64,170	57,170
Total paid .....	96,700	72,290	62,290

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Unpaid claims and claim expenses, net of reinsurance, end of period .....	643,465	541,682	479,
Reinsurance receivables, end of period .....	103,014	104,266	93,
	-----	-----	-----
Unpaid claims and claim expenses, gross of reinsurance, end of period (1) .....	\$746,479	\$645,948	\$572,
	=====	=====	=====

(1) All years include the results from the Company's discontinued non-core property catastrophe reinsurance business. See "Other Transactions" and Note S to the Consolidated Financial Statements.

Provisions for claims and claim expenses incurred in prior years, as reflected in the above table, reflect the periodic accretion of the claims reserve amounts previously discounted with respect to the Company's excess workers' compensation line of business. During 2005, 2004 and 2003, \$21.1 million, \$18.1 million and \$21.5 million, respectively, of such discount was accreted. Accordingly, of the Company's provisions for prior years' claims and claim expenses incurred, net of reinsurance, in 2005, 2004 and 2003, \$35.6 million, \$12.8 million and \$(1.0) million, respectively, of such provisions were made based on new loss experience data that emerged during the respective years. In 2005, the additional provision arose primarily from adverse loss experience in the Company's excess workers' compensation line, principally due to moderately increased claim frequency, relative to prior periods, relating to policies written during the competitive market cycle years from 1997 to 2001. In 2004, the additional provision arose primarily from adverse loss experience in the Company's excess workers' compensation line, principally due to moderately increased claim frequency, relative to prior periods, relating to policies written during the competitive market cycle years from 1997 to 2000. These additional provisions did not in either year result from specific changes in the Company's key assumptions used to estimate the reserves since the preceding period end. Rather, in both years, they resulted from the Company's application of the same estimating processes it has historically utilized to emerging experience data, including premium, loss and expense information, and the impact of these factors on inception-to-date experience. In each period, the Company makes its best estimate of reserves based on all of the information available to it at that time, which necessarily takes into account new experience emerging during the period. See "Critical Accounting Policies and Estimates - Future Policy Benefits and Unpaid Claims and Claim Expenses" in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

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The effects of the amortization and accrual, as applicable, of discount to reflect the time value of money have been removed from the amounts set forth in the loss development table which follows in order to present the gross loss development, net of reinsurance. During 2005, 2004 and 2003, \$21.1 million, \$18.1 million and \$21.5 million, respectively, of previous years' discount was amortized, and \$77.5 million, \$64.9 million and \$44.9 million, respectively, of new discount was accrued.

The loss development table below illustrates the development of reserves from March 5, 1996 to December 31, 2005 and is net of reinsurance.

March 5,	-----	December 31,	-----
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	1996(1)	1996	1997	1998	1999	2000
	-----	-----	-----	-----	-----	-----
	(dollars in thousands)					
Reserve for unpaid claims and claim expenses, net of reinsurance .....	\$520,370	\$532,923	\$541,280	\$422,159	\$434,513	\$ 444,061
Cumulative amount of liability paid:						
One year later .....	23,467	28,162	98,365	40,815	40,660	(29,990) (2)
Two years later ....	50,713	125,020	127,481	74,571	4,020 (2)	26,398
Three years later ..	140,943	152,842	156,119	33,429 (2)	54,846	71,938
Four years later ...	167,811	179,705	111,253 (2)	78,981	94,899	123,330
Five years later ...	193,363	133,228 (2)	150,772	114,295	139,949	178,852
Six years later ....	153,504 (2)	170,405	182,281	154,101	187,952	
Seven years later ..	188,719	197,318	217,649	196,599		
Eight years later ..	214,715	230,278	256,444			
Nine years later ...	246,714	266,087				
Ten years later ....	280,181					
Liability reestimated as of:						
One year later .....	507,375	513,402	523,430	410,875	424,187	442,624
Two years later ....	487,830	500,964	511,602	404,559	420,420	442,807
Three years later ..	476,854	488,432	503,906	401,475	417,869	446,948
Four years later ...	476,600	487,195	500,514	396,403	423,426	502,140
Five years later ...	476,890	478,206	492,280	399,311	466,975	568,993
Six years later ....	470,283	468,142	493,586	437,913	522,592	
Seven years later ..	460,670	472,492	531,603	488,849		
Eight years later ..	463,015	507,670	580,714			
Nine years later ...	501,208	554,029				
Ten years later ....	546,203					
Cumulative deficiency(3) .....	\$ (25,833)	\$ (21,106)	\$ (39,434)	\$ (66,690)	\$ (88,079)	\$ (124,932)

December 31,

	2001	2002	2003	2004	2005
	-----	-----	-----	-----	-----
	(dollars in thousands)				
Reserve for unpaid claims and claim expenses, net of reinsurance .....	\$ 638,191	\$ 680,835	\$744,760	\$853,515	\$1,011,699
Cumulative amount of liability paid:					
One year later .....	61,954	57,235	64,170	81,847	
Two years later ....	112,639	118,685	134,981		
Three years later ..	169,890	187,303			
Four years later ...	231,870				
Five years later ...					
Six years later ....					
Seven years later ..					
Eight years later ..					
Nine years later ...					
Ten years later ....					
Liability reestimated					



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as of:

One year later .....	636,125	678,535	766,886	908,162
Two years later ....	634,578	714,303	838,458	
Three years later ..	678,009	790,941		
Four years later ...	754,717			
Five years later ...				
Six years later ....				
Seven years later ..				
Eight years later ..				
Nine years later ...				
Ten years later ....				

Cumulative

deficiency(3) .....	\$ (116,526)	\$ (110,106)	\$ (93,698)	\$ (54,647)
---------------------	--------------	--------------	-------------	-------------

- (1) Amounts are as of or for the periods subsequent to March 5, 1996, the date the Company acquired its workers' compensation business.
- (2) The cumulative amount of liability paid through December 31, 2001 reflects the Company's receipt of \$74.3 million related to the commutation of the reinsurance agreements with Oracle Reinsurance Company Ltd. in 2001. See "Other Transactions."
- (3) Full years 2000 through 2005 include the results from the Company's discontinued non-core property catastrophe reinsurance business. See "Other Transactions" and Note S to the Consolidated Financial Statements.

The "Reserve for unpaid claims and claim expenses, net of reinsurance" line in the table above shows the estimated reserve for unpaid claims and claim expenses recorded at the end of each of the periods indicated. These net liabilities represent the estimated amount of losses and expenses for claims arising in the current year and all prior years that are unpaid at the end of each period. The "Cumulative amount of liability paid" lines of the table represent the cumulative amounts paid with respect to the liability previously recorded as of the end of each succeeding period. The "Liability reestimated" lines of the table show the reestimated amount relating to the previously recorded liability and is based upon experience as of the end of each succeeding period. This estimate is either increased or decreased as additional information about the frequency and severity of claims for each succeeding period becomes available and is reviewed. The Company periodically reviews the estimated reserves for claims and claim expenses and any changes are reflected currently in earnings for each period. See "Critical Accounting Policies and Estimates - Future Policy Benefits and Unpaid Claims and Claim Expenses" in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations. The "Cumulative deficiency" line in the table represents the aggregate change in the net estimated claim reserve liabilities from the dates indicated through December 31, 2005.

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The table below is gross of reinsurance and illustrates the effects of the discount to reflect the time value of money that was removed from the amounts set forth in the loss development table above.

	December 31,				
March 5, 1996(1)	-----	-----	-----	-----	-----
	1996	1997	1998	1999	2000

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	(dollars in thousands)					
Reserve for unpaid claims and claim expenses before discount:						
Net of reinsurance .....	\$ 520,370	\$ 532,923	\$ 541,280	\$ 422,159	\$ 434,513	\$ 444,061
Add reinsurance recoverable .....	13,501	16,730	23,454	164,825	179,180	206,704
Deduct discount for time value of money .....	164,000	168,827	176,683	180,770	192,220	203,710
Unpaid claims and claim expenses as reported on balance sheets .....	369,871	380,826	388,051	406,214	421,473	447,055
Reestimated unpaid claims and claim expenses, gross of reinsurance, net of discount, as of December 31, 2005 .....	517,185	517,228	537,083	563,654	610,573	671,031
Discounted cumulative deficiency, gross of reinsurance .....	(147,314)	(136,402)	(149,032)	(157,440)	(189,100)	(223,976)
Add accretion of discount and change in reinsurance recoverable .....	121,481	115,296	109,598	90,750	101,021	99,044
Cumulative deficiency, before discount, net of reinsurance (2) .....	\$ (25,833)	\$ (21,106)	\$ (39,434)	\$ (66,690)	\$ (88,079)	\$ (124,932)

December 31,

	2001	2002	2003	2004	2005
	(dollars in thousands)				
Reserve for unpaid claims and claim expenses before discount:					
Net of reinsurance .....	\$ 638,191	\$ 680,835	\$ 744,760	\$853,515	1,011,699
Add reinsurance recoverable .....	92,828	95,709	93,030	104,266	103,014
Deduct discount for time value of money .....	224,241	241,688	265,100	311,833	368,234
Unpaid claims and claim expenses as reported on balance sheets .....	506,778	534,856	572,690	645,948	746,479
Reestimated unpaid claims and claim expenses, gross of reinsurance, net of discount, as of December 31, 2005 .....	722,741	722,539	708,690	714,843	

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Discounted cumulative deficiency, gross of reinsurance .....	(215,963)	(187,683)	(136,000)	(68,895)
 Add accretion of discount and change in reinsurance recoverable .....	 99,437	 77,577	 42,302	 14,248
	-----	-----	-----	-----
 Cumulative deficiency, before discount, net of reinsurance (2) .....	 \$(116,526)	 \$(110,106)	 \$ (93,698)	 \$(54,647)
	=====	=====	=====	=====

- (1) Amounts are as of or for the periods subsequent to March 5, 1996, the date the Company acquired its workers' compensation business.
- (2) Full years 2000 through 2005 include the results from the Company's discontinued non-core property catastrophe reinsurance business. See "Other Transactions" and Note S to the Consolidated Financial Statements.

The excess workers' compensation insurance reserves carried in the Consolidated Financial Statements are calculated in accordance with GAAP and, net of reinsurance, are approximately \$162.0 million less than those reported by the Company for statutory financial statement purposes at December 31, 2005. This difference is primarily due to the use of different discount factors between GAAP and statutory accounting principles and differences in the bases against which such discount factors are applied. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates - Future Policy Benefits and Unpaid Claims and Claim Expenses" and Note A to the Consolidated Financial Statements for certain additional information regarding reserve assumptions under GAAP.

### COMPETITION

The financial services industry is highly competitive. The Company competes with numerous other insurance and financial services companies both in connection with sales of insurance and asset accumulation products and integrated disability and absence management services and in acquiring blocks of business and companies. Many of these organizations have substantially greater asset bases, higher ratings from ratings agencies, larger and more diversified portfolios of insurance products and larger sales operations. Competition in asset accumulation product markets is also encountered from banks, securities brokerage firms and other financial intermediaries marketing alternative savings products, such as mutual funds, traditional bank investments and retirement funding alternatives.

The Company believes that its reputation in the marketplace, quality of service, unique programs which integrate employee benefit products and absence management services and investment returns have enabled it to compete effectively for new business in its targeted markets. The Company reacts to changes in the marketplace generally by focusing on products with adequate margins and attempting to avoid those with low margins. The Company believes that its smaller size, relative to some of its competitors, enables it to more easily tailor its products to the demands of customers.

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### REGULATION

The Company's insurance subsidiaries are regulated by state insurance authorities in the states in which they are domiciled and the states in which they conduct business. These regulations, among other things, limit the amount of dividends and other payments that can be made by the Company's insurance subsidiaries without prior regulatory approval and impose restrictions on the amount and type of investments these subsidiaries may have. These regulations also affect many other aspects of the Company's insurance subsidiaries' business, including, for example, risk-based capital ("RBC") requirements, various reserve requirements, the terms, conditions and manner of sale and marketing of insurance products and the form and content of required financial statements. These regulations are intended to protect policyholders rather than investors. The Company's insurance subsidiaries are required under these regulations to file detailed annual financial reports with the supervisory agencies in the various states in which they do business, and their business and accounts are subject to examination at any time by these agencies. To date, no examinations have produced any significant adverse findings or adjustments. The ability of the Company's insurance subsidiaries to continue to conduct their businesses is dependent upon the maintenance of their licenses in these various states.

In April 2004, the New York State Attorney General ("NYAG") initiated an investigation into certain insurance broker compensation arrangements and other aspects of dealings between insurance brokers and insurance companies, and, in connection therewith, filed a civil complaint in October 2004 against a major insurance brokerage firm, Marsh & McLennan, based on certain of such firm's compensation arrangements with insurers and alleged misconduct in connection with the placement of insurance business. Other state regulators subsequently announced the commencement of similar investigations and reviews. As previously disclosed, the Company has received administrative subpoenas or similar requests for information from the Illinois Division of Insurance, the Missouri Department of Insurance, the NYAG's office and the North Carolina Department of Insurance in connection with their investigations. The Company anticipates that additional regulatory inquiries may be received by its insurance subsidiaries as the various investigations continue. The Company has fully cooperated with inquiries it has received to date, and it intends to fully cooperate with any future inquiries of this type.

As also previously disclosed, based on an internal review in 2004 relating to the Company's insurance subsidiaries, the Company had identified certain potential issues concerning past insurance solicitation practices involving SNCC and Marsh & McLennan. The instances that the Company was able to specifically identify in this regard were limited in number and involved modest amounts of premium. The Company reported on these issues to the NYAG's office and to the Missouri Department of Insurance. In 2005, SNCC was the subject of a targeted market conduct examination by the Missouri Department of Insurance relating to these issues, which did not result in any significant adverse findings. The Company will fully cooperate with these and any other regulatory agencies relating to these issues. It is not possible to predict the future impact of this matter on the Company or of the various investigations, or any regulatory changes or litigation resulting from such investigations, on the insurance industry or on the Company and its insurance subsidiaries.

From time to time, increased scrutiny has been placed upon the insurance regulatory framework, and a number of state legislatures have considered or enacted legislative measures that alter, and in many cases increase, state authority to regulate insurance companies. In addition to legislative initiatives of this type, the National Association of Insurance Commissioners (the "NAIC") and insurance regulators are continuously involved in a process of reexamining existing laws and regulations and their application to insurance

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companies. Furthermore, while the federal government currently does not directly regulate the insurance business, federal legislation and administrative policies in a number of areas, such as employee benefits regulation, age, sex and disability-based discrimination, financial services regulation and federal taxation, can significantly affect the insurance business. It is not possible to predict the future impact of changing regulation on the operations of the Company and its insurance subsidiaries.

The NAIC's RBC requirements for insurance companies take into account asset risks, insurance risks, interest rate risks and other relevant risks with respect to the insurer's business and specify varying degrees of regulatory action to occur to the extent that an insurer does not meet the specified RBC thresholds, with increasing degrees of regulatory scrutiny or intervention provided for companies in categories of lesser RBC compliance. The Company believes that its insurance subsidiaries are adequately capitalized under the RBC requirements and that the thresholds will not have any significant regulatory effect on the Company. However, were the insurance subsidiaries' RBC position to materially decline in the future, the insurance subsidiaries' continued ability to pay dividends and the degree of regulatory supervision or control to which they are subjected may be affected.

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The Company's insurance subsidiaries can also be required, under solvency or guaranty laws of most states in which they do business, to pay assessments to fund policyholder losses or liabilities of insurance companies that become insolvent. These assessments may be deferred or forgiven under most solvency or guaranty laws if they would threaten an insurer's financial strength and, in most instances, may be offset against future state premium taxes. SNCC did not recognize any expense in 2005 and recognized expense of \$0.8 million and \$1.6 million in 2004 and 2003, respectively, for these types of assessments. None of the Company's life insurance subsidiaries has ever incurred any significant costs of this nature.

### EMPLOYEES

The Company and its subsidiaries employed approximately 1,170 persons at December 31, 2005. The Company believes that it enjoys good relations with its employees.

### OTHER SUBSIDIARIES

The Company conducts certain of its investment management activities through its wholly-owned subsidiary, Delphi Capital Management, Inc. ("DCM"), and makes certain investments through other wholly-owned non-insurance subsidiaries.

### OTHER TRANSACTIONS

During 1998, the Company entered into various reinsurance agreements with Oracle Reinsurance Company Ltd. ("Oracle Re"), a wholly owned subsidiary of Delphi International Ltd. ("Delphi International"), an independent Bermuda insurance holding company. In October 2001, Oracle Re and the Company effected the commutation of these reinsurance agreements, pursuant to which Oracle Re paid approximately \$84.0 million to the Company (net of \$11.5 million which had been held by the Company) related to the reserves ceded to Oracle Re under such agreements. These transactions did not have a material impact on the Company's consolidated financial position, liquidity or net income. In furtherance of the commutation of the reinsurance agreements, the Company agreed to waive a portion of the amounts due to the Company under certain subordinated notes issued by

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Delphi International. As a result of this waiver, the Company recognized a pre-tax loss of \$7.5 million in 2001 for the other than temporary decline in the value of these notes. In March 2002, Delphi International repaid the adjusted amounts due under the subordinated notes and the Company did not realize any significant additional loss in connection with such repayment.

In the fourth quarter of 2000, the Company liquidated a substantial majority of the investments of its investment subsidiaries. The proceeds from these sales were used in 2001 to repay \$150.0 million of outstanding borrowings under its revolving credit facilities, to repurchase \$64.0 million liquidation amount of the Capital Securities of its subsidiary, Delphi Funding L.L.C. (the "Capital Securities"), and to repurchase \$8.0 million principal amount of its 8% Senior Notes which matured in October 2003 (the "Matured Senior Notes").

In May 2003, the Company issued \$143.8 million in principal amount of 8.00% Senior Notes due 2033 (the "2033 Senior Notes") in a public offering. The proceeds from the 2033 Senior Notes were used to repay the outstanding borrowings under the Company's revolving credit facility and to repay in full the principal amount of \$66.5 million of the Matured Senior Notes. The 2033 Senior Notes, which were issued at par value, will mature on May 15, 2033 and are redeemable at par at the option of the Company, in whole or in part, at any time on or after May 15, 2008. The 2033 Senior Notes are not redeemable at the option of any holder of the notes prior to maturity nor are they entitled to any sinking fund redemptions. Interest on the 2033 Senior Notes is payable quarterly on February 15, May 15, August 15 and November 15 of each year. The 2033 Senior Notes are senior unsecured obligations of the Company and, as such, are effectively subordinated to all claims of secured creditors of the Company and its subsidiaries and to claims of unsecured creditors of the Company's subsidiaries, including the insurance subsidiaries' obligations to policyholders. As a result of the issuance of the 2033 Senior Notes, under the terms of the Company's previous revolving credit facility, the maximum amount of borrowings available to the Company thereunder was reduced from \$150 million to \$100 million and the facility was converted to an unsecured facility, with collateral being released to the Company. The 2033 Senior Notes were issued in denominations of \$25 and multiples of \$25 and are listed on the New York Stock Exchange. See Note D to the Consolidated Financial Statements.

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In May 2003, Delphi Financial Statutory Trust I (the "Trust"), a subsidiary of the Company, issued \$20.0 million liquidation amount of Floating Rate Capital Securities (the "2003 Capital Securities") in a private placement. In connection with the issuance of the 2003 Capital Securities and the related purchase by the Company of all of the common securities of the Trust (the "2003 Common Securities" and, collectively with the 2003 Capital Securities, the "Trust Securities"), the Company issued \$20.6 million principal amount of floating rate junior subordinated deferrable interest debentures, due 2033 (the "2003 Junior Debentures"). Interest on the 2003 Junior Debentures is payable quarterly on February 15, May 15, August 15 and November 15 of each year. The interest rate on the 2003 Junior Debentures resets quarterly to a rate equal to the London interbank offered interest rate ("LIBOR") for three-month U.S. dollar deposits, plus 4.10% (not to exceed 12.50%). The weighted average interest rate on the outstanding advances was 7.40%, 5.56% and 5.31% for the years ended December 31, 2005, 2004 and 2003, respectively. The distribution and other payment dates on the Trust Securities correspond to the interest and other payment dates on the 2003 Junior Debentures. The 2003 Junior Debentures are unsecured and subordinated in right of payment to all of the Company's existing and future senior indebtedness. Beginning in May 2008, the Company will have the right to redeem the 2003 Junior Debentures, in whole or in part,

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at a price equal to 100% of the principal amount of the debentures, plus accrued and unpaid interest to the date of redemption.

In May 2005, the Company entered into a new \$200 million revolving credit facility with Bank of America, N.A. as administrative agent, and a group of major banking institutions (the "Credit Agreement"), which replaced the existing \$100 million revolving credit facility scheduled to expire in December 2006. The Company had outstanding borrowings of \$91.0 million under the Credit Agreement at December 31, 2005 and \$14.0 million of outstanding borrowings under the previous revolving credit facility at December 31, 2004. Interest on borrowings under the Credit Agreement is payable, at the Company's election, either at a floating rate based on LIBOR plus a specified margin which varies depending on the level of the specified ratings of the Company's senior unsecured debt, as in effect from time to time, or at Bank of America's prime rate. Certain commitment and utilization fees are also payable under the Credit Agreement. The Credit Agreement contains certain financial and various other affirmative and negative covenants considered ordinary for this type of credit agreement. They include, among others, the maintenance of a specified debt to capital ratio, minimum consolidated net worth of the Company, minimum risk-based capital requirements for the Company's insurance subsidiaries, RSLIC and SNCC, and certain limitations on investments and subsidiary indebtedness. As of December 31, 2005, the Company was in compliance in all material respects with the financial and various other affirmative and negative covenants in the Credit Agreement. The maturity date of the Credit Agreement is May 26, 2010.

During the fourth quarter of 2005, the Company decided to exit its non-core property catastrophe reinsurance business, due to the volatility associated with such business and other strategic considerations, and has not thereafter entered into or renewed any assumed property reinsurance contracts. The Company has classified the operating results of this business as discontinued operations. See Note S to the Consolidated Financial Statements. A substantial majority of these reinsurance contracts expired on or before December 31, 2005 and all of the remaining contracts will expire prior to the end of the third quarter of 2006. Although the Company will continue to collect modest amounts of premium and pay losses under the terms of the remaining contracts until their expiration, these amounts are not expected to be material to the Company's results of operations. For the years ended December 31, 2005, 2004 and 2003, the Company recognized premium income of \$17.4 million, \$9.5 million, and \$7.5 million, respectively, and incurred losses of \$37.9 million, \$4.7 million, and \$0.3 million, respectively, from this line of business. For the years ended December 31, 2005, 2004 and 2003, the Company recognized operating (loss) income of \$(13.4) million, \$2.1 million, and \$3.6 million, respectively, net of income tax (benefit) expense of \$(7.2) million, \$1.2 million, and \$2.0 million, respectively, from this business. The assets and liabilities related to the property catastrophe reinsurance business were not material to the Company's consolidated financial position.

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### ITEM 1A. RISK FACTORS.

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

The Company's reserves for future policy benefits and unpaid claims and claim expenses are estimates. See "Critical Accounting Policies and Estimates - Future Policy Benefits and Unpaid Claims and Claim Expenses." in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations for a description of the most significant assumptions used in the estimation process.

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

### THE MARKET VALUES OF THE COMPANY'S INVESTMENTS FLUCTUATE.

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

Declines in the fair value of investments that are considered in the judgment of management to be other than temporary are reported as realized investment losses. See "Critical Accounting Policies and Estimates - Investments." in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, for a description of management's evaluation process. The Company has experienced and may in the future experience losses from other than temporary declines in security values. Such losses are recorded as realized investment losses in the income statement. See "Results of Operations - 2005 Compared to 2004" in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations. In addition, the Company invests in certain limited partnerships and limited liability companies that invest in various financial instruments. These investments are reflected in the Company's financial statements under the equity method; accordingly, positive or negative changes in the value of the investees' financial instruments are included in net investment income. Thus, the Company's results of operations, in addition to its liquidity and financial condition, could be materially adversely affected if these entities were to experience significant losses in the values of their financial assets.

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

The management of the Company's investment portfolio is an important component of the Company's profitability since a substantial portion of the Company's operating income is generated from the difference between the yield achieved on invested assets and, in the case of asset accumulation products, the interest credited on policyholder funds and, in the case of the Company's other products for which reserves are discounted, the discount rate used to calculate the related reserves. See "Liquidity and Capital Resources - Investments." in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, for a description of the Company's investment portfolio and



strategy.

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

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

Because the Company's primary assets and liabilities are financial in nature, the Company's consolidated financial position and earnings are subject to risks resulting from changes in interest rates. The Company manages this risk by active portfolio management focusing on minimizing its exposure to fluctuations in interest rates by matching its invested assets and related liabilities and by periodically adjusting the crediting rates on its annuity products. See "Liquidity and Capital Resources - Asset/Liability Management and Market Risk." in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations. Profitability of certain group employee benefit products is also affected by the difference between the yield achieved on invested assets and the discount rate used to calculate the related reserves. The Company manages this risk by seeking to adjust the prices charged for these products.

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

The Company transfers its exposure to some risks through reinsurance arrangements with other insurance and reinsurance companies. Under the Company's reinsurance arrangements, another insurer assumes a specified portion of the Company's losses and loss adjustment expenses in exchange for a specified portion of policy premiums. At December 31, 2005 and 2004, the Company had reinsurance receivables of \$413.1 million and \$428.7 million, respectively. The availability, amount, cost and terms of reinsurance may vary significantly based on market conditions. Any decrease in the amount of the Company's reinsurance will increase the Company's risk of loss and any increase in the cost of reinsurance will, absent a decrease in the reinsurance amount, reduce the Company's premium income. In either case, the Company's operating results could be adversely affected unless it is able to accordingly adjust the prices or other terms of its insurance policies or successfully implement other operational initiatives, as to which no assurance can be given. Furthermore, the Company is subject to credit risk with respect to reinsurance. The Company obtains reinsurance primarily through indemnity reinsurance transactions in which the Company is still liable for the transferred risks if the reinsurers fail to meet their financial obligations. Such failures could materially affect the Company's results of operations, liquidity or financial condition.

Some reinsurers experienced significant losses related to the terrorist events of September 11, 2001. As a result of this and other market factors, higher prices and less favorable terms and conditions continue to be offered in the reinsurance market. These market conditions are reflected in the terms of the replacement reinsurance arrangements entered into during 2003 and remaining in

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effect for the Company's excess workers' compensation and long-term disability products. See "Liquidity and Capital Resources - Reinsurance." in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations. In the future, the Company's reinsurers may continue to seek price increases, although the extent of any such increases cannot currently be predicted. Also, there has been significantly reduced availability of reinsurance covering risks such as terrorist and catastrophic events. Accordingly, substantially all of the Company's coverages of this nature were discontinued during 2002, which would result in the Company retaining a higher portion of losses from such events if they occur. The Company has not been able to replace such coverages on acceptable terms due to present market conditions, and there can be no assurance that the Company will be able to do so in the future. However, under the Terrorism Act, which terminates on December 31, 2007, the federal government will pay 90% of the Company's covered losses during 2006 and 85% of the Company's covered losses during 2007, relating to acts of international terrorism from property and casualty products directly written by SNCC above the Company's annual deductible. See "Business - Group Employee Benefit Products." The occurrence of a significant catastrophic event could have a material adverse effect on the Company's results of operations, liquidity or financial condition.

### THE INSURANCE BUSINESS IS A HEAVILY REGULATED INDUSTRY.

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

In April 2004, the New York Attorney General ("NYAG") initiated an investigation into certain insurance broker compensation arrangements and other aspects of dealings between insurance brokers and insurance companies, and, in connection therewith, filed a civil complaint in October 2004 against a major insurance brokerage firm based on certain of such firm's compensation arrangements with insurers and alleged misconduct in connection with the placement of

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insurance business. Other state regulators subsequently announced the commencement of similar investigations and reviews. The Company has received administrative subpoenas or similar requests for information from the Illinois Division of Insurance, the Missouri Department of Insurance, the NYAG's office and the North Carolina Department of Insurance in connection with their investigations. The Company anticipates that additional regulatory inquiries may be received by its insurance subsidiaries as the various investigations continue. The Company has fully cooperated with inquiries it has received to date, and it intends to fully cooperate with any future inquiries of this type.

As also previously disclosed, based on an internal review in 2004 relating to the Company's insurance subsidiaries, the Company had identified certain

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potential issues concerning past insurance solicitation practices involving SNCC and Marsh & McLennan. The instances that the Company was able to specifically identify in this regard were limited in number and involved modest amounts of premium. The Company reported on these issues to the NYAG's office and to the Missouri Department of Insurance. In 2005, SNCC was the subject of a targeted market conduct examination by the Missouri Department of Insurance relating to these issues, which did not result in any significant adverse findings. The Company will fully cooperate with these and any other regulatory agencies relating to these issues. It is not possible to predict the future impact of this matter on the Company or of the various investigations, or any regulatory changes or litigation resulting from such investigations, on the insurance industry or on the Company and its insurance subsidiaries.

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

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

### THE FINANCIAL SERVICES INDUSTRY IS HIGHLY COMPETITIVE.

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

### THE COMPANY MAY BE ADVERSELY IMPACTED BY A DECLINE IN THE RATINGS OF ITS INSURANCE SUBSIDIARIES OR ITS OWN CREDIT RATINGS.

Ratings with respect to claims-paying ability and financial strength have become an increasingly important factor impacting the competitive position of insurance companies. The financial strength ratings of RSLIC as of February 2006 as assigned by A.M. Best, Fitch, Moody's and Standard & Poor's were A (Excellent), A (Strong), A3 (Good) and A (Strong), respectively. The financial strength ratings of SNCC as of February 2006 as assigned by A.M. Best, Fitch and Standard & Poor's were A (Excellent), A (Strong) and A (Strong), respectively. Each of the rating agencies reviews its ratings of companies periodically and there can be no assurance that current ratings will be maintained or improved in the future. Claims-paying and financial strength ratings are based upon factors relevant to policyholders and are not directed toward protection of investors. Downgrades in the ratings of the Company's insurance subsidiaries could adversely affect sales of their products and could have a material adverse effect on the results of the Company's operations. In addition, downgrades in the Company's credit ratings could materially adversely affect its ability to

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access the capital markets. The Company's senior unsecured debt ratings as of February 2006 from A.M. Best, Fitch, Moody's and Standard & Poor's were bbb, BBB, Baa3 and BBB, respectively.

ALMOST HALF OF THE VOTING POWER OF DELPHI IS CONTROLLED BY ROBERT ROSENKRANZ, WHOSE INTERESTS MAY DIFFER FROM THOSE OF OTHER SECURITYHOLDERS.

Each share of our Class A Common Stock entitles the holder to one vote and each share of our Class B Common Stock entitles the holder to a number of votes per share equal to the lesser of (1) the number of votes such that the aggregate of all outstanding shares of Class B Common Stock will be entitled to cast 49.9% of all of the votes represented by the aggregate of all outstanding shares of Class A Common Stock and Class B Common Stock or (2) ten votes. Each share of

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Class B Common Stock is convertible at any time into one share of Class A Common Stock. The holders of the Class A Common Stock vote as a separate class to elect one director of the Company. As of March 1, 2006, Mr. Robert Rosenkranz, our Chairman, President and Chief Executive Officer, by means of beneficial ownership of the general partner of Rosenkranz & Company and direct or beneficial ownership, had the power to vote all of the outstanding shares of Class B Common Stock, which as of such date represented 49.9% of the aggregate voting power of the Common Stock. Holders of a majority of the combined voting power of our stockholders have the power to elect all of the members of our Board of Directors (other than the director elected by the holders of Class A Common Stock) and to determine the outcome of fundamental corporate transactions, including mergers and acquisitions, consolidations and sales of all or substantially all of our assets. We are a party to consulting and other agreements with certain affiliates of Mr. Rosenkranz which are expected to continue in accordance with their terms.

### ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

### ITEM 2. PROPERTIES

The Company leases its principal executive office at 1105 North Market Street, Suite 1230, Wilmington, Delaware under an operating lease expiring in October 2009. RSLIC leases its administrative office at 2001 Market Street, Suite 1500, Philadelphia, Pennsylvania, under an operating lease expiring in December 2015. SNCC owns its home office building at 2043 Woodland Parkway, Suite 200, St. Louis, Missouri, which consists of approximately 58,000 square feet. SNCC also owns a neighboring office building located at 2029 Woodland Parkway, St. Louis, Missouri. The building consists of approximately 17,000 square feet and is largely occupied by SNCC with a small portion leased to third parties. During 2005, SNCC bought land with the intended use for construction of a new home office. It is located at 1832 Schuetz Road, St. Louis, Missouri. During 2005, DCM and FRSLIC relocated their offices to the 29th and 30th floors of 590 Madison Avenue, New York, New York and are under an operating lease expiring in November 2010. A substantial portion of the former office space that DCM and FRSLIC leased at 153 East 53rd Street, 49th Floor, New York, New York, which is under an operating lease expiring in July 2008, has been sublet to third parties. Matrix leases its principal office at 5225 Hellyer Avenue, Suite 210, San Jose, California under an operating lease expiring in December 2010. The Company also maintains sales and administrative offices throughout the country to provide nationwide sales support and service existing business.

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### ITEM 3. LEGAL PROCEEDINGS

In the course of its business, the Company is a party to litigation and other proceedings, primarily involving its insurance operations. In some cases, these proceedings entail claims against the Company for punitive damages and similar types of relief. The ultimate disposition of such pending litigation and proceedings is not expected to have a material adverse effect on the Company's financial position. In addition, incident to its discontinued products, the Company has been and is currently a party to various arbitrations arising out of accident and health reinsurance arrangements in which it and other companies formerly were participating reinsurers. During the second quarter of 2004, the Company, along with other former participants, reached a settlement resolving the matters in dispute in one of these arbitrations, and a favorable determination in another such arbitration was rendered during the third quarter of 2005. The Company increased its reserves related to the reinsurance business in dispute in the settled arbitration by a total of \$5.5 million during the year ended December 31, 2004. The Company believes that it has substantial defenses upon which to contest the claims made in the remaining arbitration, although it is not possible to predict its ultimate outcome. In the opinion of management, such arbitration, when ultimately resolved, will not have an adverse effect on the Company's financial position.

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### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Executive Officers of the Company

The table below presents certain information concerning each of the executive officers of the Company:

Name	Age	Position
----	---	-----
Robert Rosenkranz	63	Director of the Company; Chairman of the Board, President and Chief Executive Officer of the Company; Chairman of the Board of RSLIC
Robert M. Smith, Jr.	54	Director and Executive Vice President of the Company
Chad W. Coulter	43	Vice President, Secretary and General Counsel of the Company; Vice President, General Counsel and Assistant Secretary of RSLIC
Thomas W. Burghart	47	Vice President and Treasurer of the Company and RSLIC
Lawrence E. Daurelle	54	Director of the Company and President and Chief Executive Officer of RSLIC
Harold F. Ilg	58	Director of the Company and Chairman of the Board of SNCC

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Mr. Rosenkranz has served as the President and Chief Executive Officer of the Company since May 1987 and has served as Chairman of the Board of Directors of the Company since April 1989. He also serves as Chairman of the Board or as a Director of the Company's principal subsidiaries. Mr. Rosenkranz, by means of beneficial ownership of the general partner of Rosenkranz & Company and direct or beneficial ownership, has the power to vote all of the outstanding shares of Class B Common Stock, which represent 49.9% of the aggregate voting power of the Company's common stock as of March 1, 2006.

Mr. Smith has served as Executive Vice President of the Company and DCM since November 1999 and as a Director of the Company since January 1995. He has also served as the Chief Investment Officer of RSLIC and FRSLIC since April 2001. From July 1994 to November 1999, he served as Vice President of the Company and DCM. Mr. Smith also serves as a Director of the Company's principal subsidiaries.

Mr. Coulter has served as Vice President and General Counsel of the Company and as Vice President, General Counsel and Assistant Secretary of RSLIC, FRSLIC and RSLIC-Texas since January 1998, and has served as Secretary of the Company since May 2003. He also served for RSLIC in similar capacities from February 1994 to August 1997, and in various capacities from January 1991 to February 1994. From August 1997 to December 1997, Mr. Coulter was Vice President and General Counsel of National Life of Vermont.

Mr. Burghart has served as Vice President and Treasurer of the Company since April 2001 and as Vice President and Treasurer of RSLIC, FRSLIC and RSLIC-Texas since October 2000. From March 1992 to September 2000, he served as the Second Vice President, Actuarial Statements, of RSLIC.

Mr. Daurelle has served as a Director of the Company since August 2002. He also has served as President and Chief Executive Officer of RSLIC, FRSLIC and RSLIC-Texas since October 2000. He served as Vice President and Treasurer of the Company from August 1998 to April 2001. He also serves on the Board of Directors of RSLIC, FRSLIC and RSLIC-Texas. From May 1995 to October 2000, Mr. Daurelle was Vice President and Treasurer of RSLIC, FRSLIC and RSLIC-Texas.

Mr. Ilg has served as a Director of the Company since August 2002. He also has served as Chairman of the Board of SNCC since January 1999, as well as the President and a Director of Safety National Re since 1997. He serves on the Board of Directors of RSLIC, FRSLIC and RSLIC-Texas. From April 1999 until October 2000, he served as President and Chief Executive Officer of RSLIC, FRSLIC, and RSLIC-Texas. Prior to January 1999, he served as Vice Chairman of the Board of SNCC, where he has been employed in various capacities since 1978.

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### PART II

#### ITEM 5. MARKET FOR THE COMPANY'S COMMON STOCK AND RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The closing price of the Company's Class A Common Stock was \$52.20 on March 1, 2006. There were approximately 3,900 holders of record of the Company's Class A Common Stock as of March 1, 2006.

The Company's Class A Common Stock is listed on the New York Stock Exchange under the symbol DFG. The following table sets forth the high and low sales prices for the Company's Class A Common Stock and the cash dividends paid per share for the Company's Class A and Class B Common Stock.

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	High	Low	Dividends
	-----	-----	-----
2004: First Quarter	\$42.30	\$35.99	\$0.08
Second Quarter	44.53	36.29	0.08
Third Quarter	44.85	38.82	0.08
Fourth Quarter	47.60	37.66	0.08
2005: First Quarter	\$47.10	\$40.63	\$0.09
Second Quarter	44.90	39.05	0.09
Third Quarter	49.48	43.95	0.09
Fourth Quarter	49.06	42.98	0.09

In 2001, the Company's Board of Directors approved the initiation of a quarterly cash dividend payable on the Company's Class A Common Stock and Class B Common Stock. The quarterly cash dividend was \$0.08 per share during 2004. In the first quarter of 2005, the Company's Board of Directors increased the cash dividend by 12.5% to \$0.09 per share. In the first quarter of 2006, the cash dividend declared by the Company's Board of Directors was increased by 11.1% to \$0.10 per share, and was paid on the Company's Class A Common Stock and Class B Common Stock on March 8, 2006. The Company intends to continue to pay a quarterly dividend at this level. However, the declaration and payment of such dividends, including the amount and frequency of such dividends, is at the discretion of the Board and depends upon many factors, including the Company's consolidated financial position, liquidity requirements, operating results and such other factors as the Board may deem relevant. Cash dividend payments are permitted under the respective terms of the Company's \$200.0 million revolving credit facility and the 2033 Senior Notes.

In addition, dividend payments by the Company's insurance subsidiaries to the Company are subject to certain regulatory restrictions. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" and "Business - Regulation."

The following table shows the purchases of equity securities under the Company's existing repurchase program during the three months ended December 31, 2005:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (2)
	-----	-----	-----	-----
October 1 - 31, 2005	--	--	--	--
November 1 - 30, 2005	15,000	\$47.60	15,000	1,078,050
December 1 - 31, 2005	135,000	\$47.15	135,000	943,050
	-----		-----	
Total	150,000	\$47.19	150,000	943,050
	=====		=====	

(1) As of December 31, 2005, the Company had purchased 2,710,035 shares, at a total cost of \$66.4 million in the open market. In addition, during 2004,

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the Company received 13,176 shares of the Company's Class A Common Stock with an aggregate value of \$0.3 million in liquidation of a partnership interest, which increased the total number of shares of treasury stock outstanding to 2,723,211, as of December 31, 2005.

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- (2) On August 31, 1998, the Company's Board of Directors authorized the purchase of 1,591,812 outstanding shares of the Company's Class A Common Stock from time to time on the open market. In August 1999 and February 2001, the Board of Directors increased the number of outstanding shares authorized for repurchase by 1,530,000 and 531,273, respectively. The program has no expiration date.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes.

	Year Ended December 31,				
	2005	2004	2003	2002	
(dollars and shares in thousands, except per share)					
INCOME STATEMENT DATA(1) :					
Insurance premiums and fee income:					
Core group employee benefit products .....	\$ 936,244	\$ 784,990	\$673,653	\$559,174	\$4
Non-core group employee benefit products(2) .....	24,918	16,066	14,908	44,883	
Asset accumulation products .....	3,220	3,335	4,158	2,645	
Other .....	25,829	23,686	18,893	16,713	
	-----	-----	-----	-----	-----
Net investment income (3) .....	990,211	828,077	711,612	623,415	5
Net realized investment gains (losses) (4) .....	223,569	202,444	186,337	161,983	1
(Loss) gain on extinguishment of debt and capital securities(3) .....	9,003	15,460	12,724	(28,469)	(
	--	--	--	(332)	
	-----	-----	-----	-----	-----
Total revenue .....	1,222,783	1,045,981	910,673	756,597	6
Income from continuing operations(5) ....	126,684	121,400	95,295	58,965	
Net income (5) .....	113,334	123,543	98,916	60,652	
BASIC RESULTS PER SHARE(1) (5) :					
Income from continuing operations .....	\$ 3.88	\$ 3.80	\$ 3.05	\$ 1.89	\$
Net income .....	3.47	3.87	3.17	1.95	
Weighted average shares outstanding .....	32,672	31,952	31,208	31,139	
DILUTED RESULTS PER SHARE(1) (5) :					
Income from continuing operations .....	\$ 3.78	\$ 3.68	\$ 2.98	\$ 1.85	\$



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Net income .....	3.38	3.75	3.09	1.90
Weighted average shares outstanding .....	33,511	32,941	32,023	31,887

OTHER DATA:

Cash dividends paid per share(6): .....	\$ 0.36	\$ 0.32	\$ 0.23	\$ 0.20	\$
Diluted book value per share(7) .....	31.46	29.36	25.49	21.83	

	December 31,			
	2005	2004	2003	2002
	(dollars in thousands)			
BALANCE SHEET DATA:				
Total investments .....	\$3,912,604	\$3,541,076	\$3,202,754	\$2,816,051
Total assets .....	5,276,170	4,829,467	4,177,532	3,734,942
Corporate debt(3) (8) .....	234,750	157,750	143,750	118,139
Junior subordinated deferrable interest debentures underlying company-obligated mandatorily redeemable capital securities issued by unconsolidated subsidiaries(9) .....	59,762	59,762	--	--
Company-obligated mandatorily redeemable capital securities of subsidiaries(3) (9) .....	--	--	56,050	36,050
Shareholders' equity .....	1,033,039	939,848	798,440	681,655
Corporate debt to total capitalization ratio(10) .....	17.7%	13.6%	14.4%	14.1%

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- (1) During the fourth quarter of 2005, the Company decided to exit its non-core property catastrophe reinsurance business, due to the volatility associated with such business and other strategic considerations, and has not thereafter entered into or renewed any assumed property reinsurance contracts. A substantial majority of these reinsurance contracts expired on or before December 31, 2005 and all of the remaining contracts will expire prior to the end of the third quarter of 2006. The Company has classified the operating results of this business as discontinued operations. Prior period information has been reclassified to conform to the current period presentation. See "Other Transactions" and Note S to the Consolidated Financial Statements.

Net income includes (loss) income from discontinued operations, net of federal income tax (benefit) expense, as follows:

Year Ended December 31,				
2005	2004	2003	2002	2001
(dollars in thousands, except per share data)				

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(Loss) income from discontinued operations, net of income tax (benefit) expense.....	\$(13,350)	\$2,143	\$3,621	\$1,687	\$ 762
Basic per share amount.....	(0.41)	0.07	0.12	0.06	0.02
Diluted per share amount.....	(0.40)	0.07	0.11	0.05	0.03

(2) Non-core group employee benefit products include LPTs, primary workers' compensation, bail bond insurance, workers' compensation reinsurance and reinsurance facilities. Premiums from non-core group employee benefit products include premiums from LPTs, which are episodic in nature, of \$4.3 million, \$26.8 million, \$0, \$5.3 million and \$10.4 million, in 2001, 2002, 2003, 2004 and 2005, respectively. See "Business - Group Employee Benefit Products" and "Business - Reinsurance."

(3) In 2001, the Company used the proceeds from the sales of a substantial majority of investments of its investment subsidiaries during the fourth quarter of 2000 to repay \$150.0 million of outstanding borrowings under its revolving credit facilities, to repurchase \$64.0 million liquidation amount of the Capital Securities and to repurchase \$8.0 million principal amount of the Matured Senior Notes. See "Business - Other Transactions." The Company recognized a gain on extinguishment of debt and capital securities of \$11.5 million in connection with these repurchases. In the second quarter of 2002, the Company repurchased \$10.5 million aggregate principal amount of the Matured Senior Notes and recognized a loss on extinguishment of debt of \$0.3 million in connection with this repurchase.

(4) In 2005, 2004, 2003, 2002 and 2001, the Company recognized pre-tax losses of \$4.2 million, \$3.9 million, \$13.0 million, \$54.1 million and \$79.3 million, respectively, due to the other than temporary declines in the market values of certain securities, which are reported as net realized investment losses.

(5) Results for 2001 include a charge of \$0.91 per diluted share or \$28.8 million, net of an income tax benefit of \$15.5 million and reinsurance coverages of \$21.8 million, for reserve strengthening primarily related to an unusually high number of large losses in the Company's excess workers' compensation business. Included in this charge, on a pre-tax basis, are additions to excess workers' compensation case reserves of \$9.0 million and incurred but not reported ("IBNR") reserves of \$24.0 million. This charge also includes reported workers' compensation losses of \$6.3 million and a \$5.0 million addition to long-term disability IBNR reserves attributable to the terrorist attacks on the World Trade Center. In the years subsequent to 2001, the number of large losses experienced by the Company returned to the Company's pre-2001 historical average.

During the second half of 2004, the Company's income taxes payable was reduced by \$6.6 million primarily from the favorable resolution of Internal Revenue Service ("IRS") audits of the 1998 through 2002 tax years. This reduction represented the release of previous accruals for potential audit adjustments which were subsequently settled or eliminated and the further refinement of existing tax exposures.

Income from continuing operations and net income include realized investment gains (losses), net of federal income tax expense (benefit) and the (loss) gain on extinguishment of debt and capital securities, net of federal income tax (benefit) expense, as follows:

Year Ended December 31,

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	2005	2004	2003	2002	2001
	(dollars in thousands, except per share data)				
Realized investment gains (losses), net of income tax expense (benefit) .....	\$5,852	\$10,049	\$8,271	\$(18,505)	\$(45,688)
Basic per share amount .....	0.18	0.32	0.26	(0.59)	(1.48)
Diluted per share amount .....	0.17	0.30	0.26	(0.58)	(1.44)
(Loss) gain on extinguishment of debt and capital securities, net of income tax (benefit) expense .....	--	--	--	(216)	7,446
Basic per share amount .....	--	--	--	(0.01)	0.24
Diluted per share amount .....	--	--	--	(0.01)	0.23

- (6) In 2001, the Company's Board of Directors approved the initiation of a quarterly cash dividend payable on the Company's outstanding Class A and Class B Common Stock. The quarterly cash dividend was \$0.05 per share during 2001, 2002 and the first three quarters of 2003. In the fourth quarter of 2003, the Company's Board of Directors increased the cash dividend to \$0.08 per share. In the first quarter of 2005, the Company's Board of Directors increased the cash dividend to \$0.09 per share. During 2005, 2004, 2003, 2002 and 2001, the Company paid cash dividends on its capital stock in the amount of \$11.6 million, \$10.1 million, \$7.4 million, \$6.0 million and \$5.7 million, respectively. See Note K to the Consolidated Financial Statements.
- (7) Diluted book value per share is calculated by dividing shareholders' equity (as determined in accordance with GAAP), as increased by the proceeds and tax benefit from the assumed exercise of outstanding in-the-money stock options, by total shares outstanding, also increased by shares issued upon the assumed exercise of the options and deferred shares.
- (8) In May 2003, the Company issued \$143.8 million of the 2033 Senior Notes. See "Business - Other Transactions" and Note D to the Consolidated Financial Statements.

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- (9) In May 2003, the Trust issued \$20.0 million liquidation amount of 2003 Capital Securities in a private placement. See "Business - Other Transactions" and Note J to the Consolidated Financial Statements.

As of March 31, 2004, the Company adopted revised Financial Accounting Standards Board Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities." The revised interpretation changed the conceptual framework for determining if an entity holds a controlling interest in a variable interest entity and required the Company to deconsolidate its subsidiaries that hold junior subordinated deferrable interest debentures of the Company which underlie the Company-obligated mandatorily redeemable capital securities of these subsidiaries. Therefore, the Company presented in its consolidated financial statements the junior subordinated deferrable interest debentures of \$59.8 million as a liability and its interest of \$3.7 million in the subsidiaries that hold these debentures as a component of other assets.

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(10) The corporate debt to total capitalization ratio is calculated by dividing long-term corporate debt by the sum of the Company's long-term corporate debt, junior subordinated deferrable interest debentures underlying company-obligated mandatorily redeemable capital securities issued by unconsolidated subsidiaries/Company-obligated mandatorily redeemable capital securities of subsidiaries and shareholders' equity.

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

#### INTRODUCTION

The Company, through its subsidiaries, underwrites a diverse portfolio of group employee benefit products, primarily group life, disability, and excess workers' compensation insurance. Revenues from this group of products are primarily comprised of earned premiums and investment income. The profitability of group employee benefit products is affected by, among other things, differences between actual and projected claims experience, the retention of existing customers, product mix and the Company's ability to attract new customers, change premium rates and contract terms and control administrative expenses. The Company transfers its exposure to some group employee benefit risks through reinsurance ceded arrangements with other insurance and reinsurance companies. Accordingly, the profitability of the Company's group employee benefit products is affected by the amount, cost and terms of reinsurance it obtains. The profitability of certain group employee benefit products is also affected by the difference between the yield achieved on invested assets and the discount rate used to calculate the related reserves. The Company is continuing to experience favorable market conditions for its excess workers' compensation products due to high primary workers' compensation rates. For its other group employee benefit products, the Company is maintaining its underwriting discipline under competitive market conditions and is continuing to increase the size of its sales force in order to enhance its focus on the small case niche (insured groups of 10 to 500 individuals), including employers which are first-time providers of these employee benefits, which it believes to offer opportunities for superior profitability. In the fourth quarter of 2005, the Company decided to exit its non-core property catastrophe reinsurance business, due to the volatility associated with such business and other strategic considerations, and has not thereafter renewed or written any new reinsurance contracts in this business. Accordingly, the Company reclassified the operating results of this business as discontinued operations. Prior period information has been reclassified to conform to the current period presentation. See "Results of Operations - 2005 Compared to 2004 - (Loss) Income from Discontinued Operations."

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

The following discussion and analysis of the results of operations and financial condition of the Company should be read in conjunction with the Consolidated Financial Statements and related notes. The preparation of financial statements in conformity with GAAP requires management, in some instances, to make

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judgments about the application of these principles. The amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period could differ materially from the amounts reported if different conditions existed or different judgments were utilized. A discussion of how management applies certain critical accounting policies and makes certain estimates is presented below under the caption "Critical Accounting Policies and Estimates" and should be read in conjunction with the following discussion and analysis of results of operations and financial condition of the Company. In addition, a discussion of uncertainties and contingencies which can affect actual results and could cause future results to differ materially from those expressed in certain forward-looking statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations can be found in Item 1A. "Risk Factors." See "Forward-Looking Statements And Cautionary Statements Regarding Certain factors That May Affect Future Results."

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### RESULTS OF OPERATIONS

#### 2005 COMPARED TO 2004

Summary of Results. Net income was \$113.3 million, or \$3.38 per diluted share, in 2005 as compared to \$123.5 million, or \$3.75 per diluted share, in 2004. Net income in 2005 and 2004 included realized investment gains (net of the related income tax expense) of \$5.9 million, or \$0.17 per diluted share, and \$10.0 million, or \$0.30 per diluted share, respectively. Net income in 2005 benefited from growth in income from the Company's core group employee benefit products, increased product spreads on the Company's asset accumulation products and an increase in net investment income, and was adversely impacted by losses from discontinued operations and an increase in interest expense. Core group employee benefit products include group life, disability, excess workers' compensation, travel accident and dental insurance. See "Business - Group Employee Benefit Products." Premiums from these core group employee benefit products increased 19% in 2005 and the combined ratio (loss ratio plus expense ratio) for these products was modestly lower than in 2004. Net investment income in 2005, which increased 10% from 2004, reflects an 11% increase in average invested assets. During 2005 and 2004, the Company had (losses) income from discontinued operations (net of the related income tax (benefit) expense) of \$(13.4) million, or \$(0.40) per diluted share, and \$2.1 million, or \$0.07 per diluted share, respectively, attributable its non-core property catastrophe reinsurance business which it decided to exit during the fourth quarter of 2005. The increase in interest expense was primarily due to the increases in the Company's weighted average borrowings and the weighted average borrowing rate due to increases in the levels of the short-term interest indices referenced under the Company's revolving credit facility during 2005 as compared to the full year of 2004. In addition, net income for the 2004 period included a reduction of income tax expense of \$6.6 million primarily resulting from the favorable resolution of IRS audits of the 1998 through 2002 tax years. This reduction represented the release of previous accruals for potential audit adjustments which were subsequently settled or eliminated and the further refinement of existing tax exposures.

Premium and Fee Income. Premium and fee income in 2005 was \$990.2 million as compared to \$828.1 million in 2004, an increase of 20%. Premiums from core group employee benefit products increased 19% to \$936.2 million in 2005 from \$785.0 million in 2004. This increase reflects normal growth in employment and salary levels for the Company's existing customer base, price increases, new business production and an increase in premium income related to an indemnity reinsurance

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arrangement which the Company entered into in the fourth quarter 2004. Under this arrangement, the Company assumes certain group disability insurance policies on an ongoing basis and is responsible for underwriting, pricing and claims management with respect to the reinsured business. The increase also reflects a decrease in premiums ceded by the Company to reinsurers for these products. Premiums from excess workers' compensation insurance for self-insured employers increased 15% to \$220.3 million in 2005 from \$190.8 million in 2004. This increase was primarily due to the demand for this product as a result of high primary workers' compensation rates. SNCC continued to obtain significant improvements in contract terms, in particular higher SIR levels, while maintaining its pricing in connection with its renewals of insurance coverage during 2005. On average, SIR levels increased approximately 8% in 2005. SNCC has continued to maintain its pricing on its 2006 renewals and SIRs are up 9% in these renewals. Excess workers' compensation new business production, which represents the amount of new annualized premium sold, increased 62% to \$46.0 million in 2005 from \$28.4 million in 2004 and the retention of existing customers in 2005 remained strong. New business production for 2005 and 2006 benefited from a renewal rights agreement that SNCC entered into in July 2005. Under the agreement, SNCC acquired, among other things, the right to offer renewal quotes to expiring excess workers' compensation policies of a former competitor. Premiums from the Company's other core group employee benefit products increased 20% to \$715.9 million in 2005 from \$594.2 million in 2004, reflecting new business production and a decrease in premiums ceded by the Company to reinsurers for these products. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Reinsurance." New business production for the Company's other core group employee benefit products was \$198.1 million in 2005 and \$180.9 million in 2004. New business production includes only directly written business, and does not include business reinsured under the Company's indemnity reinsurance arrangement discussed above. The level of production achieved from these products reflects the Company's focus on the small case niche (insured groups of 10 to 500 individuals) which resulted in a 14% increase in production based on the number of cases sold as compared to 2004. The Company continues to maintain its underwriting discipline under competitive market conditions for these products and to implement price increases for certain existing disability and group life customers.

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Non-core group employee benefit products include LPTs, primary workers' compensation, bail bond insurance, workers' compensation reinsurance and reinsurance facilities. See "Business - Group Employee Benefit Products" and "Business - Reinsurance." Premiums from non-core group employee benefit products were \$24.9 million in 2005 as compared to \$16.1 million in 2004. Premiums from the non-core group employee benefit products in 2005 included a higher level of premiums from LPTs, which are episodic in nature.

Deposits from the Company's asset accumulation products were \$95.0 million in 2005 as compared to \$133.1 million in 2004. These deposits consist of new annuity sales, which are recorded as liabilities rather than as premiums. The Company continues to maintain its discipline in setting the crediting rates offered on its asset accumulation products. The decrease in deposits was attributable to the increase in short-term interest rates, which has caused other short-term investment products such as certificates of deposits to be an attractive alternative to fixed annuity products, and to increased market performance of equity-indexed annuities during 2005, which reduced demand for fixed annuity products. The Company is continuing to maintain its discipline in setting the crediting rates offered on its asset accumulation products in 2006 in an effort to achieve its targeted interest rate spreads on these products.

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Net Investment Income. Net investment income in 2005 was \$223.6 million as compared to \$202.4 million in 2004, an increase of 10%. The level of net investment income in the 2005 period reflects an 11% increase in average invested assets to \$3,621.6 million in 2005 from \$3,273.0 million in 2004. The tax equivalent weighted average annual yield on invested assets was 6.4% in 2005 and 2004.

Net Realized Investment Gains. Net realized investment gains were \$9.0 million in 2005 as compared to \$15.5 million in 2004. The Company's investment strategy results in periodic sales of securities and, therefore, the recognition of realized investment gains and losses. During 2005 and 2004, the Company recognized \$13.2 million and \$19.4 million, respectively, of net gains on the sales of securities. The Company monitors its investments on an ongoing basis. When the market value of a security declines below its cost, and management judges the decline to be other than temporary, the security is written down to fair value, and the decline is reported as a realized investment loss. In 2005 and 2004, the Company recognized \$4.2 million and \$3.9 million, respectively, of losses due to the other than temporary declines in the market values of certain fixed maturity securities.

Such losses in 2005 (\$2.7 million on an after-tax basis) resulted primarily from credit quality-related deterioration in certain corporate securities and the Company may recognize additional losses of this type in the future. The Company anticipates that if certain other existing declines in security values are determined to be other than temporary, it may recognize additional investment losses in the range of \$5 million to \$10 million, on an after-tax basis, with respect to the relevant securities. However, the extent of any such losses will depend on future market developments and changes in security values, and such losses may be outside this range. The Company continuously monitors the affected securities pursuant to its procedures for evaluation for other than temporary impairment in valuation. See "Critical Accounting Policies and Estimates" for a description of these procedures, which take into account a number of factors. It is not possible to predict the extent of any future changes in value, positive or negative, or the results of the future application of these procedures, with respect to these securities. There can be no assurance that the Company will realize investment gains in the future in an amount sufficient to offset any such losses.

Benefits and Expenses. Policyholder benefits and expenses were \$1,018.8 million as compared to \$863.1 million in 2004, an increase of 18%. This increase primarily reflects the increase in premiums from the Company's group employee benefit products discussed above, and also reflects an addition to reserves for prior years' claims and claim expenses in the amount of \$32.9 million, which arose primarily from adverse loss experience in the Company's excess workers' compensation line, principally due to moderately increased claim frequency, relative to prior periods, relating to policies written during the competitive market cycle years from 1997 to 2001. If this experience trend were to continue in the future, absent favorable loss developments in other policy years, the Company's results of operations could be materially adversely affected. The combined ratio (loss ratio plus expense ratio) for the Company's group employee benefits products decreased to 94.1% in 2005 from 95.0% in 2004. The weighted average annual crediting rate on the Company's asset accumulation products, which reflects the effects of the first year bonus crediting rate on certain newly issued products, was 4.6% and 4.7% in 2005 and 2004, respectively.

Interest Expense. Interest expense was \$20.5 million in 2005 as compared to \$18.5 million in 2004, an increase of \$2.0 million. This increase primarily resulted from the increases in the weighted average borrowings and the weighted average borrowing rate due to increases in the levels of short-term interest indices referenced under the Company's revolving credit facility during 2005 as compared to 2004. The increase was also attributable to the write-off of \$0.5

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million of capitalized debt issuance costs related to the Company's previous \$100 million revolving credit facility scheduled to expire in December 2006, which was terminated in May 2005 when the Company entered into a new \$200 million revolving credit facility.

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Income Tax Expense. Income tax expense was \$56.9 million in 2005 as compared to \$43.0 million in 2004. The Company's effective tax rate was 31.0% in 2005 and 26.2% in 2004. The Company's lower effective tax rate during 2004 reflects a \$6.6 million reduction in federal income tax expense primarily resulting from the favorable resolution of IRS audits of the 1998 through 2002 tax years. This reduction represents the release of previous accruals for potential audit adjustments which were subsequently settled or eliminated and further refinement of existing tax exposures.

(Loss) Income from Discontinued Operations. During the fourth quarter of 2005, the Company decided to exit its non-core property catastrophe reinsurance business, due to the volatility associated with such business and other strategic considerations, and has not thereafter entered into or renewed any assumed property reinsurance contracts. In 2005 and 2004, the Company recognized after-tax operating (loss) income of \$(13.4) million, or \$(0.40) per diluted share, and \$2.1 million, or \$0.07 per diluted share, respectively, net of income tax (benefit) expense of \$(7.2) million and \$1.2 million, respectively, from this business. See Note S to the Consolidated Financial Statements.

### 2004 COMPARED TO 2003

Summary of Results. Net income was \$123.5 million, or \$3.75 per diluted share, in 2004 as compared to \$98.9 million, or \$3.09 per diluted share, in 2003. Net income in 2004 and 2003 included realized investment gains (net of the related income tax expense) of \$10.0 million, or \$0.30 per diluted share, and \$8.3 million, or \$0.26 per diluted share, respectively. The increase in net income in 2004 is attributable to growth in income from group employee benefit products, net investment income and a reduction in income tax expense. Premiums from the Company's core group employee benefit products increased 17% in 2004 and the combined ratio (loss ratio plus expense ratio) was 95.0% in 2004 and 2003. The weighted average annual crediting rate on the Company's asset accumulation products, which reflects the effects of the first year bonus crediting rate on certain newly issued products, decreased from 5.5% in 2003 to 4.7% in 2004. Net investment income in 2004, which increased 9% from 2003, reflects an 11% increase in average invested assets. In addition, income tax expense was reduced by \$6.6 million during 2004 primarily resulting from the favorable resolution of IRS audits of the 1998 through 2002 tax years. This reduction represented the release of previous accruals for potential audit adjustments which were subsequently settled or eliminated and the further refinement of existing tax exposures. Net income in 2004 and 2003 also included income from discontinued operations (net of the related income tax expense) of \$2.1 million, or \$0.07 per diluted share, and \$3.6 million, or \$0.11 per diluted share, respectively.

Premium and Fee Income. Premium and fee income in 2004 was \$828.1 million as compared to \$711.6 million in 2003, an increase of 16%. Premiums from core group employee benefit products increased 17% to \$785.0 million in 2004 from \$673.7 million in 2003. This increase reflected normal growth in employment and salary levels for the Company's existing customer base, price increases, new business production and a decrease in premiums ceded by the Company to reinsurers for these products. Core group employee benefit products include group life, disability, excess workers' compensation, travel accident and dental insurance. Premiums from excess workers' compensation insurance for self-insured employers



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increased 26% to \$190.8 million in 2004 from \$151.5 million in 2003. This increase was primarily due to the favorable pricing environment and demand for this product as a result of high primary workers' compensation rates. SNCC obtained average price increases of 9% in connection with its renewals of insurance coverage during 2004, and has continued to obtain significant improvements in contract terms, in particular higher SIR levels, in these renewals. On average, SIRs increased 8% in 2004. In addition, retention of existing customers for excess workers' compensation products in 2004 was higher than in 2003. Excess workers' compensation new business production, which represents the amount of new annualized premium sold, was \$28.4 million in 2004 as compared with exceptionally strong production in 2003 of \$45.1 million. The significantly higher renewal ratio and rate increases offset the decline in new business production as the Company focused on achieving rate increases on its existing business and maintained pricing and underwriting discipline as to new sales. Premiums from the Company's other core group employee benefit products increased 14% to \$594.2 million in 2004 from \$522.1 million in 2003, reflecting new business production and a decrease in premiums ceded by the Company to reinsurers for these products. New business production for the Company's other core group employee benefit products was \$180.9 million in 2004 and \$175.1 million in 2003. The 2004 production level for these products reflects the Company's focus on the small case niche (insured groups of 10 to 500 individuals) which resulted in a 22% increase in production based on the number of cases sold as compared to 2003. The Company continued to maintain its underwriting discipline under competitive market conditions for these products and implemented price increases for certain existing disability and group life customers.

Non-core group employee benefit products include LPTs, primary workers' compensation, bail bond insurance, workers' compensation reinsurance and reinsurance facilities. Premiums from non-core group employee benefit products were \$16.1 million in 2004 as compared to \$14.9 million in 2003.

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Deposits from the Company's asset accumulation products were \$133.1 million in 2004 as compared to \$100.6 million in 2003. These deposits consist of new annuity sales, which are recorded as liabilities rather than as premiums. The Company continued to maintain its discipline in setting the crediting rates offered on its asset accumulation products, since the interest rate spreads available on these products remained below average throughout 2003 and 2004. The increase in deposits from the Company's asset accumulation products in 2004 was primarily due to an increase in the number of independent agents and marketing companies distributing the Company's annuity products.

Net Investment Income. Net investment income in 2004 was \$202.4 million as compared to \$186.3 million in 2003, an increase of 9%. The level of net investment income in the 2004 period reflects an increase in average invested assets in 2004 partially offset by a decrease in the tax equivalent weighted average annual yield. The tax equivalent weighted average annual yield on invested assets was 6.4% on average invested assets of \$3,273.0 million in 2004 and 6.5% on average invested assets of \$2,948.2 million in 2003.

Net Realized Investment Gains. Net realized investment gains were \$15.5 million in 2004 as compared to \$12.7 million in 2003. The Company's investment strategy results in periodic sales of securities and, therefore, the recognition of realized investment gains and losses. During 2004 and 2003, the Company recognized \$19.4 million and \$25.7 million, respectively, of net gains on the sales of securities. The Company monitors its investments on an ongoing basis. When the market value of a security declines below its cost, and management

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judges the decline to be other than temporary, the security is written down to fair value, and the decline is reported as a realized investment loss. In 2004 and 2003, the Company recognized \$3.9 million and \$13.0 million, respectively, of losses due to the other than temporary declines in the market values of certain fixed maturity securities.

**Benefits and Expenses.** Policyholder benefits and expenses were \$863.1 million as compared to \$754.6 million in 2003, an increase of 14%. This increase primarily reflects the increase in premiums from the Company's group employee benefit products discussed above, and also reflects an addition to reserves for prior years' claims and claim expenses in the amount of \$12.8 million, which arose primarily from adverse loss experience in the Company's excess workers' compensation line, principally due to moderately increased claim frequency, relative to prior periods, relating to policies written during the competitive market cycle years from 1997 to 2000. If this experience trend were to continue in the future, absent favorable loss developments in other policy years, the Company's results of operations could be materially adversely affected. The combined ratio (loss ratio plus expense ratio) for the Company's group employee benefits products was 95.0% in 2004 and 2003. Benefits and expenses related to the Company's asset accumulation products decreased \$3.0 million primarily due to a decrease in the weighted average annual crediting rate on these products, which reflected the effects of the first year bonus crediting rate on certain newly issued products, from 5.5% in 2003 to 4.7% in 2004.

**Income Tax Expense.** Income tax expense was \$43.0 million in 2004 as compared to \$42.6 million in 2003. The Company's effective tax rate was 26.2% in 2004 and 30.9% in 2003. The decrease in the Company's effective tax rate during 2004 reflects a \$6.6 million reduction in federal income tax expense primarily resulting from the favorable resolution of IRS audits of the 1998 through 2002 tax years. This reduction represents the release of previous accruals for potential audit adjustments which were subsequently settled or eliminated and further refinement of existing tax exposures.

**Income from Discontinued Operations.** After-tax operating income from the Company's discontinued property catastrophe reinsurance business in 2004 and 2003 was \$2.1 million, or \$0.07 per diluted share, and \$3.6 million, or \$0.11 per diluted share, respectively, net of related income tax expense of \$1.2 million and \$2.0 million, respectively. During the fourth quarter of 2005, the Company decided to exit its non-core property catastrophe reinsurance business, due to the volatility associated with such business and other strategic considerations, and has not thereafter entered into or renewed any assumed property reinsurance contracts. See Note S to the Consolidated Financial Statements.

### LIQUIDITY AND CAPITAL RESOURCES

**General.** The Company held approximately \$104.7 million of financial resources at the holding company level at December 31, 2005, primarily comprised of investments in the common stock of its investment subsidiaries, investments in limited partnerships and limited liability companies and short-term investments. The assets of the investment subsidiaries are primarily invested in limited partnerships and limited liability companies. A shelf registration statement is also in effect under which securities yielding proceeds of up to \$106.2 million may be issued by the Company.

In May 2005, the Company entered into a new \$200 million revolving credit facility with Bank of America, N.A. as administrative agent, and a group of major banking institutions (the "Credit Agreement"), which replaced the existing \$100 million revolving credit facility scheduled to expire in December 2006. This facility, which expires in May 2010, contains certain financial and various other affirmative and negative covenants considered ordinary for this type of credit

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agreement. They include, among others, the maintenance of a specified debt to capital ratio, minimum consolidated net worth of the Company, minimum risk-based capital requirements for the Company's insurance subsidiaries, RSLIC and SNCC, and certain limitations on investments and subsidiary indebtedness. At December 31, 2005, the Company had \$109.0 million of borrowings available under the Credit Agreement.

Other sources of liquidity at the holding company level include dividends paid from subsidiaries, primarily generated from operating cash flows and investments. During 2006, the Company's insurance subsidiaries will be permitted, without prior regulatory approval, to make dividend payments totaling \$72.5 million. The Company's insurance subsidiaries may also pay additional dividends with the requisite regulatory approvals. See "Business - Regulation." In general, dividends from the Company's non-insurance subsidiaries are not subject to regulatory or other restrictions.

The Company's current liquidity needs, in addition to funding its operating expenses, include principal and interest payments on outstanding borrowings under the Credit Agreement, interest payments on the 2033 Senior Notes, and distributions on the Capital Securities and the 2003 Capital Securities. The maximum amount of borrowings available under the Company's Credit Agreement is \$200.0 million. The 2033 Senior Notes mature in their entirety in May 2033 and are not subject to any sinking fund requirements but are redeemable by the Company at par at any time on or after May 15, 2008. The junior subordinated deferrable interest debentures underlying the Capital Securities are not redeemable prior to March 25, 2007. The junior subordinated deferrable interest debentures underlying the 2003 Capital Securities are redeemable, in whole or in part, beginning May 15, 2008. See Notes D and J to the Consolidated Financial Statements.

The following table summarizes the Company's significant contractual obligations at December 31, 2005 and the future periods in which such obligations are expected to be settled in cash. The 2033 Senior Notes and the junior subordinated deferrable interest debentures underlying company-obligated mandatorily redeemable capital securities issued by unconsolidated subsidiaries are assumed to be repaid on their respective maturity dates. Additional details regarding these obligations are provided in the notes to the consolidated financial statements, as referenced in the table:

## CONTRACTUAL OBLIGATIONS

	Total	Payments Due by Period		
		Less than 1 Year	1 -3 Years	3 Ye
		(dollars in thousands)		
Other long-term liabilities (1) .....	\$3,414,684	\$522,100	\$671,464	\$505
Corporate debt (Note D) .....	234,750	91,000	--	
Interest on corporate debt (Note D) (2) .....	318,906	12,497	24,015	23
Advances from Federal Home Loan Bank (Note E) .....	55,000	--	--	
Interest on advances from Federal Home Loan Bank (Note E) .....	59,271	4,106	8,211	8

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Junior subordinated deferrable interest debentures underlying company-obligated mandatorily redeemable capital securities issued by unconsolidated subsidiaries (Note J) .....	59,762	--	--	
Interest on junior subordinated deferrable interest debentures (Note J) (3) .....	119,207	5,066	10,137	10
Operating lease obligations (Note M) .....	64,327	11,480	20,343	13
	\$4,325,907	\$646,249	\$734,170	\$560

- (1) Other long-term liabilities consist of future policy benefits and unpaid claims and claim expenses relating to the Company's insurance products, as well as policyholder account balances. Substantially all of the amounts reflected in this table with respect to such liabilities consist of estimates by the Company's management based on various actuarial and other assumptions relating to the Company's insurance products and, as to policyholder account balances, the periods for which the related annuity and other contracts will remain in force and the crediting rates to be applied thereto in the future. In accordance with GAAP, a substantial portion of such liabilities, as they relate to the Company's insurance products, are carried on a discounted basis on its consolidated balance sheet; however, the amounts contained in this table are presented on an undiscounted basis. The actual payments relating to these liabilities will differ, both in amount and timing, from those indicated in this table. See "Critical Accounting Policies and Estimates - Future Policy Benefits and Unpaid Claims and Claim Expenses."
- (2) Primarily includes interest on the 2033 Senior Notes.
- (3) Includes interest on the outstanding junior subordinated debentures underlying the Capital Securities and the 2003 Junior Subordinated Debentures underlying the 2003 Capital Securities. Interest on the 2003 Junior Subordinated Debentures was computed using the indexed rate in effect at December 31, 2005 of 8.43%.

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Sources of liquidity available to the Company on a parent company-only basis, including the undistributed earnings of its subsidiaries and additional borrowings available under the Credit Agreement, are expected to exceed the Company's current and long-term cash requirements. The Company from time to time engages in discussions with respect to acquiring blocks of business and insurance and financial services companies, any of which could, if consummated, be material to the Company's operations.

The principal liquidity requirements of the Company's insurance subsidiaries are their contractual obligations to policyholders and other financing sources. The primary sources of funding for these obligations, in addition to operating earnings, are the marketable investments included in the investment portfolios of these subsidiaries. The Company actively manages its investment portfolio to match its invested assets and related liabilities. The Company regularly analyzes the results of its asset/liability matching through cash flow analysis and duration matching under multiple interest rate scenarios. See "Asset/Liability Management and Market Risk." Therefore, the Company believes that these sources of funding will be adequate for its insurance subsidiaries to satisfy on both a short-term and long-term basis these contractual obligations throughout their estimated or stated period. However, if such contractual obligations were to arise more rapidly or in greater amounts than anticipated in

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the Company's asset/liability matching analysis, the Company could be required to sell securities earlier than anticipated, potentially resulting in the realization of capital losses (particularly, as regards fixed income securities, in a rising interest rate environment), or to borrow funds from available credit sources, in order to fund the payment of such obligations. In any of such events, the Company's results of operations, liquidity and financial condition could be materially adversely affected.

Cash Flows. Operating activities increased cash by \$309.4 million, \$264.1 million and \$237.5 million in 2005, 2004 and 2003, respectively. Net investing activities used \$362.1 million of cash during 2005 primarily for the purchase of securities, and financing activities provided \$56.9 million of cash principally due to the increase in borrowings under the Credit Agreement, partially offset by the repayment of certain Federal Home Loan Bank advances.

Share Repurchase Program. The Company's board of directors has authorized a share repurchase program. Share repurchases are effected by the Company in the open market or in negotiated transactions in compliance with the safe harbor provisions of Rule 10b-18 under the Securities Exchange Act of 1934. Execution of the share repurchase program is based on management's assessment of market conditions for its common stock and other potential uses of capital. During 2005, the Company repurchased 150,000 shares of its Class A Common Stock for a total cost of \$7.1 million with a volume weighted average price of \$47.19 per share. At December 31, 2005, the repurchase of approximately 0.9 million shares remained authorized under this program.

Investments. The Company's overall investment strategy emphasizes safety and liquidity, while seeking the best available return, by focusing on, among other things, managing the Company's interest-sensitive assets and liabilities and seeking to minimize the Company's exposure to fluctuations in interest rates. The Company's investment portfolio, which totaled \$3,912.6 million at December 31, 2005, primarily consists of investments in fixed maturity securities, mortgage loans, investments in limited partnerships and short-term investments. During 2005, the market value of the Company's investment portfolio, in relation to its amortized cost, decreased by \$72.5 million from year-end 2004, before related changes in the cost of business acquired of \$15.3 million and the income tax provision of \$20.0 million. In addition, the Company recognized pre-tax net investment gains of \$9.0 million in 2005. The weighted average credit rating of the Company's fixed maturity portfolio as rated by Standard & Poor's Corporation was "AA" at December 31, 2005. While the investment grade rating of the Company's fixed maturity portfolio addresses credit risk, it does not address other risks, such as prepayment and extension risks, which are discussed below.

At December 31, 2005, approximately 35% of the Company's total invested assets were comprised of corporate fixed maturity securities. Eighty-two percent of the Company's corporate fixed maturity portfolio, based on fair values, has been rated investment grade by nationally recognized statistical rating organizations. Investment grade corporate fixed maturity securities are distributed among the various rating categories as follows: AAA - 4%, AA - 6%, A - 31%, and BBB - 41%. Corporate fixed maturity securities subject the Company to credit risk and, to a lesser extent, interest rate risk. To reduce its exposure to corporate credit risk, the Company diversifies its investments across economic sectors, industry classes and issuers.

Mortgage-backed securities comprised 22% of the Company's total invested assets at December 31, 2005. Ninety-seven percent of the Company's mortgage-backed securities portfolio, based on fair values, has been rated as investment grade by nationally recognized statistical rating organizations. Mortgage-backed securities subject the Company to a degree of interest rate risk, including prepayment and extension risk, which is generally a function of the sensitivity of each security's underlying collateral to prepayments under varying interest rate environments and the repayment priority of the securities in the particular

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securitization structure. The Company seeks to limit the extent of this risk by emphasizing the more predictable payment classes and securities with stable collateral.

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The Company, through its insurance subsidiaries, maintains a program in which investments are financed using advances from various Federal Home Loan Banks. The Company has utilized this program to manage the duration of its liabilities and to earn spread income, which is the difference between the financing cost and the earnings from the investments purchased with those funds. At December 31, 2005, the Company had an outstanding advance of \$55.0 million. The advance was obtained at a fixed rate and has a term to maturity of 14.5 years. During 2005, \$30.0 million of Federal Home Loan Bank advances matured and were repaid by the Company. In addition, the Company has from time to time utilized reverse repurchase agreements, futures and option contracts and interest rate and credit default swaps in connection with its investment strategy. These transactions may require the Company to maintain securities or cash on deposit with the applicable counterparty as collateral. As the market value of the collateral or contracts changes, the Company may be required to deposit additional collateral or be entitled to have a portion of the collateral returned to it. The Company also maintains a securities lending program under which certain securities from its portfolio are loaned to other institutions for short periods of time. The Company maintains full ownership rights to the securities loaned and continues to earn interest and dividends on them. The collateral received for securities loaned is recorded at the fair value of the collateral, which is generally in an amount in excess of the market value of the securities loaned. The Company's institutional lending agent monitors the market value of the securities loaned and obtains additional collateral as necessary. See Note F to the Consolidated Financial Statements.

The types and amounts of investments made by the Company's insurance subsidiaries are subject to the insurance laws and regulations of their respective states of domicile. Each of these states has comprehensive investment regulations. In addition, the Company's Credit Agreement also contains limitations, with which the Company is currently in compliance in all material respects, on the composition of the Company's investment portfolio. The Company also continually monitors its investment portfolio and attempts to ensure that the risks associated with concentrations of investments in either a particular sector of the market or a single entity are limited.

Asset/Liability Management and Market Risk. Because the Company's primary assets and liabilities are financial in nature, the Company's consolidated financial position and earnings are subject to risks resulting from changes in interest rates. The Company manages this risk by active portfolio management focusing on minimizing its exposure to fluctuations in interest rates by matching its invested assets and related liabilities and by periodically adjusting the crediting rates on its annuity products and the discount rate used to calculate reserves on the Company's other products. In its asset/liability matching process, the Company determines and monitors on a quarterly basis the duration of its insurance liabilities in the aggregate and the duration of the investment portfolio supporting such liabilities in order to ensure that the difference between such durations, or the "duration gap," remains below an internally specified maximum, and similarly determines and monitors the duration gap as between its interest-sensitive liabilities, substantially all of which consist of its asset accumulation products, and the components of its investment portfolio supporting such liabilities in relation to a separate internally specified maximum. As of December 31, 2005, the Company maintained these duration gaps within the aforementioned maximums. In addition, the Company, at

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times, has utilized futures and option contracts and interest rate or credit default swap agreements primarily to reduce the risk associated with changes in the value of its fixed maturity portfolio. At December 31, 2005, the Company had no material outstanding futures or option contracts or interest rate or credit default swap agreements. The Company, at times, may also invest in non-dollar denominated fixed maturity securities that expose it to fluctuations in foreign currency rates, and therefore, may hedge such exposure by using currency forward contracts. The Company's investment in non-dollar denominated fixed maturity securities during 2005 was less than 0.3% of total invested assets.

The Company regularly analyzes the results of its asset/liability matching through cash flow analysis and duration matching under multiple interest rate scenarios. These analyses enable the Company to measure the potential gain or loss in fair value of its interest-rate sensitive financial instruments due to hypothetical changes in interest rates. Based on these analyses, if interest rates were to immediately increase by 10% from their year-end levels, the fair value of the Company's interest-sensitive assets, net of corresponding changes in the fair value of cost of business acquired and insurance and investment-related liabilities, would decline by approximately \$61.0 million at December 31, 2005 as compared to a decline of approximately \$49.8 million at December 31, 2004. These analyses incorporate numerous assumptions and estimates and assume no changes in the composition of the Company's investment portfolio in reaction to such interest rate changes. Consequently, the results of this analysis will likely be materially different from the actual changes in the value of the Company's assets that will be experienced under given interest rate scenarios.

The Company manages the composition of its borrowed capital by considering factors such as the ratio of borrowed capital to total capital, future debt requirements, the interest rate environment and other market conditions. At December 31, 2005, a hypothetical 10% decrease in market interest rates would cause a corresponding \$9.3 million increase in the fair value of the Company's fixed-rate corporate debt which matures in 2033 as compared to an increase of \$11.0 million at December 31, 2004. Because interest expense on the Company's floating-rate corporate debt that was outstanding at

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December 31, 2005 would have fluctuated as prevailing interest rates changed, changes in market interest rates would not have materially affected its fair value.

Reinsurance. The Company cedes portions of the risks relating to its group employee benefit products under indemnity reinsurance agreements with various unaffiliated reinsurers. The Company pays reinsurance premiums generally based upon percentages of the Company's premiums on the business reinsured. These agreements expire at various intervals as to new risks, and replacement agreements are negotiated on terms believed appropriate in light of current market conditions. During 2003, the Company replaced certain of its existing reinsurance arrangements for its excess workers' compensation and long-term disability products. Under the replacement arrangements for excess workers' compensation products, the Company reinsures excess workers' compensation risks between \$5.0 million (compared to \$3.0 million previously) and \$50.0 million, and a substantial majority in proportionate amount of the risks between \$50.0 million and \$100.0 million, per policy per occurrence. In addition, during 2005, the company entered into a reinsurance arrangement under which the Company cedes 30% of its excess workers' compensation risks between \$100.0 million and \$150.0 million, per policy per occurrence. For long-term disability products (effective October 1, 2003 for new policies and, for

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existing policies, the earlier of the next policy anniversary date or October 1, 2004) the Company reinsures risks in excess of \$7,500 (compared to \$2,500 previously) in benefits per individual per month. These changes have reduced the reinsurance premiums paid by the Company for these products.

RSLIC Performance-Contingent Options. In December 2005, the Stock Option and Compensation Committee (the "Committee") of the Board of Directors of the Company granted additional performance-contingent incentive options to purchase 50,000 shares of the Company's Class A Common Stock to each of Lawrence E. Daurelle, President and Chief Executive Officer of RSLIC, and the other six members of executive management of RSLIC. Such options have a ten-year term and an exercise price equal to the fair market value of a share of the Stock at the date of grant. The options have the same five-year financial performance target and performance period as the performance-contingent incentive options that were granted in April 2004. The options will become exercisable if the specified target is met; otherwise a reduced number of such options will become exercisable according to where the performance target falls within a specified range, as defined and computed under the related option agreements for the five-year performance period consisting of fiscal years 2004 through 2008. See Note N to the Consolidated Financial Statements.

SNCC Performance-Contingent Options. Also, in December 2005, the Committee approved the amendment of the respective performance-contingent incentive options to purchase 225,000 shares of the Company's Class A Common Stock previously granted to each of Harold F. Ilg, Chairman of the Company's subsidiary, SNCC, and the other four members of executive management of SNCC. Pursuant to such amendment, such options will become exercisable if the aggregate consolidated Pre-Tax Operating Income of SIG Holdings, Inc., SNCC's intermediate parent company, as defined and computed under the related option agreements ("SIG PTOI"), for the five-year performance period consisting of fiscal years 2003 through 2007 is at least \$417.2 million; otherwise, a reduced number of such options will become exercisable to the extent that the aggregate SIG PTOI for such period exceeds \$370.4 million, determined by interpolating between zero and 225,000 according to where the SIG PTOI amount falls in the range between \$370.4 million and \$417.2 million. None of such options became exercisable for the three-year performance period consisting of fiscal years 2003 through 2005. See Note N to the Consolidated Financial Statements.

### OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements (as defined in the rules and regulations of the Securities and Exchange Commission) that have or are reasonably likely to have a material current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

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### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with GAAP requires the Company's management, in some instances, to make judgments about the application of these principles. The amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period could differ materially from the amounts reported if different conditions existed or different judgments were utilized. Management's judgment is most critical in the estimation of its liabilities for future policy benefits and unpaid claims and claim expenses and its assets for cost of business acquired and in the valuation of its investments. A discussion of how



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management applies these critical accounting policies follows.

Future Policy Benefits and Unpaid Claims and Claim Expenses. The Company establishes reserves that are intended to be sufficient to fund the future policy benefits and unpaid claims and claim expenses relating to its insurance products. These reserves, which totaled \$1,862.9 million at December 31, 2005, represent management's best estimate of future policy benefits and unpaid claims and claim expenses. The reserves are calculated using various generally recognized actuarial methodologies and are based upon assumptions and estimates that management believes are appropriate and which vary by type of product. Annually, external actuarial experts also review the Company's methodologies, assumptions and the resulting reserves. The Company's projected ultimate insurance liabilities and associated reserves are estimates, which are subject to variability. This variability arises because the factors and events affecting the ultimate liability for claims have not all taken place, and thus cannot be evaluated with certainty. As a result, actual future ultimate losses will not develop exactly as projected and may vary significantly from the projections. The estimation process is complex and involves information obtained from company-specific and industry-wide data, as well as general economic information. The Company's insurance reserves are based upon management's informed estimates and judgments using currently available data. As additional experience emerges and other data become available, these estimates and judgments are reviewed and may be revised. The methods and assumptions used to establish the Company's insurance reserves are continually reviewed and updated based on current circumstances, and any resulting adjustments may result in reserve increases or decreases that would be reflected in the Company's results of operations for the periods in which such revisions are made. There were no material changes in the current year in the actuarial methods and/or assumptions from those used in the previous periods; however, in 2005 and 2004, the Company experienced a degree of adverse variance in loss experience from its past projections. See Item 1, "Business - Property and Casualty Insurance Reserves."

The most significant assumptions made in the estimation process for future policy benefits and unpaid claims and claim expenses for the Company's disability and accident products relate to mortality, morbidity, claim termination and discount rates. Mortality and morbidity assumptions are based on various actuarial tables that are generally utilized in the industry, modified as believed to be necessary for possible variations. The claim termination rate represents the probability that a disability claim will close or change due to maximum benefits being paid under the policy, the recovery or death of the claimant, or a change in status in any given period. Establishing claim termination rates is complex and involves many factors, including the cause of disability, the claimant's age and the type of contractual benefits provided. The Company uses its extensive claim experience database to develop its claim termination rate assumptions, which are applied as an average to its large population of active claims. A one percent increase or decrease in the group long-term disability claim termination rate established by the Company, which the Company believes is a reasonable range of variance in this regard, would have decreased or increased, respectively, the reserves established for claims incurred in 2005 by approximately \$0.6 million, which would have increased or decreased, respectively, its 2005 net income by \$0.4 million. Disability reserves are discounted using interest rate assumptions based upon projected portfolio yield rates for the assets supporting the liabilities. The Company's discount rate assumptions are discussed in further detail below.

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The Company's reserves for unpaid claims and claim expenses are determined on an individual basis for reported claims, for which case reserves are established,

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and estimates of incurred but not reported ("IBNR") losses are developed on the basis of past experience. The unpaid claims and claim expense reserves carried for the Company's property and casualty insurance products represent the difference between the selected ultimate loss amount and the loss amount paid to date. The unpaid claims and claim expense reserves carried for the Company's disability and accident insurance products are established by the incurred loss development method utilizing various mathematic tools in order to project future loss experience based on the Company's historical loss experience. The difference between total unpaid claims and claim expense reserves and case unpaid claims and claim expense reserves represent the IBNR reserve. The following table summarizes the composition of the Company's total reserves for disability, accident and casualty claims and claim expenses, as between case and IBNR reserves, as of December 31, 2005 (dollars in millions):

Balance, net of reinsurance:	
Case reserves	
Disability and accident	\$ 481.7
Property and casualty	248.0
IBNR reserves	
Disability and accident	159.2
Property and casualty	395.5
	-----
Total reserves	1,284.4
Reinsurance receivables	249.1
	-----
Balance, gross of reinsurance	\$1,533.5
	=====
Balance Sheets:	
Future policy benefits:	
Disability and accident	\$ 539.9
Unpaid claims and claim expenses:	
Disability and accident	247.1
Property and casualty	746.5
	-----
	\$1,533.5
	=====

The most significant assumptions made in the estimation process for unpaid claims and claim expenses for the Company's property and casualty insurance products are the trend in loss costs, the expected frequency and severity of claims, changes in the timing of the reporting of losses from the loss date to the notification date, and expected costs to settle unpaid claims. Other assumptions include that the coverages under these insurance products will not be expanded by future legislative action or judicial interpretation and that extraordinary classes of losses not previously in existence will not arise in the future. The assumptions vary based on the year the claim is incurred. At December 31, 2005, disability and primary and excess workers' compensation reserves for unpaid claims and claim expenses with a carrying value of \$844.1 million have been discounted at a weighted average rate of 5.5%, with the rates ranging from 3.7% to 7.5%. Disability reserves for unpaid claims and claim expenses are discounted using interest rate assumptions based upon projected portfolio yield rates for the assets supporting the liabilities. The assets selected to support these liabilities produce cash flows that are intended to match the timing and amount of anticipated claim and claim expense payments. Primary and excess workers' compensation claim reserves are discounted using interest rate assumptions based on the risk-free rate of return for U.S. Government securities with a duration comparable to the expected duration and payment pattern of the claims at the time the claims are settled. The rates used to discount reserves are determined annually. The level of the rate utilized to

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discount reserves in a particular period directly impacts the level of the reserves established for such period. For example, a 25 basis point increase in the discount rates the Company applied to disability and primary and excess workers' compensation claims incurred in 2005 would have decreased the amount of the reserves it established with respect to such claims by approximately \$2.2 million, and a 25 basis point decrease in such rates would have increased the amount of the reserves so established by the same amount. In both cases, discount rate changes of this type and magnitude would reasonably reflect corresponding changes in market interest rates. These levels of change to the Company's discount rate would have increased, in the first case or decreased, in the second, its 2005 net income by \$1.4 million.

The primary actuarial methods used to establish the Company's reserves for unpaid claims and claim expenses for its property and casualty insurance products are the incurred loss development method and the Bornhuetter-Ferguson expected loss method. Under the incurred loss development method, various mathematic tools are utilized in order to project future loss experience based on the Company's historical loss experience. This method is utilized for accident

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years as to which management believes a sufficient level of historical loss experience exists. For more recent years for which this level of experience does not exist, management utilizes the Bornhuetter-Ferguson expected loss method to establish loss reserves. Under this method, in addition to historical loss experience, the Company also takes into account an expected loss ratio based on information determined during the initial pricing of the business, including, among other factors, rate increases and changes in terms and conditions.

The Company's actuaries select an ultimate loss reserve amount for its property and casualty insurance products by reviewing the results of the actuarial methods described above, as well as other tertiary methods which serve to provide supplemental data points, and applying judgments to achieve a point estimate for the ultimate loss amount, rather than calculating ranges around the reserves. Reserves for unpaid claims and claim expenses for such products represent management's best estimate and are based upon this actuarially derived point estimate. In reviewing and determining the adequacy of this estimate, management considers several factors such as historical results, changes to policy pricing, terms and conditions, deductibles and attachment points, claims-handling staffing, practices and procedures, effects of claim inflation, industry loss trends, reinsurance coverages, underwriting initiatives, and changes in state legislative and regulatory environments.

For the Company's property and casualty insurance products, a review of the seven most recent years' historical loss development variation reflects an annual range of -3.4% to + 6.6%. The average annual increase reflected in such review was +3.6% and the average decrease was -1.7%. If the Company were to assume subsequent loss development of + 3.6% or -1.7%, each of which are within historical variation, the estimated unpaid claims and claims expense reserves, net of reinsurance, established for such products as of December 31, 2005 would be increased by \$22.9 million in the first case, which would have decreased its 2005 net income by \$14.9 million, or decreased by \$10.8 million in the second, which would have increased its 2005 net income by \$7.0 million. Management believes that while fluctuations of this magnitude could have a material impact on the Company's results of operations, they would not be likely to materially affect its financial condition or liquidity. However, it is possible that, using other assumptions or variables that are outside of the range of historical variation, the level of the Company's unpaid claims and claim expenses could be

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changed by an amount that could be material to the Company's results of operations, financial condition and liquidity.

For the reasons described above, if the Company's actual loss experience from its current or discontinued products is different from the Company's assumptions or estimates, the Company's reserves could be inadequate. In such event, the Company's results of operations, liquidity and financial condition could be materially adversely affected.

**Deferred Acquisition Costs.** Costs related to the acquisition of new insurance business, such as commissions, certain costs of policy issuance and underwriting, and certain sales office expenses, are deferred when incurred. The unamortized balance of these deferred acquisition costs is included in cost of business acquired on the consolidated balance sheet. Deferred acquisition costs related to group life, disability and accident products, which totaled \$171.2 million at December 31, 2005, are amortized over the anticipated premium-paying period of the related policies in proportion to the ratio of the present value of annual expected premium income to the present value of the total expected premium income. Deferred acquisition costs related to casualty insurance products, which totaled \$13.4 million at December 31, 2005, are amortized over the period in which the related premium is earned. Deferred acquisition costs related to annuity products, which totaled \$58.5 million at December 31, 2005, are amortized over the anticipated lives of the policies in relation to the present value of estimated gross profits from such policies' anticipated surrender charges and mortality, investment and expense margins. The amortization is a constant percentage of estimated gross profits based on the ratio of the present value of amounts deferred as compared to the present value of estimated gross profits. Adjustments are made each year to reflect the actual gross profits to date as compared to assumed experience and any changes in the remaining expected future gross profits. The unamortized balance of deferred policy acquisition costs related to certain asset accumulation products is adjusted for the impact on estimated future gross profits as if net unrealized appreciation and depreciation on available for sale securities had been realized at the balance sheet date. The impact of this adjustment, net of the related income tax expense or benefit, is included in net unrealized appreciation and depreciation as a component of other comprehensive income in shareholders' equity. Deferred acquisition costs are charged to current earnings to the extent that it is determined that future premiums or estimated gross profits will not be adequate to cover the amounts deferred. The amortization of deferred acquisition costs totaled \$67.2 million, \$61.1 million and \$53.7 million in 2005, 2004 and 2003, respectively. These amounts represented 31% of the total amounts of the deferred acquisition cost balances outstanding at the beginning of the respective periods.

**Investments.** Investments are primarily carried at fair value with unrealized appreciation and depreciation included as a component of other comprehensive income in shareholders' equity, net of the related income tax benefit or expense and the related adjustment to cost of business acquired. Ninety seven percent of the Company's fixed maturity and equity securities portfolio are actively traded in a liquid market or have other liquidity mechanisms. Securities acquired through

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private placements, which are not actively traded in a liquid market and do not have other mechanisms for their liquidation, totaled \$110.2 million at December 31, 2005. The Company estimates the fair value for these securities primarily by comparison to similar securities with quoted market prices. If quotes are not available on similar securities, the Company estimates fair value based on

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recent purchases or sales of similar securities or other internally prepared valuations. Key assumptions used in this process include the level of risk-free interest rates, risk premiums, and performance of underlying collateral, if applicable. All such investments are classified as available for sale. The Company's ability to liquidate these investments in a timely manner, if necessary, may be adversely impacted by the lack of an actively traded market. Historically, the Company has not realized amounts on dispositions of non-marketable investments that varied materially from the amounts estimated by the Company under this valuation methodology. The Company believes that its estimates reasonably reflect the fair value of these securities; however, had there been an active market for these securities during the applicable reporting period, the market prices may have been materially different than the amounts reported.

Declines in the fair value of investments that are considered in the judgment of management to be other than temporary are reported as realized investment losses. The Company evaluates, among other things, the financial position and prospects of the issuer, conditions in the issuer's industry and geographic area, liquidity of the investment, changes in the amount or timing of expected future cash flows from the investment, and recent downgrades of the issuer by a rating agency to determine if and when a decline in the fair value of an investment below amortized cost is other than temporary. The length of time and extent to which the fair value of the investment is lower than its amortized cost and the Company's ability and intent to retain the investment to allow for any anticipated recovery in the investment's fair value are also considered. In 2005, 2004 and 2003, the Company recognized losses totaling \$4.2 million, \$3.9 million and \$13.0 million, respectively, for the other than temporary decline in the value of certain fixed maturity securities. These losses were recognized as a result of events that occurred in the respective periods, such as downgrades in an issuer's credit ratings, deteriorating financial results of issuers, adverse changes in the amount and timing of estimated future cash flows from securities and the impact of adverse economic conditions on issuers' financial positions. Investment grade and non-investment grade fixed maturity securities comprised 75.9% and 7.1%, respectively, of the Company's total investment portfolio at December 31, 2005. Gross unrealized appreciation and gross unrealized depreciation, before the related income tax expense or benefit and the related adjustment to cost of business acquired, attributable to investment grade fixed maturity securities totaled \$70.4 million and \$24.0 million, respectively, at December 31, 2005. Gross unrealized appreciation and gross unrealized depreciation, before the related income tax expense or benefit and the related adjustment to cost of business acquired, attributable to non-investment grade fixed maturity securities totaled \$3.2 million and \$13.5 million, respectively, at December 31, 2005. Unrealized appreciation and depreciation, net of the related income tax expense or benefit and the related adjustment to cost of business acquired, has been reflected on the Company's balance sheet as a component of other comprehensive income. The Company anticipates that if certain existing declines in security values are determined to be other than temporary, it may recognize additional investment losses in the range of \$7 million to \$15 million pre-tax (\$5 million to \$10 million on an after-tax basis) with respect to the relevant securities. However, the extent of any such losses will depend on future market developments and changes in security values, and such losses may exceed or be lower than such range. It is not possible to predict the extent of any future changes in value, positive or negative, or the results of the future application of the Company's procedures for the evaluation of other than temporary impairment in valuation. There can be no assurance that the Company will realize investment gains in the future in an amount sufficient to offset any such losses.

The Company also invests in certain limited partnerships and limited liability companies which invest in various financial instruments. These investments are reflected in the Company's financial statements under the equity method; accordingly, positive or negative changes in the value of the investees'

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underlying investments are included in net investment income. For this purpose, the Company estimates the values of its investments in these entities based on values provided by their managers, as adjusted based on available information concerning the underlying investment portfolios. As of December 31, 2005 and 2004, there were no adjustments in such values, as compared with a reduction in value of \$6.7 million as of December 31, 2003. The Company believes that its estimates reasonably reflect the values of its investments in these entities; however, there can be no assurance that such values will ultimately be realized upon liquidation of such investments.

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

In connection with, and because it desires to take advantage of, the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Company cautions readers regarding certain forward-looking statements in the above "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Form

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10-K and in any other statement made by, or on behalf of, the Company, whether in future filings with the Securities and Exchange Commission or otherwise. Forward-looking statements are statements not based on historical information and which relate to future operations, strategies, financial results, prospects, outlooks or other developments. Some forward-looking statements may be identified by the use of terms such as "expects," "believes," "anticipates," "intends," "judgment," "outlook" or other similar expressions. Forward-looking statements are necessarily based upon estimates and assumptions that are inherently subject to significant business, economic, competitive and other uncertainties and contingencies, many of which are beyond the Company's control and many of which, with respect to future business decisions, are subject to change. Examples of such uncertainties and contingencies include, among other important factors, those affecting the insurance industry generally, such as the economic and interest rate environment, federal and state legislative and regulatory developments, including but not limited to changes in financial services, employee benefit and tax laws and regulations, market pricing and competitive trends relating to insurance products and services, acts of terrorism or war, and the availability and cost of reinsurance, and those relating specifically to the Company's business, such as the level of its insurance premiums and fee income, the claims experience, persistency and other factors affecting the profitability of its insurance products, the performance of its investment portfolio and changes in the Company's investment strategy, acquisitions of companies or blocks of business, and ratings by major rating organizations of the Company and its insurance subsidiaries. These uncertainties and contingencies can affect actual results and could cause actual results to differ materially from those expressed in any forward-looking statements made by, or on behalf of, the Company. Certain of these uncertainties and contingencies are described in more detail in "Item 1A, Risk Factors." The Company disclaims any obligation to update forward-looking information.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by Item 7A is included in this Form 10-K under the heading "Liquidity and Capital Resources - Asset/Liability Management and Market Risk" beginning on page 31 of this Form 10-K.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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The information required by Item 8 is included in this Form 10-K beginning on page 44 of this Form 10-K.

### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

### ITEM 9A. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer ("CEO") and Vice President and Treasurer (the individual who acts in the capacity of chief financial officer), of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in the rules and regulations of the Securities and Exchange Commission). Based on that evaluation, the Company's management, including the CEO and Vice President and Treasurer, concluded that the Company's disclosure controls and procedures were effective. There were no changes in the Company's internal control over financial reporting during the fourth fiscal quarter of 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. The Company filed its annual certifications by the Chief Executive Officer and the Vice President and Treasurer required by Section 302 of the Sarbanes-Oxley Act of 2002 as exhibits to this Form 10-K.

Management's annual report on internal control over financial reporting and the attestation report of the Company's registered public accounting firm are included below.

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### MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Vice President and Treasurer (the individual who acts in the capacity of chief financial officer), we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2005 based on the framework in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2005.

A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future

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periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in such firm's report which is included elsewhere herein.

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### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Directors  
Delphi Financial Group, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Delphi Financial Group, Inc. and its subsidiaries (collectively, the "Company") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Criteria"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



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In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO Criteria. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO Criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2005 of the Company and our report dated February 23, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Philadelphia, Pennsylvania  
February 23, 2006

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### ITEM 9B. OTHER INFORMATION

None.

## PART III

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by Item 10 is included in the Company's definitive Proxy Statement, to be filed pursuant to Regulation 14A of the Securities Exchange Act of 1934 in connection with the Company's 2006 Annual Meeting of Stockholders, under the captions "Election of Directors," "Section 16(a) Beneficial Ownership Reporting Compliance," and "Code of Ethics" and is incorporated herein by reference, and in Item 4 in Part I of this Form 10-K.

On June 23, 2005, Robert Rosenkranz, the Company's Chairman, President and Chief Executive Officer, submitted to the NYSE the Written Affirmation required by the rules of the NYSE certifying that he was not aware of any violations by the Company of NYSE corporate governance listing standards.

### ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is included in the Company's definitive Proxy Statement, to be filed pursuant to Regulation 14A of the Securities Exchange Act of 1934 in connection with the Company's 2006 Annual Meeting of Stockholders, under the caption "Executive Compensation" and is incorporated herein by reference.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by Item 12 is included in the Company's definitive Proxy Statement, to be filed pursuant to Regulation 14A of the Securities Exchange Act of 1934 in connection with the Company's 2006 Annual Meeting of Stockholders, under the captions "Security Ownership of Certain Beneficial Owners and Management" and "Equity Compensation Plan Information" and is incorporated herein by reference.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

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The information required by Item 13 is included in the Company's definitive Proxy Statement, to be filed pursuant to Regulation 14A of the Securities Exchange Act of 1934 in connection with the Company's 2006 Annual Meeting of Stockholders, under the caption "Certain Relationships and Related Party Transactions" and is incorporated herein by reference.

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 is included in the Company's definitive Proxy Statement, to be filed pursuant to Regulation 14A of the Securities Exchange Act of 1934 in connection with the Company's 2006 Annual Meeting of Stockholders, under the caption "Independent Auditors" and is incorporated herein by reference.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

- (a) The financial statements and financial statement schedules filed as part of this report are listed in the Index to Consolidated Financial Statements and Financial Statement Schedules on page 45 of this Form 10-K.
- (b) The following Exhibits are numbered in accordance with the Exhibit Table of Item 601 of Regulation S-K:
  - 2.1 Agreement and Plan of Merger, dated October 5, 1995, among the Company, SIG Holdings Acquisition Corp., and SIG Holdings, Inc. (6)
  - 2.2 Agreement and Plan of Merger, dated June 11, 1998, by and among Delphi Financial Group, Inc., Matrix Absence Management, Inc. and the Shareholders named therein (10)
  - 2.3 Stock Purchase Agreement, dated as of October 1, 1998, by and among Delphi Financial Group, Inc., Unicover Managers, Inc., Unicover Intermediaries, LLC and the Shareholders named therein (10)
  - 2.4 Merger, Exchange and Release Agreement, dated April 30, 1999, by and among Delphi Financial Group, Inc., Unicover Managers, Inc., Unicover Intermediaries, LLC, Unicover Management Partners, LLC and the Buyers named therein (11)
  - 3.1 Amendment to Restated Certificate of Incorporation of Delphi Financial Group, Inc. (Exhibit 3.2) (2)

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- 3.2 Certificate of Amendment of Restated Certificate of Incorporation of Delphi Financial Group, Inc. (Exhibit 3.1) (7)
- 3.3 Certificate of Amendment of Restated Certificate of Incorporation of Delphi Financial Group, Inc. (Exhibit 3.1) (23)
- 3.4 Amended and Restated By-laws of Delphi Financial Group, Inc. (2)
- 3.5 Amendment to the Amended and Restated By-laws of Delphi Financial Group, Inc. dated August 4, 2005 (Exhibit 3.1) (24)
- 4.1 Indenture, dated as of October 8, 1993, between Delphi Financial

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- Group, Inc. and State Street Bank of Connecticut (formerly Shawmut Bank Connecticut, N.A.) as Trustee (matured 8.0% Senior Notes due 2003) (3)
- 4.2 Indenture, dated as of May 20, 2003, between Delphi Financial Group, Inc. and Wilmington Trust Company, as Trustee (Exhibit 4(a)) (16)
- 4.3 First Supplemental Indenture, dated as of May 20, 2003, between Delphi Financial Group, Inc. and Wilmington Trust Company, as Trustee (Exhibit 4(b)) (16)
- 4.4 Amended and Restated Limited Liability Agreement of Delphi Funding L.L.C. dated as of March 25, 1997, among Delphi Financial Group, Inc., as Managing Member, Chestnut Investors III, Inc., as Resigning Member, and the Holders of Capital Securities described therein, as Members (Exhibit 4(a)) (8)
- 4.5 Subordinated Indenture, dated as of March 25, 1997, between Delphi Financial Group, Inc. and Wilmington Trust Company as Trustee (Exhibit 4(b)) (8)
- 4.6 Guarantee Agreement dated March 25, 1997, between Delphi Financial Group, Inc., as Guarantor, and Wilmington Trust Company, as Trustee (Exhibit 4(c)) (8)
- 4.7 Amended and Restated Declaration of Delphi Financial Statutory Trust I, dated as of May 15, 2003, by and among U.S. Bank National Association, as Institutional Trustee, Delphi Financial Group, Inc., as Sponsor, and the Administrators named therein (Exhibit 4.1) (17)
- 4.8 Indenture, dated as of May 15, 2003, between Delphi Financial Group, Inc. and U.S. Bank National Association, as Trustee (Exhibit 4.2) (17)
- 4.9 Guarantee Agreement, dated as of May 15, 2003, by and between Delphi Financial Group, Inc., as Guarantor, and U.S. Bank National Association, as Trustee (Exhibit 4.3) (17)
- 10.1 Credit Agreement, dated as of May 26, 2005, among Delphi Financial Group, Inc. as the Borrower, Bank of America, N.A., as Administrative Agent, and the Other Lenders Party Thereto (Exhibit 10.1) (22)
- 10.2 Delphi Financial Group, Inc. Second Amended and Restated Nonqualified Employee Stock Option Plan, as amended May 23, 2001 (Exhibit 10.1) (12)
- 10.3 Delphi Financial Group, Inc. 2003 Employee Long-Term Incentive and Share Award Plan, as amended (Exhibit 10.1) (18)
- 10.4 The Delphi Capital Management, Inc. Pension Plan for Robert Rosenkranz (1)
- 10.5 Second Amendment to the Delphi Capital Management, Inc. Pension Plan for Robert Rosenkranz (Exhibit 10.2) (14)
- 10.6 Investment Consulting Agreement, dated as of November 10, 1988, between Rosenkranz Asset Managers, LLC (as assignee of Rosenkranz, Inc.) and the Company (Exhibit 10.8) (2)
- 10.7 Investment Consulting Agreement, dated as of November 6, 1988, between Rosenkranz Asset Managers, LLC (as assignee of Rosenkranz, Inc.) and Reliance Standard Life Insurance Company (Exhibit 10.9) (2)

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- 10.8 Delphi Financial Group, Inc. Amended and Restated Long-Term Performance-Based Incentive Plan (Exhibit 10.3) (17)
  - 10.9 Amendment to Delphi Financial Group, Inc. Amended and Restated Long-Term Performance-Based Incentive Plan (Exhibit 10.1) (21)
  - 10.10 2003 Bonus Criteria for Chairman, President and Chief Executive Officer of Delphi Financial Group, Inc. (Exhibit 10.1) (15)
  - 10.11 SIG Holdings, Inc. 1992 Long-Term Incentive Plan (Exhibit 10.12) (5)
  - 10.12 Stockholders Agreement, dated as of October 5, 1995, among the Company and the affiliate stockholders named therein (Exhibit 10.30) (6)
  - 10.13 Reliance Standard Life Insurance Company Nonqualified Deferred Compensation Plan (Exhibit 10.14) (6)
  - 10.14 Reliance Standard Life Insurance Company Supplemental Executive Retirement Plan (Exhibit 10.15) (6)
  - 10.15 Reliance Standard Life Insurance Company Management Incentive Compensation Plan (Exhibit 10.2) (19)
  - 10.16 Stock Option Award Agreement, dated July 8, 2003, for Harold F. Ilg (Exhibit 10.5) (17)
  - 10.17 Amendment of Stock Option Award Agreement, dated January 4, 2006, for Harold F. Ilg (26)
  - 10.18 Stock Option Award Agreement, dated May 19, 2004, for Lawrence E. Daurelle (Exhibit 10.1) (19)
  - 10.19 Stock Option Award Agreement, dated January 4, 2006, for Lawrence E. Daurelle (26)
  - 10.20 Delphi Financial Group, Inc. Second Amended and Restated Directors Stock Option Plan, as amended May 28, 2003 (Exhibit 10.2) (17)
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- 10.21 Delphi Financial Group, Inc. Annual Incentive Compensation Plan (Exhibit 10.2) (18)
  - 10.22 Employment Agreement, dated March 18, 1994, for Robert M. Smith, Jr. (Exhibit 10.31) (4)
  - 10.23 Employment Agreement, dated July 8, 2003, between Safety National Casualty Corporation and Harold F. Ilg (Exhibit 10.6) (17)
  - 10.24 Form of Restricted Share Unit Award Agreement (Exhibit 99.1) (20)
  - 10.25 SIG Holdings, Inc. Note Agreement, dated as of May 20, 1994 (8.5% Senior Secured Notes due 2003) (5)
  - 10.26 Borrower Pledge Agreement, dated as of May 20, 1994, between SIG Holdings, Inc. and the Chase Manhattan Bank, N.A., as collateral agent (5)

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- 10.27 Reinsurance Agreement, dated January 27, 1998, between Reliance Standard Life Insurance Company and Oracle Reinsurance Company Ltd. (9)
- 10.28 Casualty Excess of Loss Reinsurance Agreement, dated January 27, 1998, between Safety National Casualty Corporation and Oracle Reinsurance Company Ltd. (9)
- 10.29 Commutation, Prepayment and Redemption Agreement, dated September 14, 2001, between Delphi Financial Group, Inc., Safety National Casualty Corporation, Reliance Standard Life Insurance Company, Delphi International Ltd. and Oracle Reinsurance Company Ltd. (Exhibit 10.1) (13)
- 11.1 Computation of Results per Share of Common Stock (25)
- 21.1 List of Subsidiaries of the Company (26)
- 23.1 Consent of Ernst & Young LLP (26)
- 24.1 Powers of Attorney (26)
- 31.1 Certification by the Chairman of the Board, President and Chief Executive Officer of Periodic Report Pursuant to Rule 13a-14(a) or 15d-14(a) (26)
- 31.2 Certification by the Vice President and Treasurer of Periodic Report Pursuant to Rule 13a-14(a) or 15d-14(a) (26)
- 32.1 Certification of Periodic Report Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (26)

- 
- (1) Incorporated herein by reference to the designated exhibit to the Company's Form 10-K for the year ended December 31, 1992.
- (2) Incorporated herein by reference to the designated exhibit to the Company's Registration Statement on Form S-1 dated March 13, 1990 (Registration No. 33-32827).
- (3) Incorporated herein by reference to the designated exhibit to the Company's Form 10-K for the year ended December 31, 1993.
- (4) Incorporated herein by reference to the designated exhibit to the Company's Form 10-K for the year ended December 31, 1994.
- (5) Incorporated herein by reference to the designated exhibit to the Company's Form 10-K for the year ended December 31, 1995.
- (6) Incorporated herein by reference to the designated exhibit to the Company's Registration Statement on Form S-4 dated January 30, 1996 (Registration No. 33-99164).
- (7) Incorporated herein by reference to the designated exhibit to the Company's Form 10-Q for the quarter ended June 30, 1997.
- (8) Incorporated herein by reference to the designated exhibit to the Company's Current Report on Form 8-K dated March 21, 1997.
- (9) Incorporated herein by reference to the designated exhibit to the Company's Form 10-K for the year ended December 31, 1997.

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- (10) Incorporated herein by reference to the designated exhibit to the Company's Form 10-K for the year ended December 31, 1998.
  - (11) Incorporated herein by reference to the designated exhibit to the Company's Form 10-Q for the quarter ended March 31, 1999.
  - (12) Incorporated herein by reference to the designated exhibit to the Company's Form 10-Q for the quarter ended June 30, 2001.
  - (13) Incorporated herein by reference to the designated exhibit to the Company's Form 10-Q for the quarter ended September 30, 2001.
  - (14) Incorporated herein by reference to the designated exhibit to the Company's Form 10-Q for the quarter ended September 30, 2002.
  - (15) Incorporated herein by reference to the designated exhibit to the Company's Form 10-Q for the quarter ended March 31, 2003.
  - (16) Incorporated herein by reference to the designated exhibit to the Company's Current Report on Form 8-K dated May 20, 2003.
  - (17) Incorporated herein by reference to the designated exhibit to the Company's Form 10-Q for the quarter ended June 30, 2003.
  - (18) Incorporated herein by reference to the designated exhibit to the Company's Form 10-Q for the quarter ended March 31, 2004.
  - (19) Incorporated herein by reference to the designated exhibit to the Company's Form 10-Q for the quarter ended June 30, 2004.
  - (20) Incorporated herein by reference to the designated exhibit to the Company's Current Report on Form 8-K dated February 9, 2005.
  - (21) Incorporated herein by reference to the designated exhibit to the Company's Form 10-Q for the quarter ended March 31, 2005.
  - (22) Incorporated herein by reference to the designated exhibit to the Company's Current Report on Form 8-K dated May 26, 2005.
  - (23) Incorporated herein by reference to the designated exhibit to the Company's Form 10-Q for the quarter ended June 30, 2005.
  - (24) Incorporated herein by reference to the designated exhibit to the Company's Current Report on Form 8-K dated August 4, 2005.
  - (25) Incorporated herein by reference to Note O to the Consolidated Financial Statements included elsewhere herein.
  - (26) Filed herewith.
- (c) The financial statement schedules listed in the Index to Consolidated Financial Statements and Financial Statement Schedules on page 45 of this Form 10-K are included under Item 8 and are presented beginning on page 75 of this Form 10-K. All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Delphi Financial Group, Inc.

By: /s/ ROBERT ROSENKRANZ

-----  
 Chairman of the Board, President and  
 Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name -----	Capacity -----	Date -----
/s/ ROBERT ROSENKRANZ ----- (Robert Rosenkranz)	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)	March 15, 2006
* ----- (Kevin R. Brine)	Director	March 15, 2006
* ----- (Lawrence E. Daurelle)	Director	March 15, 2006
* ----- (Edward A. Fox)	Director	March 15, 2006
* ----- (Steven A. Hirsh)	Director	March 15, 2006
* ----- (Harold F. Ilg)	Director	March 15, 2006
* ----- (James M. Litvack)	Director	March 15, 2006

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* ----- (James N. Meehan)	Director	March 15, 2006
* ----- (Philip R. O'Connor)	Director	March 15, 2006
* ----- (Donald A. Sherman)	Director	March 15, 2006
/s/ ROBERT M. SMITH, JR. ----- (Robert M. Smith, Jr.)	Director and Executive Vice President	March 15, 2006
* ----- (Robert F. Wright)	Director	March 15, 2006
* ----- (Thomas W. Burghart)	Vice President and Treasurer (Principal Accounting and Financial Officer)	March 15, 2006

\* BY: /s/ ROBERT ROSENKRANZ  
-----  
Attorney-in-Fact

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
SELECTED QUARTERLY FINANCIAL RESULTS (UNAUDITED)  
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)

	Year Ended December 31, 2005			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	-----	-----	-----	-----
Revenues excluding realized investment gains ..	\$289,240	\$301,164	\$304,492	\$318,884
Realized investment gains .....	1,817	3,320	3,397	469
	-----	-----	-----	-----
Total revenues .....	291,057	304,484	307,889	319,353
Operating income .....	47,363	50,402	52,455	53,801
Income from continuing operations .....	29,247	30,990	32,838	33,609
Net income .....	30,107	31,977	22,032	29,218



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### Basic results per share of common stock:

Income from continuing operations .....	\$	0.91	\$	0.96	\$	1.00	\$	1.02
Net income .....		0.93		0.99		0.67		0.88

### Diluted results per share of common stock:

Income from continuing operations .....	\$	0.88	\$	0.93	\$	0.97	\$	1.00
Net income .....		0.91		0.96		0.65		0.87

### Year Ended December 31, 2004

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues excluding realized investment gains ..	\$251,230	\$252,660	\$256,751	\$269,880
Realized investment gains .....	5,221	1,941	1,433	6,865
<b>Total revenues .....</b>	<b>256,451</b>	<b>254,601</b>	<b>258,184</b>	<b>276,745</b>
Operating income .....	47,257	40,976	45,679	49,018
Income from continuing operations .....	29,750	25,641	33,201	32,808
Net income .....	30,621	27,133	32,179	33,610

### Basic results per share of common stock:

Income from continuing operations .....	\$	0.94	\$	0.80	\$	1.04	\$	1.02
Net income .....		0.97		0.85		1.00		1.05

### Diluted results per share of common stock:

Income from continuing operations .....	\$	0.91	\$	0.78	\$	1.01	\$	0.99
Net income .....		0.94		0.82		0.98		1.01

Computations of results per share for each quarter are made independently of results per share for the year. Due to transactions affecting the weighted average number of shares outstanding in each quarter, the sum of quarterly results per share does not equal results per share for the year.

In the fourth quarter of 2005, the Company decided to exit its non-core property catastrophe reinsurance business and has classified the operating results of this business as discontinued operations. Results prior to the fourth quarter of 2005 have been reclassified to conform to the current period presentation. Net income for the first, second, third and fourth quarters of 2005 include after-tax income (loss) from discontinued operations of \$0.8 million, \$1.0 million \$(10.8) million and \$(4.4) million, respectively. Net income for the first, second, third and fourth quarters of 2004 include after-tax income (loss) from discontinued operations of \$0.9 million, \$1.4 million, \$(1.0) million and \$0.8 million, respectively. See "Other Transactions" and Note S to the Consolidated Financial Statements. Results for the first, second, third and fourth quarters of 2005 include pre-tax investment losses of \$0.5 million, \$0.7 million \$3.0 million and \$0, respectively, due to the other than temporary declines in the market values of certain fixed maturity securities. Results for the first, second, third and fourth quarters of 2004 include pre-tax investment losses of \$2.4 million, \$0.1 million, \$0.6 million and \$0.8 million, respectively, due to the other than temporary declines in the market values of certain fixed maturity securities. Results for the third and fourth quarters of 2004 also include a reduction of federal income tax expense of \$4.6 million and \$2.0 million, respectively, primarily resulting from the favorable resolution of IRS audits of the 1998 through 2002 tax years. This reduction represents the release of previous accruals for potential audit adjustments which were

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subsequently settled or eliminated and further refinement of existing tax exposures. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Notes B and G to the Consolidated Financial Statements.

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### DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES

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#### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Directors  
Delphi Financial Group, Inc.

We have audited the accompanying consolidated balance sheets of Delphi Financial Group, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedules listed in the Index to Consolidated Financial Statements and Financial Statement Schedules. These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and

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schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Delphi Financial Group, Inc. and subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 23, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Philadelphia, Pennsylvania  
February 23, 2006

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

	Year Ended December	
	2005	2004
Revenue:		
Premium and fee income .....	\$ 990,211	\$ 828,077
Net investment income .....	223,569	202,444
Net realized investment gains .....	9,003	15,460
	1,222,783	1,045,981
Benefits and expenses:		
Benefits, claims and interest credited to policyholders .....	725,207	614,488
Commissions .....	66,677	60,796
Amortization of cost of business acquired .....	69,281	62,043
Other operating expenses .....	157,597	125,724

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	1,018,762	863,051
	-----	-----
Income from continuing operations before interest and income tax expense .....	204,021	182,930
Interest expense:		
Corporate debt .....	15,607	14,040
Junior subordinated deferrable interest debentures .....	4,855	4,486
	-----	-----
	20,462	18,526
	-----	-----
Income from continuing operations before income tax expense ...	183,559	164,404
Income tax expense .....	56,875	43,004
	-----	-----
Income from continuing operations .....	126,684	121,400
(Loss) income from discontinued operations, net of income tax (benefit) expense .....	(13,350)	2,143
	-----	-----
Net income .....	\$ 113,334	\$ 123,543
	=====	=====
Basic results per share of common stock:		
Income from continuing operations .....	\$ 3.88	\$ 3.80
Net income .....	3.47	3.87
Diluted results per share of common stock:		
Income from continuing operations .....	\$ 3.78	\$ 3.68
Net income .....	3.38	3.75
Dividends paid per share of common stock .....	\$ 0.36	\$ 0.32

See notes to consolidated financial statements.

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

	December
	-----
	2005
	-----
Assets:	
Investments:	
Fixed maturity securities, available for sale .....	\$3,244,764
Short-term investments .....	94,308
Other investments .....	573,532
	-----
	3,912,604
Cash .....	28,493
Cost of business acquired .....	248,138
Reinsurance receivables .....	413,113
Goodwill .....	93,929
Securities lending collateral .....	244,821
Other assets .....	235,644
Assets held in separate account .....	99,428
	-----

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Total assets .....	\$5,276,170
	=====
Liabilities and Shareholders' Equity:	
Future policy benefits:	
Life .....	\$ 273,486
Disability and accident .....	539,929
Unpaid claims and claim expenses:	
Life .....	55,885
Disability and accident .....	247,093
Casualty .....	746,479
Policyholder account balances .....	1,039,610
Corporate debt .....	234,750
Junior subordinated deferrable interest debentures underlying	
company-obligated mandatorily redeemable capital	
securities issued by unconsolidated subsidiaries .....	59,762
Securities lending payable .....	244,821
Advances from Federal Home Loan Bank .....	55,342
Other liabilities and policyholder funds .....	646,546
Liabilities related to separate account .....	99,428
	-----
Total liabilities .....	4,243,131
	-----
Shareholders' equity:	
Preferred Stock, \$.01 par; 50,000,000 shares authorized .....	--
Class A Common Stock, \$.01 par; 150,000,000 shares authorized;	
31,274,166 and 30,418,291 shares issued and outstanding, respectively ..	313
Class B Common Stock, \$.01 par; 20,000,000 shares authorized;	
3,904,481 shares issued and outstanding .....	39
Additional paid-in capital .....	442,531
Accumulated other comprehensive income .....	20,264
Retained earnings .....	636,285
Treasury stock, at cost; 2,723,211 and 2,573,211 shares of	
Class A Common Stock, respectively .....	(66,393)
	-----
Total shareholders' equity .....	1,033,039
	-----
Total liabilities and shareholders' equity .....	\$5,276,170
	=====

See notes to consolidated financial statements.

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

	Class A Common Stock	Class B Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retain Earnin
	-----	-----	-----	-----	-----
Balance, January 1, 2003 .....	\$189	\$32	\$373,356	\$ 30,003	\$329,5
Net income .....	--	--	--	--	98,9

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Other comprehensive income:					
Increase in net unrealized appreciation on investments .....	--	--	--	26,395	
Increase in net loss on cash flow hedge .....	--	--	--	(4,106)	
Net change in minimum pension liability adjustment .....	--	--	--	136	
Comprehensive income .....					
Issuance of stock, exercise of stock options and share conversions .....	8	(4)	8,865	--	
Stock-based compensation .....	--	--	1,465	--	
Acquisition of treasury stock .....	--	--	--	--	
Cash dividends .....	--	--	--	--	(7,4
Three-for-two stock split .....	98	14	(113)	--	
	-----	-----	-----	-----	-----
Balance, December 31, 2003 .....	\$295	\$42	\$383,573	\$ 52,428	\$421,0
Net income .....					
	--	--	--	--	123,5
Other comprehensive income:					
Increase in net unrealized appreciation on investments .....	--	--	--	4,716	
Decrease in net loss on cash flow hedge .....	--	--	--	786	
Net change in minimum pension liability adjustment .....	--	--	--	(559)	
Comprehensive income .....					
Issuance of stock, exercise of stock options and share conversions .....	9	(3)	20,596	--	
Stock-based compensation .....	--	--	2,739	--	
Acquisition of treasury stock .....	--	--	--	--	
Cash dividends .....	--	--	--	--	(10,0
	-----	-----	-----	-----	-----
Balance, December 31, 2004 .....	\$304	\$39	\$406,908	\$ 57,371	\$534,5
Net income .....					
	--	--	--	--	113,3
Other comprehensive income:					
Decrease in net unrealized appreciation on investments .....	--	--	--	(37,193)	
Decrease in net loss on cash flow hedge .....	--	--	--	785	
Net change in minimum pension liability adjustment .....	--	--	--	(699)	
Comprehensive income .....					
Issuance of stock, exercise of stock options and share conversions .....	9	--	27,697	--	
Stock-based compensation .....	--	--	7,926	--	
Acquisition of treasury stock .....	--	--	--	--	
Cash dividends .....	--	--	--	--	(11,5
	-----	-----	-----	-----	-----
Balance, December 31, 2005 .....	\$313	\$39	\$442,531	\$ 20,264	\$636,2
	=====	=====	=====	=====	=====

See notes to consolidated financial statements.

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

	Year Ended December 31,		
	2005	2004	2003
<b>Operating activities:</b>			
Net income .....	\$ 113,334	\$ 123,543	\$ 113,334
Adjustments to reconcile net income to net cash provided by operating activities:			
Change in policy liabilities and policyholder accounts .....	227,188	201,571	188,000
Net change in reinsurance receivables and payables ....	13,818	(16,568)	(1,334)
Amortization, principally the cost of business acquired and investments .....	62,014	49,325	50,000
Deferred costs of business acquired .....	(89,601)	(84,627)	(84,627)
Net realized gains on investments .....	(9,003)	(15,460)	(15,460)
Net change in federal income tax liability .....	16,924	24,057	24,057
Other .....	(25,274)	(17,746)	(17,746)
Net cash provided by operating activities .....	309,400	264,095	264,095
<b>Investing activities:</b>			
Purchases of investments and loans made .....	(1,946,034)	(1,881,235)	(1,881,235)
Sales of investments and receipts from repayment of loans	1,408,018	1,390,290	1,390,290
Maturities of investments .....	180,292	211,483	211,483
Net change in short-term investments .....	1,484	18,991	18,991
Change in deposit in separate account .....	(5,876)	(5,090)	(5,090)
Net cash used by investing activities .....	(362,116)	(265,561)	(265,561)
<b>Financing activities:</b>			
Deposits to policyholder accounts .....	102,708	140,173	140,173
Withdrawals from policyholder accounts .....	(101,701)	(88,251)	(88,251)
Proceeds from issuance of 2033 Senior Notes .....	--	--	--
Borrowings under revolving credit facility .....	88,000	38,000	38,000
Principal payments under revolving credit facility .....	(11,000)	(24,000)	(24,000)
Repayments or repurchase of other corporate debt .....	--	--	--
Proceeds from issuance of 2003 Capital Securities .....	--	--	--
Change in liability for Federal Home Loan Bank advances ..	(30,000)	(65,000)	(65,000)
Other financing activities .....	8,878	6,135	6,135
Net cash provided (used) by financing activities ...	56,885	7,057	7,057
Increase (decrease) in cash .....	4,169	5,591	5,591
Cash at beginning of year .....	24,324	18,733	18,733
Cash at end of year .....	\$ 28,493	\$ 24,324	\$ 18,733

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See notes to consolidated financial statements.

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### DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2005

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Principles of Consolidation.** The consolidated financial statements include the accounts of Delphi Financial Group, Inc. ("DFG") and all of its wholly-owned subsidiaries, including, among others, Reliance Standard Life Insurance Company ("RSLIC"), Safety National Casualty Corporation ("SNCC"), First Reliance Standard Life Insurance Company ("FRSLIC"), Reliance Standard Life Insurance Company of Texas ("RSLIC-Texas"), Safety First Insurance Company ("SFIC"), SIG Holdings, Inc. ("SIG") and Matrix Absence Management, Inc. ("Matrix"). The term "Company" shall refer herein collectively to DFG and its subsidiaries, unless the context indicates otherwise. All significant intercompany accounts and transactions have been eliminated. Certain reclassifications have been made in the 2004 and 2003 consolidated financial statements to conform with the 2005 presentation. As of December 31, 2005, Mr. Robert Rosenkranz, Chairman of the Board, President and Chief Executive Officer of DFG, by means of beneficial ownership of the general partner of Rosenkranz & Company and direct or beneficial ownership, had the power to vote all of the outstanding shares of Class B Common Stock, which represents 49.9% of the aggregate voting power of the Company's common stock.

**Nature of Operations.** The Company manages all aspects of employee absence to enhance the productivity of its clients and provides the related insurance coverages: short-term and long-term disability, primary and excess workers' compensation, group life and travel accident. The Company's asset accumulation business emphasizes fixed annuity products. The Company offers its products and services in all fifty states and the District of Columbia. The Company's two reportable segments are group employee benefit products and asset accumulation products. The Company's reportable segments are strategic operating divisions that offer distinct types of products with different marketing strategies. The Company evaluates the performance of its segments on the basis of income from continuing operations excluding realized investment gains and losses and before interest and income tax expense. The accounting policies of the Company's segments are the same as those used in the consolidated financial statements.

**Use of Estimates.** The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**Investments.** Fixed maturity securities available for sale are carried at fair value with unrealized appreciation and depreciation included as a component of accumulated other comprehensive income, net of the related income tax expense or benefit and the related adjustment to cost of business acquired. Short-term investments are carried at fair value. Other investments consist primarily of mortgage loans, investments in limited partnerships, equity securities, trading account securities, investments in limited liability companies and amounts receivable from investment sales. At December 31, 2005 and 2004, the Company had mortgage loans of \$148.0 million and \$80.2 million, respectively. Mortgage loans are carried at unpaid principal balances, including any unamortized premium or



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discount. Net realized investment gains and losses on investment sales are determined under the specific identification method and are included in income. At December 31, 2005 and 2004, the Company had investments in limited partnerships of \$108.4 million and \$81.4 million, respectively. Investments in limited partnerships are reflected on the equity method, with earnings included in net investment income. Equity securities are carried at fair value with unrealized appreciation and depreciation included as a component of accumulated other comprehensive income, net of the related income tax expense or benefit. Investments in limited liability companies are primarily reflected on the equity method, with earnings included in net investment income. Trading account securities consist primarily of bonds, common stocks and preferred stocks and are carried at fair value with unrealized appreciation and depreciation included in net investment income. Interest and dividend income and realized gains and losses from trading account securities are also included in income.

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### DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) DECEMBER 31, 2005

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (CONTINUED)

Declines in the fair value of investments which are considered to be other than temporary are reported as realized losses. The Company evaluates, among other things, the financial position and prospects of the issuer, conditions in the issuer's industry and geographic area, liquidity of the investment, changes in the amount or timing of expected future cash flows from the investment, and recent downgrades of the issuer by a rating agency to determine if and when a decline in the fair value of an investment below amortized cost is other than temporary. The length of time and extent to which the fair value of the investment is lower than amortized cost and the Company's ability and intent to retain the investment to allow for any anticipated recovery in the investment's fair value are also considered.

During the fourth quarter of 2005, the Company adopted the Financial Accounting Standards Board ("FASB") Staff Position ("FSP") on Statement of Financial Accounting Standard ("SFAS") 115-1 and SFAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." The FSP was issued in November 2005 and replaced the impairment recognition and measurement guidance set forth in Emerging Issues Task Force ("EITF") Issue 03-1 and superceded EITF Topic No. D-44, "Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value." The FSP also amended SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," SFAS No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations," and APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." The FSP clarifies that an other-than-temporary impairment loss should be recognized when the investor has decided to sell an available for sale security that is other than temporarily impaired and the investor does not expect the security's fair value to fully recover prior to the expected sale. Such impairment loss should be recognized as other-than-temporary in the period in which the decision to sell is made. The adoption of the FSP did not have a material effect on the financial position or results of operations of the Company.

Cost of Business Acquired. Costs relating to the acquisition of new insurance business, such as commissions, certain costs of policy issuance and underwriting and certain sales office expenses, are deferred when incurred. For certain annuity products, these costs are amortized over the anticipated lives of the

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policies in relation to the present value of estimated gross profits from such policies' anticipated surrender charges and mortality, investment and expense margins. Deferred acquisition costs for life, disability and accident products are amortized over the anticipated premium-paying period of the related policies in proportion to the ratio of the present value of annual expected premium income to the present value of the total expected premium income. Deferred acquisition costs for casualty insurance products are amortized over the period in which the related premium is earned. The present value of estimated future profits ("PVFP"), which was recorded in connection with the acquisition of RSLIC and FRSLIC in 1987, is included in cost of business acquired. The PVFP related to annuities is subject to accrual of interest on the unamortized balance at the credited rate and amortization is a constant percentage of the present value of estimated future gross profits on the business. Amortization of the PVFP for disability and group life insurance is at the discount rate established at the time of the acquisition. The unamortized balance of cost of business acquired related to certain asset accumulation products is also adjusted for the impact on estimated future gross profits as if net unrealized appreciation and depreciation on available for sale securities had been realized at the balance sheet date. The impact of this adjustment, net of the related income tax expense or benefit, is included in net unrealized appreciation and depreciation as a component of accumulated other comprehensive income.

Receivables from Reinsurers. Receivables from reinsurers for future policy benefits, unpaid claims and claim expenses and policyholder account balances are estimated in a manner consistent with the related liabilities associated with the reinsured policies.

Goodwill. Goodwill and intangible assets deemed to have indefinite lives are required to be periodically reviewed for impairment. Other intangible assets with finite lives are required to be amortized over their useful lives. At January 1, 2003, unamortized goodwill of \$60.9 million was attributable to the acquisition of SNCC, whose operations are included in the group employee benefits segment, and \$33.0 million was attributable to the acquisition of Matrix, whose operations are reported in the "other" segment. Any impairment losses would be reflected within operating results in the income statement. The impairment test is performed annually unless events suggest an impairment may have occurred in the

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### DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) DECEMBER 31, 2005

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (CONTINUED)

interim. Based on these tests, the Company determined that no impairment of goodwill had occurred during the years ended December 31, 2005, 2004, or 2003, respectively.

Separate Account. The separate account assets and liabilities represent funds invested in a separately administered variable life insurance product for which the policyholder, rather than the Company, bears the investment risk. The Company receives a proportionate share of the income or loss of the assets of the separate account, and income is generally reinvested in the separate account. The Company allocates its proportionate interest in the separate account's assets to the corresponding captions in the Company's balance sheet.

Future Policy Benefits. The liabilities for future policy benefits for

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traditional nonparticipating business, excluding annuity business, have been computed using a net level method. Mortality, morbidity and other assumptions are based either on the Company's past experience or various actuarial tables, modified as necessary for possible variations. Changes in these assumptions could result in changes in these liabilities.

Unpaid Claims and Claim Expenses. The liability for unpaid claims and claim expenses includes amounts determined on an individual basis for reported losses and estimates of incurred but not reported losses developed on the basis of past experience. The methods of making these estimates and establishing the resulting reserves are continually reviewed and updated, with any resulting adjustments reflected in earnings currently. At December 31, 2005, disability and primary and excess workers' compensation reserves with a carrying value of \$844.1 million have been discounted at a weighted average rate of 5.5%, with the rates ranging from 3.7% to 7.5%.

Policyholder Account Balances. Policyholder account balances are comprised of the Company's reserves for interest-sensitive insurance products, including annuities. Reserves for annuity products are equal to the policyholders' aggregate accumulated value.

Junior Subordinated Deferrable Interest Debentures underlying Company-obligated Mandatorily Redeemable Capital Securities issued by Unconsolidated Subsidiaries. Pursuant to revised Financial Accounting Standards Board Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities," the Company does not consolidate its subsidiaries that hold junior subordinated deferrable interest debentures of the Company which underlie the Company-obligated mandatorily redeemable capital securities of these subsidiaries. Instead, the Company has presented in its consolidated financial statements the junior subordinated deferrable interest debentures of \$59.8 million as a liability and its interest of \$3.7 million in the subsidiaries that hold these debentures as a component of other assets.

Income Taxes. The Company files a life/non-life consolidated federal tax return, pursuant to an election made with the 2001 tax return. RSLIC-Texas and RSLIC are taxed as life insurance companies and comprise the life subgroup. The non-life subgroup includes DFG, SNCC, FRSLIC, SFIC and the non-insurance subsidiaries of the Company. The Company computes a balance sheet amount for deferred income taxes, which is included in other assets or other liabilities, at the rates expected to be in effect when the underlying differences will be reported in the Company's income tax returns.

Premium Recognition. The Company's group insurance products consist primarily of short-duration contracts, and, accordingly, premiums for these products are reported as earned over the contract period and recognized in proportion to the amount of insurance protection provided. All insurance-related revenue is reported net of premiums ceded under reinsurance arrangements. A reserve is provided for the portion of premiums written which relates to unexpired contract terms. Deposits for asset accumulation products are recorded as liabilities rather than as premiums, since these products generally do not involve mortality or morbidity risk. Revenue from asset accumulation products consists of policy charges for the cost of insurance, policy administration charges and surrender charges assessed against the policyholder account balances during the period.

Stock Options. Prior to 2003, the Company accounted for stock options according to Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and related interpretations. The Company's stock option plans are more fully described in Note N. All options granted prior to 2003 had an intrinsic value of zero on the date of grant under APB No. 25, and, therefore, no stock-based employee compensation expense is recognized in the

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
DECEMBER 31, 2005

## NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (CONTINUED)

Company's financial statements for these options. Effective January 1, 2003, the Company adopted the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Under the prospective method provisions of SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," the recognition provisions of SFAS No. 123 are applied to all option awards granted, modified, or settled after January 1, 2003. The amount of expense related to stock-based compensation included in the determination of the Company's net income for 2003, 2004 and 2005 is lower than if these provisions had been applied to all awards granted since the original January 1, 1995 effective date of SFAS No. 123. The following table illustrates the effect on net income and earnings per share as if the Company had begun to apply the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation as of its original effective date:

	Year Ended December 31,		
	2005	2004	2003
	(dollars in thousands, except per share data)		
Net income, as reported .....	\$113,334	\$123,543	\$98,916
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects .....	5,701	2,222	1,218
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects .....	(5,964)	(2,955)	(2,229)
Pro forma net income .....	\$113,071	\$122,810	\$97,905
Earnings per share:			
Basic, as reported .....	\$ 3.47	\$ 3.87	\$ 3.17
Basic, pro forma .....	3.46	3.84	3.14
Diluted, as reported .....	\$ 3.38	\$ 3.75	\$ 3.09
Diluted, pro forma .....	3.35	3.70	3.03

The weighted average per share fair value used to calculate compensation expense for 2005, 2004 and 2003 was \$14.77, \$11.46 and \$7.85, respectively. These fair values were estimated at the grant date using the Black-Scholes option pricing model with the following assumptions: risk-free interest rates ranging from 2.3% to 4.4%, volatility factors of the expected market price of the Company's common stock ranging from 10% to 29%, expected lives of the options of two to five years and dividend yields from 0.6% to 0.9%. Compensation expense is recognized over the expected life of the option using the straight-line method.

Statements of Cash Flows. The Company uses short-term, highly liquid debt instruments purchased with maturities of three months or less as part of its

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investment management program and, as such, classifies these investments under the caption "short-term investments" in its Consolidated Balance Sheets and Consolidated Statements of Cash Flows.

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### DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) DECEMBER 31, 2005

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (CONTINUED)

##### Recently Issued Accounting Standards

In December 2004, the FASB issued SFAS No. 123 (Revised) ("123R"), "Share-Based Payment," a revision of SFAS No. 123, which requires all share-based payments to employees, including grants of employee stock options, to be recognized as expense in the income statement based on their fair values and prohibits pro forma disclosure as an alternative. SFAS No. 123R was scheduled to be effective no later than the first interim or annual period beginning after June 15, 2005 with early adoption also permitted. However, in April 2005 the United States Securities and Exchange Commission delayed the effective date for registrants that are not small business issuers to adopt SFAS No. 123R no later than the beginning of the first fiscal year beginning after June 15, 2005. Upon adoption of SFAS No. 123R, the Company is required to select a transition method between two permitted alternatives, a "modified prospective" transition method or a "modified retrospective" transition method. Under the "modified prospective" method, compensation cost is recognized for all new awards granted after the date of adoption and any previously granted awards that are not fully vested. Under the "modified retrospective" method, compensation cost is recognized based on the requirements of the modified prospective method described above, but this method also permits the restatement of financial statements, either for all prior periods presented or prior interim periods in the year of adoption, based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures. Effective January 1, 2006, the Company adopted FAS No. 123R using the "modified prospective" transition method.

Since FAS No. 123R must be applied not only to new awards but to previously granted awards that are not fully vested on the effective date, and the Company has already adopted SFAS No. 123 using the prospective transition method, compensation cost for some previously granted awards that were not recognized under SFAS No. 123 will be recognized under SFAS No. 123R. However, had the Company adopted SFAS No. 123R in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share above in "Stock Options." In addition, SFAS No. 123R requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as previously required under GAAP. The Company's benefits of tax deductions in excess of recognized compensation cost were \$7.5 million, \$4.6 million and \$2.3 million in 2005, 2004 or 2003, respectively. The adoption of SFAS No. 123R will not have a material effect on the financial position or results of operations of the Company.

#### NOTE B - INVESTMENTS

The amortized cost and fair value of investments in fixed maturity securities available for sale are as follows:

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	December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(dollars in thousands)			
Mortgage-backed securities.....	\$ 839,889	\$14,589	\$ (11,936)	\$ 842,54
Corporate securities.....	1,349,205	39,422	(21,760)	1,366,86
U.S. Treasury and other U.S. Government guaranteed securities.....	422,618	2,173	(3,053)	421,73
Obligations of U.S. states, municipalities and political subdivisions.....	596,944	17,415	(742)	613,61
Total fixed maturity securities.....	<u>\$3,208,656</u>	<u>\$73,599</u>	<u>\$ (37,491)</u>	<u>\$3,244,76</u>

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
 DECEMBER 31, 2005

NOTE B - INVESTMENTS - (CONTINUED)

	December 31, 2004			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(dollars in thousands)			
Mortgage-backed securities.....	\$ 761,406	\$ 19,713	\$ (4,051)	\$ 777,06
Corporate securities.....	1,356,314	75,123	(6,066)	1,425,37
U.S. Treasury and other U.S. Government guaranteed securities.....	330,856	3,721	(314)	334,26
Obligations of U.S. states, municipalities and political subdivisions.....	489,942	22,637	(268)	512,31
Total fixed maturity securities.....	<u>\$2,938,518</u>	<u>\$121,194</u>	<u>\$ (10,699)</u>	<u>\$3,049,01</u>

The amortized cost and fair value of fixed maturity securities available for sale at December 31, 2005, by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations, with or without prepayment penalties.

Amortized Cost	Fair Value
-----	-----

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(dollars in thousands)

Mortgage-backed securities .....	\$ 839,889	\$ 842,542
Other securities:		
Less than one year .....	98,040	97,691
Greater than 1, up to 5 years ...	696,215	706,925
Greater than 5, up to 10 years ..	804,742	810,156
Greater than 10 years .....	769,770	787,450
	-----	-----
Total .....	\$3,208,656	\$3,244,764
	=====	=====

Net investment income was attributable to the following:

	Year Ended December 31,		
	-----	-----	-----
	2005	2004	2003
	-----	-----	-----
	(dollars in thousands)		
Gross investment income:			
Fixed maturity securities ..	\$189,814	\$185,765	\$169,428
Mortgage loans .....	14,764	8,133	4,676
Other .....	44,012	35,463	41,343
	-----	-----	-----
	248,590	229,361	215,447
Less: Investment expenses .....	25,021	26,917	29,110
	-----	-----	-----
	\$223,569	\$202,444	\$186,337
	=====	=====	=====

Net realized investment gains arose from the following:

	Year Ended December 31,		
	-----	-----	-----
	2005	2004	2003
	-----	-----	-----
	(dollars in thousands)		
Fixed maturity securities ....	\$2,656	\$13,178	\$11,857
Other investments .....	6,347	2,282	867
	-----	-----	-----
	\$9,003	\$15,460	\$12,724
	=====	=====	=====

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
 DECEMBER 31, 2005

NOTE B - INVESTMENTS - (CONTINUED)





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The Company regularly evaluates its investment portfolio for factors that may indicate that a decline in the fair value of an investment is other than temporary. The gross unrealized losses in 2005 are attributable to over five hundred seventy fixed maturity security positions with no unrealized loss attributable to any one security exceeding \$1.8 million. At December 31, 2005 approximately 62% of these aggregate gross unrealized losses relate to fixed maturity security positions as to which such losses represent 10% or less of the amortized cost for the applicable security. Unrealized losses attributable to investment grade fixed maturity securities as determined by nationally recognized statistical rating organizations at December 31, 2005 comprised 64% of the aggregate gross unrealized losses. Unrealized losses attributable to non-investment grade fixed maturity securities at December 31, 2005 comprised 36% of the aggregate gross unrealized losses. For non-investment grade fixed maturity securities, management evaluated the financial position and prospects of the issuers, conditions in the issuers' industries and geographic areas, and liquidity of the investments. Based on an evaluation of these factors and the other factors described in Note A to the Consolidated Financial Statements and the Company's ability and intent to retain the investments to allow for the anticipated recovery in the investments' fair value, management believes that the unrealized losses in the table above are temporary.

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### DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) DECEMBER 31, 2005

#### NOTE B - INVESTMENTS - (CONTINUED)

The Company, at times, enters into futures and option contracts and interest rate and credit default swap agreements in connection with its investment strategy primarily to reduce the risk associated with changes in the value of its fixed maturity portfolio. These positions are carried at fair value with gains and losses included in income. The Company recognized net investment gains (losses) of \$0.6 million, \$(0.6) million and \$(3.7) million in 2005, 2004 and 2003, respectively, related to these instruments. The Company had no material outstanding futures and option contracts or interest rate and credit default swap agreements at December 31, 2005 or 2004. The Company, at times, may also invest in non-dollar denominated fixed maturity securities that expose it to fluctuations in foreign currency rates, and, therefore, may hedge such exposure by using currency forward contracts. The Company had no material outstanding currency forward contracts at December 31, 2005 or 2004.

Bonds and short-term investments with amortized costs of \$93.0 million and \$73.1 million at December 31, 2005 and 2004, respectively, are on deposit with various states' insurance departments in compliance with statutory requirements. Additionally, certain assets of the Company are restricted under the terms of reinsurance agreements. These agreements provide for the distribution of assets to the reinsured companies covered under the agreements prior to any general distribution to policyholders in the event of the Company's insolvency or bankruptcy. The amount of assets restricted for this purpose was \$102.7 million and \$65.1 million at December 31, 2005 and 2004, respectively.

At December 31, 2005 and 2004, approximately 35% and 40%, respectively, of the Company's total invested assets were comprised of corporate fixed maturity securities, which are diversified across economic sectors and industry classes. Mortgage-backed securities comprised 22% of the Company's total invested assets

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at December 31, 2005 and 2004. The Company's mortgage-backed securities are diversified with respect to size and geographic distribution of the underlying mortgage loans. The Company also invests in certain debt securities that are rated by nationally recognized statistical rating organizations as below investment grade or that are not rated. Such securities, which are included in fixed maturity securities, had fair values of \$276.6 million and \$201.2 million at December 31, 2005 and 2004, respectively, and constituted 7.1% and 5.7% of total invested assets at December 31, 2005 and 2004, respectively.

Summarized aggregate unaudited financial information for the limited partnerships and limited liability companies in which the Company maintained investments as of the date is set forth below:

	December 31,	
	2005	2004
	(dollars in thousands)	
Assets .....	\$29,627,216	\$24,523,835
Liabilities .....	\$ 8,609,460	\$ 6,131,594
Capital .....	21,017,756	18,392,241
Total liabilities and capital ....	\$29,627,216	\$24,523,835
Net income .....	\$ 3,669,431	\$ 3,246,081

The fair value of the Company's investment in the securities of any one issuer or securities backed by a single pool of assets, excluding U.S. Government obligations, whose value represented 10% or more of the Company's shareholders' equity at December 31, 2005 was as follows: Bankers Trust Corporation Secured Portfolio Notes, Series 1998-1 - \$155.1 million.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
 DECEMBER 31, 2005

NOTE C - DISABILITY, ACCIDENT AND CASUALTY FUTURE POLICY BENEFITS AND UNPAID CLAIMS AND CLAIM EXPENSES

The following table provides a reconciliation of the beginning and ending disability, accident and casualty future policy benefits and unpaid claims and claim expenses:

	Year Ended December 31,		
	2005	2004	2003
	(dollars in thousands)		
Balance at beginning of year, net of reinsurance .....	\$1,088,984	\$ 949,020	\$ 862,355

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Add provisions for claims and claim expenses incurred, net of reinsurance, occurring during:			
Current year .....	486,752	370,618	305,463
Prior years .....	31,735	13,960	6,401
	-----	-----	-----
Incurred claims and claim expenses during the current year, net of reinsurance .....	518,487	384,578	311,864
	-----	-----	-----
Deduct claims and claim expenses paid, net of reinsurance, occurring during:			
Current year .....	98,247	61,742	69,351
Prior years .....	224,824	182,872	155,848
	-----	-----	-----
	323,071	244,614	225,199
	-----	-----	-----
Balance at end of year, net of reinsurance .....	1,284,400	1,088,984	949,020
Reinsurance receivables at end of year .....	249,101	264,189	252,568
	-----	-----	-----
Balance at end of year, gross of reinsurance (1) .....	\$1,533,501	\$1,353,173	\$1,201,588
	=====	=====	=====
Balance Sheets:			
Future policy benefits:			
Disability and accident .....	\$ 539,929	\$ 488,909	
Unpaid claims and claim expenses:			
Disability and accident .....	247,093	218,316	
Casualty(1) .....	746,479	645,948	
	-----	-----	
	\$1,533,501	\$1,353,173	
	=====	=====	

(1) All years include the results from the Company's discontinued non-core property catastrophe reinsurance business. See Note S to the Consolidated Financial Statements.

In 2005 and 2004, the change in the provision for claims and claims expenses incurred in prior years reflects the accretion of discounted reserves and unfavorable claims development. In 2003, the change in the provision for claims and claim expenses incurred in prior years reflects the accretion of discounted reserves offset by favorable claims development. The Company's insurance policies do not provide for the retrospective adjustment of premiums based on claim experience.

NOTE D - CORPORATE DEBT

In May 2005, the Company entered into a new \$200.0 million revolving credit facility with Bank of America, N.A. as administrative agent, and a group of major banking institutions (the "Credit Agreement"), which replaced the existing \$100.0 million revolving credit facility scheduled to expire in December 2006. The Company had outstanding borrowings of \$91.0 million under the Credit Agreement at December 31, 2005 and \$14.0 million of outstanding borrowings under the previous revolving credit facility at December 31, 2004. Interest on borrowings under the Credit Agreement is payable, at the Company's election, either at a floating rate based on LIBOR plus a specified margin which varies depending on the level of the specified ratings of the Company's senior unsecured debt, as in effect from time to time, or at Bank of America, N.A.'s prime rate. Certain commitment and utilization fees are also payable under the Credit Agreement. The Credit Agreement contains certain financial and various other affirmative and negative covenants

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
DECEMBER 31, 2005

NOTE D - CORPORATE DEBT - (CONTINUED)

considered ordinary for this type of credit agreement. They include, among others, the maintenance of a specified debt to capital ratio, minimum consolidated net worth of the Company, minimum risk-based capital requirements for the Company's insurance subsidiaries, RSLIC and SNCC, and certain limitations on investments and subsidiary indebtedness. The maturity date of the Credit Agreement is May 26, 2010. As of December 31, 2005, the Company was in compliance in all material respects with the financial and various other affirmative and negative covenants in the Credit Agreement.

On May 20, 2003, the Company issued \$143.8 million of 8.00% Senior Notes due 2033 (the "2033 Senior Notes") in a public offering. The proceeds from the 2033 Senior Notes were used to repay the outstanding borrowings under the Company's previous revolving credit facility and to repay in full the principal amount of \$66.5 million of existing 8.00% senior notes at their maturity on October 1, 2003. The 2033 Senior Notes, which were issued at par value, will mature on May 15, 2033 and are redeemable at par at the option of the Company, in whole or in part, at any time on or after May 15, 2008. The 2033 Senior Notes are not redeemable at the option of any holder of the notes prior to maturity nor are they entitled to any sinking fund redemptions. Interest on the 2033 Senior Notes is payable quarterly on February 15, May 15, August 15 and November 15 of each year. The 2033 Senior Notes are senior unsecured obligations of the Company and, as such, are effectively subordinated to all claims of secured creditors of the Company and its subsidiaries and to claims of unsecured creditors of the Company's subsidiaries, including the insurance subsidiaries' obligations to policyholders. The 2033 Senior Notes were issued in denominations of \$25 and multiples of \$25 and are listed on the New York Stock Exchange. As of December 31, 2005, the Company was in compliance in all material respects with the terms of the related indenture.

To mitigate the risk of interest rates rising before the issuance of the 2033 Senior Notes could be completed, the Company entered into a treasury rate lock agreement in September 2002, with a notional amount of \$150.0 million, and an anticipated debt term of 10 years. The Company paid \$13.8 million upon the issuance of the 2033 Senior Notes in May 2003 to settle the treasury rate lock agreement. This transaction was accounted for as a cash flow hedge under the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." Accordingly, \$12.1 million of the loss on the treasury rate lock agreement was recorded in accumulated other comprehensive income in May 2003 and is being amortized into interest expense ratably over 10 years. The Company will amortize \$1.2 million of such \$12.1 million loss into interest expense over the next twelve months. The remaining \$1.7 million of loss on the treasury rate lock agreement was deemed ineffective and, therefore, was recognized as a reduction of net investment income during the second quarter of 2003. At December 31, 2005, 2004 and 2003 the net loss on the treasury rate lock agreement included in accumulated other comprehensive income was \$5.8 million, \$6.6 million and \$7.4 million, respectively, net of an income tax benefit of \$3.1 million, \$3.6 million and \$4.0 million, respectively.

In May 2003, the Company made the final \$9.0 million principal payment on the \$45.0 million of SIG's 8.5% senior secured notes, which the Company had assumed in 1996.

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The Company also repaid in full the \$5.7 million principal amount due on the 8.00% subordinated notes in June 2003, which the Company had issued in conjunction with the acquisition of Matrix in 1998.

Interest paid by the Company on its corporate debt totaled \$13.6 million, \$12.4 million and \$12.9 million during 2005, 2004 and 2003, respectively.

### NOTE E - ADVANCES FROM THE FEDERAL HOME LOAN BANK

The Company, through its insurance subsidiaries, maintains a program in which various investments are financed using advances from various Federal Home Loan Banks (collectively, the "FHLB"). At December 31, 2005 and 2004, advances from the FHLB, including accrued interest, totaled \$55.3 million and \$85.4 million, respectively. During 2005, \$30.0 million of advances from the FHLB matured and were repaid. Interest expense on the advances is included as an offset to investment income on the financed securities. The average interest rate on the outstanding advances was 7.5% and 5.7% at December 31, 2005 and 2004, respectively. The advance of \$55.0 million, which was obtained at a fixed rate, has a term of 14.5 years at December 31, 2005. This advance is collateralized by fixed maturity securities with a fair value of \$57.8 million.

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### DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) DECEMBER 31, 2005

### NOTE F - SECURITIES LENDING

The Company maintains a securities lending program under which certain securities from its portfolio are loaned to other institutions for short periods of time. The Company maintains full ownership rights to the securities loaned and continues to earn interest and dividends on them. Accordingly, such securities are included in invested assets. The Company obtains collateral for such loans at approximately 102% of the market value of a loaned security. The Company's institutional lending agent monitors the market value of the securities loaned and obtains additional collateral as necessary. The collateral is deposited by the borrower with, and held by, such agent. Cash collateral is invested by such agent to generate additional income according to specified guidelines. The securities lending collateral is reported as an asset with a corresponding liability reflected for the obligation to return the collateral. At December 31, 2005 and 2004, the Company had securities on loan with a market value of \$238.7 million and \$231.8 million and cash collateral of \$244.8 million and \$236.9 million, respectively.

### NOTE G - INCOME TAXES

Income tax expense is reconciled to the amount computed by applying the statutory federal income tax rate to income before income tax expense:

Year Ended December 31,		
2005	2004	2003
(dollars in thousands)		

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Federal income tax expense at statutory rate .....	\$64,245	\$57,543	\$48,275
Tax-exempt income and dividends received deduction .....	(7,753)	(6,693)	(6,324)
Favorable resolution of federal income tax audits and other..	383	(7,846)	695
	-----	-----	-----
	\$56,875	\$43,004	\$42,646
	=====	=====	=====

All of the Company's current and deferred income tax expense is due to federal income taxes as opposed to state income taxes.

Deferred tax assets and liabilities are determined based on the difference between the book basis and tax basis of assets and liabilities using tax rates in effect for the year in which the differences are expected to reverse. The components of the net deferred tax liability are as follows:

	December 31,	
	2005	2004
	-----	-----
	(dollars in thousands)	
Cost of business acquired .....	\$ 78,083	\$ 66,171
Future policy benefits and unpaid claims and claim expenses..	58,743	47,240
Investments .....	26,986	43,790
Other .....	10,120	7,835
	-----	-----
Gross deferred tax liabilities .....	173,932	165,036
	-----	-----
Future policy benefits and unpaid claims and claim expenses..	(6,916)	(9,819)
Cost of business acquired and other .....	(25,181)	(23,300)
Net operating loss carryforwards .....	(18,977)	(12,550)
	-----	-----
Gross deferred tax assets .....	(51,074)	(45,669)
	-----	-----
Net deferred tax liability .....	\$122,858	\$119,367
	=====	=====

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
DECEMBER 31, 2005

NOTE G - INCOME TAXES - (CONTINUED)

Current tax expense, deferred tax expense, current tax (recoverable) liability and income taxes paid and refunded are as follows:

As of or for the Year Ended		
December 31,		
-----	-----	-----
2005	2004	2003
-----	-----	-----

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(dollars in thousands)

Current tax expense .....	\$28,565	\$20,675	\$32,546
Deferred tax expense .....	28,310	22,329	10,100
Current tax (recoverable) liability ..	(1,283)	5,265	817
Income taxes paid .....	25,608	21,098	21,800
Income tax refunds .....	--	6,017	--

At December 31, 2005, DFG, SNCC and the other non-life insurance subsidiaries have net operating loss carryforwards of \$54.2 million, which will begin expiring in 2020. The Company's federal tax returns are routinely audited by the Internal Revenue Service ("IRS"). During 2004, the Company's income taxes payable was reduced by \$6.6 million primarily from the favorable resolution of IRS audits of the 1998 through 2002 tax years. This reduction represented the release of previous accruals for potential audit adjustments which were subsequently settled or eliminated and further refinement of existing tax exposures. Tax years through 2002 are closed to further assessment by the IRS. Management believes any future adjustments that may result from IRS examinations of tax returns will not have a material impact on the consolidated financial position, liquidity, or results of operations of the Company.

NOTE H - PRESENT VALUE OF FUTURE PROFITS

A summary of the activity related to the PVFP asset, which is included in cost of business acquired on the consolidated balance sheet, is shown below:

	Year Ended December 31,		
	2005	2004	2003
	(dollars in thousands)		
Balance at beginning of year..	\$ 7,058	\$ 9,087	\$11,198
Interest accrued.....	141	161	189
Amortization.....	(2,216)	(2,190)	(2,300)
Balance at end of year.....	\$ 4,983	\$ 7,058	\$ 9,087
	=====	=====	=====

An estimate of the percentage of the December 31, 2005 PVFP balance to be amortized over each of the next five years is as follows: 2006 - 42.5%, 2007 -37.0%, 2008 -10.1%, 2009 -5.4% and 2010 - 5.0%.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
 DECEMBER 31, 2005

NOTE I- FAIR VALUES OF FINANCIAL INSTRUMENTS

The fair values of the Company's financial instruments are shown below. Because fair values for all balance sheet items are not required to be disclosed by SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," the aggregate fair value amounts presented below do not necessarily represent the underlying value of the Company.

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	December 31,		2004	
	2005			
	Carrying Value	Fair Value	Carrying Value	
	(dollars in thousands)			
<b>Assets:</b>				
Fixed maturity securities, available for sale.....	\$3,244,764	\$3,244,764	\$3,049,013	\$3
Short-term investments.....	94,308	94,308	95,761	
Other investments.....	573,532	573,532	396,302	
Securities lending collateral.....	244,821	244,821	236,900	
Assets held in separate account.....	99,428	99,428	88,205	
<b>Liabilities:</b>				
Policyholder account balances.....	959,446	927,140	948,847	
Corporate debt.....	234,750	241,018	157,750	
Junior subordinated deferrable interest debentures underlying company-obligated mandatorily redeemable capital securities issued by unconsolidated subsidiaries.....	59,762	61,565	59,762	
Securities lending payable.....	244,821	244,821	236,900	
Advances from Federal Home Loan Bank.....	55,342	68,046	85,395	
Liabilities related to separate account.....	99,428	99,428	88,205	

The fair values for fixed maturity securities and short-term investments have been obtained from broker-dealers, nationally recognized statistical organizations and, in the case of certain structured notes, by reference to the fair values of the underlying investments. Securities acquired through private placements in the Company's fixed maturity and equity securities portfolio that are not actively traded in a liquid market and do not have other mechanisms for their sale totaled \$110.2 million and \$76.6 million at December 31, 2005 and 2004, respectively. The Company estimates the fair value of these securities primarily by comparison to similar securities with quoted market prices. If quotes are not available on similar securities, the Company estimates fair value based on recent purchases or sales of similar securities or other internally prepared valuations. Key assumptions used in this process include the level of risk-free interest rates, risk premiums, and performance of underlying collateral, if applicable. All such investments are classified as available for sale. The Company's ability to liquidate these investments in a timely manner, if necessary, may be adversely impacted by the lack of an actively traded market. Historically, the Company has not realized amounts on dispositions of non-marketable investments materially in excess of the gain or loss amounts estimated by the Company under this valuation methodology. The Company believes that its estimates reasonably reflect the fair values of these securities; however, had there been an active market for these securities during the applicable reporting periods, the market prices may have been materially different than the amounts reported. The carrying values for all other invested assets approximate fair values based on the nature of the investments. The carrying values for securities lending collateral and payable approximate fair value as the asset and the liability are very short-term in nature. The carrying values of separate account assets and liabilities are equal to fair value.

Policyholder account balances are net of reinsurance receivables and the carrying values have been decreased for related acquisition costs of \$60.6 million and \$46.2 million at December 31, 2005 and 2004, respectively. Fair



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values for policyholder account balances were determined by deducting an estimate of the future profits to be realized from the business, discounted at a current interest rate, from the adjusted carrying values.

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### DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) DECEMBER 31, 2005

#### NOTE I - FAIR VALUES OF FINANCIAL INSTRUMENTS - (CONTINUED)

The Company believes the fair value of its variable rate long-term debt and variable rate junior subordinated deferrable interest debentures are equal to their carrying value. The Company pays variable rates of interest on this debt and these debentures, which reflect changed market conditions since the time the terms were negotiated. The fair values of the 2033 Senior Notes and the fixed rate junior subordinated deferrable interest debentures are based on the expected cash flows discounted to net present value. The fair values for fixed rate advances from the FHLB were calculated using discounted cash flow analyses based on the interest rates for the advances at the balance sheet date.

#### NOTE J - JUNIOR SUBORDINATED DEFERRABLE INTEREST DEBENTURES UNDERLYING THE COMPANY-OBLIGATED MANDATORILY REDEEMABLE CAPITAL SECURITIES OF UNCONSOLIDATED SUBSIDIARIES

In 1997, Delphi Funding L.L.C. ("Delphi Funding"), a consolidated subsidiary of the Company prior to the adoption of revised FIN No. 46 in 2004, issued \$100.0 million liquidation amount of 9.31% Capital Securities, Series A (the "Capital Securities") in a public offering. During 2001, the Company repurchased \$64.0 million liquidation amount of the Capital Securities in the open market. In connection with the issuance of the Capital Securities and the related purchase by the Company of all of the common limited liability company interests in Delphi Funding, the Company issued to Delphi Funding \$103.1 million principal amount of 9.31% junior subordinated deferrable interest debentures, Series A, due 2027 (the "Junior Debentures"). Interest on the outstanding Junior Debentures is payable semiannually, but may, subject to certain exceptions, be deferred at any time or from time to time for a period not exceeding five years with respect to each deferral period, in which event dividends on the Capital Securities will also be deferred and the Company will not be permitted to pay cash dividends or make payments on any junior indebtedness. No interest payments on the Junior Debentures have been deferred since their issuance. The distribution and other payment dates on the Capital Securities correspond to the interest and other payment dates on the Junior Debentures. The Junior Debentures are not redeemable prior to March 25, 2007, but the Company has the right to dissolve Delphi Funding at any time and distribute the Junior Debentures to the holders of the Capital Securities. Pursuant to the related transaction documents, the Company has, on a subordinated basis, guaranteed all payments due on the Capital Securities.

On May 15, 2003, Delphi Financial Statutory Trust I (the "Trust"), a Connecticut statutory trust and consolidated subsidiary of the Company prior to the adoption of revised FIN No. 46 in 2004, issued \$20.0 million liquidation amount of Floating Rate Capital Securities (the "2003 Capital Securities") in a private placement transaction. In connection with the issuance of the 2003 Capital Securities and the related purchase by the Company of all of the common securities of the Trust (the "2003 Common Securities" and, collectively with the 2003 Capital Securities, the "Trust Securities"), the Company issued \$20.6 million principal amount of floating rate junior subordinated deferrable

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interest debentures, due 2033 (the "2003 Junior Debentures"). Interest on the 2003 Junior Debentures is payable quarterly on February 15, May 15, August 15 and November 15 of each year. The interest rate on the 2003 Junior Debentures resets quarterly to a rate equal to the London interbank offered interest rate, LIBOR, for three-month U.S. dollar deposits, plus 4.10% (not to exceed 12.50%). The weighted average interest rate on the 2003 Junior Debentures was 7.40%, 5.56%, and 5.31% for the years ended December 31, 2005, 2004 and 2003, respectively. The distribution and other payment dates on the Trust Securities correspond to the interest and other payment dates on the 2003 Junior Debentures. The 2003 Junior Debentures are unsecured and subordinated in right of payment to all of the Company's existing and future senior indebtedness. Beginning in May 2008, the Company will have the right to redeem the 2003 Junior Debentures, in whole or in part, at a price equal to 100% of the principal amount of the debentures, plus accrued and unpaid interest to the date of redemption.

As a result of the adoption of revised FIN No. 46 in 2004, the Company was required to deconsolidate its subsidiaries that hold junior subordinated deferrable interest debentures of the Company which underlie the Company-obligated mandatorily redeemable capital securities of these subsidiaries. Therefore, at December 31, 2005 and 2004, the Company presented in its consolidated financial statements the junior subordinated deferrable interest debentures of \$59.8 million as a liability and its interest of \$3.7 million in the subsidiaries that hold these debentures as a component of other assets.

Interest paid by the Company on the outstanding junior subordinated deferrable interest debentures totaled \$4.8 million, \$4.5 million and \$3.9 million during 2005, 2004 and 2003, respectively.

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### DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) DECEMBER 31, 2005

#### NOTE K - SHAREHOLDERS' EQUITY AND RESTRICTIONS

The holders of the Company's Class A Common Stock are entitled to one vote per share, and the holders of the Company's Class B Common Stock are entitled to the number of votes per share equal to the lesser of (1) the number of votes such that the aggregate of all outstanding shares of Class B Common Stock will be entitled to cast 49.9% of all votes represented by the aggregate of all outstanding shares of Class A Common Stock and Class B Common Stock or (2) ten votes per share. On November 21, 2003, the Company's Board of Directors declared a 3-for-2 common stock split effected in the form of a 50% stock dividend, which was distributed on December 22, 2003 to stockholders of record on December 8, 2003. A total of 11,211,435 shares of common stock were issued in connection with the split, and the aggregate amount of \$0.1 million, equal to the par value of the common stock issued, was reclassified from additional paid-in capital to common stock. The stated par value of each share remained at \$0.01.

In 2001, the Company's Board of Directors approved the initiation of a quarterly cash dividend, payable on the Company's outstanding Class A and Class B Common Stock. The quarterly cash dividend was \$0.05 per share during the first three quarters of 2003. In the fourth quarter of 2003, the Company's Board of Directors approved an increase in the Company's quarterly cash dividend to \$0.08 per share. In the first quarter of 2005, the quarterly cash dividend declared by the Company's Board of Directors was increased by 12.5% to \$0.09 per share.

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During 2005, 2004 and 2003, the Company paid cash dividends on its capital stock in the amounts of \$11.6 million, \$10.1 million and \$7.4 million, respectively. Under the Company's Credit Agreement, it is permitted to pay cash dividends on its capital stock and repurchase or redeem its capital stock without limitation, as long as the Company is in pro forma compliance with the requirements of the agreement.

The Company's life insurance subsidiaries had consolidated statutory capital and surplus of \$375.0 million and \$330.9 million at December 31, 2005 and 2004, respectively. Consolidated statutory net income for the Company's life insurance subsidiaries was \$56.8 million, \$30.7 million and \$24.8 million, in 2005, 2004 and 2003, respectively. The consolidated statutory net income for the Company's life insurance subsidiaries for 2005, 2004 and 2003 includes a pre-tax charge of \$4.2 million, \$2.1 million and \$16.0 million, respectively, for the other than temporary decline in the value of certain securities. The Company's casualty insurance subsidiary had statutory capital and surplus of \$359.1 million and \$286.2 million at December 31, 2005 and 2004, respectively, and consolidated statutory net income of \$17.2 million, \$34.9 million and \$30.2 million in 2005, 2004 and 2003, respectively. The consolidated statutory net income for the Company's casualty insurance subsidiary included after-tax (loss) income of \$(13.4) million, \$2.0 million and \$3.6 million attributable to its non-core property catastrophe reinsurance business that it decided to exit in the fourth quarter of 2005. Payment of dividends by the Company's insurance subsidiaries is regulated by insurance laws and is permitted based on, among other things, the level of prior-year statutory surplus and net income. The Company's insurance subsidiaries will be permitted to make dividend payments totaling \$72.5 million during 2006 without prior regulatory approval.

The Company's Board of Directors has authorized the Company to purchase up to 3.7 million shares of its outstanding Class A Common Stock from time to time on the open market. At December 31, 2005, 0.9 million shares remained authorized for future purchases. During 2005, 2004 and 2003, the Company purchased 0.2 million shares, 0 and 0.3 million shares, respectively, of its Class A Common Stock for a total cost of \$7.1 million, \$0, and \$7.5 million with a volume weighted average price of \$47.19 per share, \$0 and \$24.75 per share, respectively. During 2004, the Company received 13,176 shares of the Company's Class A Common Stock with an aggregate value of \$0.3 million in liquidation of a partnership interest.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
DECEMBER 31, 2005

NOTE K - SHAREHOLDERS' EQUITY AND RESTRICTIONS - (CONTINUED)

The following table provides a reconciliation of beginning and ending shares:

	Year Ended December 31,		
	2005	2004	2003
	(shares in thousands)		
Class A Common Stock:			
Beginning balance .....	30,418	29,457	18,928

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Issuance of stock, exercise of stock options and conversion of shares .....	856	961	710
Three-for-two stock split .....	--	--	9,819
	-----	-----	-----
Ending balance .....	31,274	30,418	29,457
	=====	=====	=====
Class B Common Stock:			
Beginning balance .....	3,904	4,177	3,195
Conversion of shares .....	--	(273)	(410)
Three-for-two stock split .....	--	--	1,392
	-----	-----	-----
Ending balance .....	3,904	3,904	4,177
	=====	=====	=====
Class A Treasury Stock:			
Beginning balance .....	2,573	2,560	1,505
Acquisition of treasury stock .....	150	13	202
Three-for-two stock split .....	--	--	853
	-----	-----	-----
Ending balance .....	2,723	2,573	2,560
	=====	=====	=====

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
 DECEMBER 31, 2005

NOTE L - ACCUMULATED OTHER COMPREHENSIVE INCOME

The components of other comprehensive income are as follows:

	Net Unrealized Appreciation (Depreciation) on Available for Sale Securities	Net Loss on Cash Flow Hedge	M P Li Adj
	-----	-----	-----
			(dollars in thou
Balance, January 1, 2003 .....	\$ 33,572	\$ (3,290)	\$
Unrealized appreciation on available for sale securities (1)..	35,186	--	--
Reclassification adjustment for gains included in net income (2) .....	(8,791)	--	--
	-----	-----	-----
Net change in unrealized appreciation on investments .....	26,395	--	--
Net loss on cash flow hedge(3) .....	--	(5,671)	--
Reclassification adjustment for losses included in net income(4) .....	--	1,565	--
	-----	-----	-----
Increase in net loss on cash flow hedge .....	--	(4,106)	--
Net change in minimum pension liability adjustment (5) .....	--	--	--
	-----	-----	-----

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Balance, December 31, 2003 .....	\$ 59,967	\$ (7,396)	\$
	-----	-----	---
Unrealized appreciation on available for sale securities (1)..	13,760	--	
Reclassification adjustment for gains included in net			
income (2) .....	(9,044)	--	
	-----	-----	---
Net change in unrealized appreciation on			
investments .....	4,716	--	
Reclassification adjustment for losses included			
in net income (4) .....	--	786	
Net change in minimum pension liability adjustment (5) .....	--	--	
	-----	-----	---
Balance, December 31, 2004 .....	\$ 64,683	\$ (6,610)	\$
	-----	-----	---
Unrealized depreciation on available for sale securities (1)..	(35,803)		
Reclassification adjustment for gains included in net			
income (2) .....	(1,390)		
	-----	-----	---
Net change in unrealized depreciation on			
investments .....	(37,193)	--	
Reclassification adjustment for losses included			
in net income (4) .....	--	785	
Net change in minimum pension liability adjustment (5) .....	--	--	
	-----	-----	---
Balance, December 31, 2005 .....	\$ 27,490	\$ (5,825)	\$ (
	=====	=====	==

- (1) Net of an income tax expense (benefit) of \$18.9 million, \$7.4 million and \$(19.3) million for the years ended December 31, 2003, 2004 and 2005, respectively. Also, net of related adjustment to cost of business acquired of \$(5.5) million, \$7.4 million and \$15.3 million for the years ended December 31, 2003, 2004 and 2005, respectively.
- (2) Net of an income tax expense of \$4.7 million, \$4.9 million and \$0.7 million for the years ended December 31, 2003, 2004 and 2005, respectively.
- (3) Net of an income tax benefit of \$3.0 million for the year ended December 31, 2003.
- (4) Net of an income tax benefit of \$0.8 million, \$0.4 million and \$0.4 million for the years ended December 31, 2003, 2004 and 2005, respectively.
- (5) Net of an income tax expense (benefit) of \$0.1 million, \$(0.3) million and \$(0.4) million for the years ended December 31, 2003, 2004 and 2005, respectively.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)  
DECEMBER 31, 2005

NOTE M - COMMITMENTS AND CONTINGENCIES

Total rental expense for operating leases, principally for administrative and sales office space, was \$10.0 million, \$9.2 million and \$7.8 million for the

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years ended December 31, 2005, 2004, and 2003, respectively. As of December 31, 2005, future net minimum rental payments under non-cancelable operating leases were approximately \$64.3 million, payable as follows: 2006 - \$11.5 million, 2007 - \$10.8 million, 2008 - \$9.6 million, 2009 - \$7.1 million, 2010 - \$6.8 million and \$18.5 million thereafter.

In the course of its business, the Company is a party to litigation and other proceedings, primarily involving its insurance operations. In some cases, these proceedings entail claims against the Company for punitive damages and similar types of relief. The ultimate disposition of such pending litigation and proceedings is not expected to have a material adverse effect on the Company's financial position. In addition, incident to its discontinued products, the Company has been and is currently a party to various arbitrations arising out of accident and health reinsurance arrangements in which it and other companies formerly were participating reinsurers. During the second quarter of 2004, the Company, along with other former participants, reached a settlement resolving the matters in dispute in one of these arbitrations, and a favorable determination in another such arbitration was rendered during the third quarter of 2005. The Company increased its reserves relating to the reinsurance business in dispute in the settled arbitration by a total of \$5.5 million during the year ended December 31, 2004. The Company believes that it has substantial defenses upon which to contest the claims made in the remaining arbitration, although it is not possible to predict the ultimate outcome of this arbitration. In the opinion of management, such arbitration, when ultimately resolved, will not have a material adverse effect on the Company's financial position.

### NOTE N - STOCK OPTIONS

Under the terms of the Company's outside director's stock plan and two employee stock option plans, a total of 5,775,000 shares of Class A Common Stock have been reserved for issuance. The exercise price for options granted under these plans is the fair market value of the underlying stock as of the date of the grant and the maximum term of an option is ten years. The stock options granted under these plans expire at various dates between 2006 and 2015.

In 2003, the Company's Board of Directors approved a long-term incentive and share award plan (the "2003 Employee Award Plan") for the granting of restricted shares, restricted share units (the receipt of shares or cash at the end of the specified deferral period), other share-based awards, or options to purchase shares of Class A Common Stock to employees and other individuals who, in the judgment of the Stock Option and Compensation Committee of the Company's Board of Directors (the "Committee"), can make substantial contributions to the long-term profitability and the value of the Company, its subsidiaries or affiliates. In 2004, the Committee amended the 2003 Employee Award Plan, to increase the aggregate number of shares by 1,000,000, which amendment was approved by the Company's stockholders at the 2004 Annual Meeting. Under the terms of the 2003 Employee Award Plan, a total of 2,500,000 shares of Class A Common Stock have been reserved for issuance. Awards of restricted shares and restricted share units are subject to restrictions on transferability and other restrictions, if any, as the Committee may impose. The Committee may determine that an award of restricted shares or restricted share units or an other share-based award to be granted under this plan qualifies as qualified performance-based compensation. The grant, vesting, and/or settlement of this type of performance-based award is contingent upon achievement of pre-established performance objectives, which may vary from individual to individual and based on performance criteria as the Committee may deem appropriate. The exercise price of options granted under this plan is determined by the Committee provided that the exercise price may not be less than the fair market value of the underlying stock as of the date of the grant. The maximum term of an option is ten years.

In February 2006, 2005 and 2004, the Company granted a total of 12,226, 10,750

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and 12,887 restricted share units of Class A Common Stock, respectively, under the 2003 Employee Award Plan to two executive officers of the Company based on their performance during 2005, 2004 and 2003, respectively. The Company recognized \$0.6 million, \$0.5 million and \$0.5 million of compensation expense in 2005, 2004 and 2003, respectively, related to these awards.

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### DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) DECEMBER 31, 2005

#### NOTE N - STOCK OPTIONS - (CONTINUED)

In May 2005, the Company granted restricted shares of 1,197 Class A Common Stock under the outside director's stock plan to a director of the Company, at such director's option, in lieu of his cash retainer for services as a member of the Company's Board of Directors for the term of service through the Company's Annual Meeting of Stockholders in May 2006. As of December 31, 2005, 598 of these shares had vested with the remainder of the shares to vest by the director's continued service through May 2006. Compensation expense related to the grant was not material in 2005 and is included in the stock based compensation expense disclosed in Note A under the caption "Stock Options."

In April 2004, the Company granted performance-contingent incentive options to purchase 150,000 shares of the Company's Class A Common Stock to each of the seven members of executive management of RSLIC, for a total of 1,050,000 options, under the 2003 Employee Award Plan. The options, which have a ten-year term and whose exercise price is equal to the fair market value of the underlying stock on the grant date, will become exercisable only to the extent that RSLIC-Texas, RSLIC's parent company, meets specified cumulative financial performance targets for the three or five year periods beginning with 2004; otherwise, such options will be forfeited. 75,000 of each executive's options will become exercisable if RSLIC-Texas's aggregate consolidated Pre-Tax Operating Income, as defined and computed under the related option agreements ("RSLT PTOI"), for the three year performance period is at least \$329.4 million; otherwise, a reduced number of such options will become exercisable to the extent that RSLT PTOI for such periods exceeds \$300.5 million, determined by interpolating between zero and 75,000 according to where the RSLT PTOI amount falls in the range between \$300.5 million and \$329.4 million. 150,000 of each executive's options (minus the number of any options that become exercisable for the three year performance period) will become exercisable if RSLIC-Texas's aggregate RSLT PTOI for the five year performance period is at least \$646.2 million; otherwise, a reduced number of such options will become exercisable to the extent that RSLT PTOI for such period exceeds \$559.9 million, determined by interpolating between zero and 150,000 according to where the RSLT PTOI amount falls in the range between \$559.9 million and \$646.2 million.

In December 2005, the Company granted additional performance-contingent incentive options to purchase 50,000 of the Company's Class A Common Stock to each of seven members of executive management of RSLIC, for a total of 350,000 options, under the 2003 Employee Award Plan and the Second Amended and Restated Employee Stock Option Plan. The options have the same financial performance targets for the five-year performance period as the performance-contingent incentive options described above.

In May 2003, the Company granted performance-contingent incentive options to purchase 225,000 shares of the Company's Class A Common Stock to each of the five members of executive management of SNCC, for a total of 1,125,000 options,

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under the 2003 Employee Award Plan and, in December 2005, approved the amendment to the performance targets under such options for the five-year performance period. The options, which have a ten-year term and whose exercise price is equal to the fair market value of the underlying stock on the grant date, will become exercisable only to the extent that SIG, SNCC's parent company, meets specified cumulative financial performance targets for the three or five fiscal year periods beginning with 2003; otherwise, such options will be forfeited. 112,500 of each executive's options will become exercisable if SIG's aggregate consolidated Pre-Tax Operating Income, as defined and computed under the related option agreements ("SIG PTOI"), for the three year performance period is at least \$216.7 million; otherwise, a reduced number of such options will become exercisable to the extent that SIG PTOI for such period exceeds \$196.1 million, determined by interpolating between zero and 112,500 according to where the SIG PTOI amount falls in the range between \$196.1 million and \$216.7 million. Under the option terms, as amended, 225,000 of each executive's options (minus the number of any options that become exercisable for the three year performance period) will become exercisable if SIG's aggregate SIG PTOI for the five year performance period is at least \$417.2 million; otherwise, a reduced number of such options will become exercisable to the extent that SIG PTOI for such period exceeds \$370.4 million, determined by interpolating between zero and 225,000 according to where the SIG PTOI amount falls in the range between \$370.4 million and \$417.2 million. As of December 31, 2005, SNCC did not meet the specified cumulative performance target for the three-year performance period ending December 31, 2005, therefore, no options to purchase shares of the Company's Class A Common Stock became exercisable.

In 2003, the Committee amended and restated the long-term performance-based incentive plan for the Company's chief executive officer (the "Amended Performance Plan"). Under the terms of the Amended Performance Plan, the Committee has the authority to grant awards annually as deemed appropriate, to determine the number of shares subject to any award and to interpret the plan. The Amended Performance Plan provides for the award of up to 238,482 shares measured by

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### DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) DECEMBER 31, 2005

#### NOTE N - STOCK OPTIONS - (CONTINUED)

reference to Stock Units, plus the Carryover Award Amount, as then in effect, per year over a ten-year term. A Stock Unit consists of restricted or deferred shares of the Company's Class B Common Stock, each of which individual shares represent one Stock Unit, and options to purchase shares of Class B Common Stock represent one-third of one Stock Unit. The Carryover Award Amount consists of 476,964 restricted or deferred shares and options to purchase 1,430,886 shares of Class B Common Stock, representing the number of shares as to which awards were available but not granted under the predecessor plan for the performance period consisting of the 1999 through 2002 calendar years, and all or a portion of the Carryover Award Amount may be applied to increase the award amount for any calendar year of the Plan, with the Carryover Award Amount to be decreased by any portions applied for purposes of future calendar years of the Plan. The restricted or deferred shares may not be sold or otherwise disposed of until the earliest of the individual's retirement, disability or death or a change of ownership of the Company, subject to such additional restrictions on sale or disposal as the Committee may determine to impose in connection with a particular award. The exercise price of the options awarded under the Amended



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Performance Plan is the fair market value of the underlying stock as of the date of the grant and the maximum term of the options is ten years. The options become exercisable 30 days following the date of grant. Under the predecessor plan, 357,723 deferred shares and 1,073,166 options were granted to the Company's chief executive officer prior to 1999. In February 2006, 2005 and 2004, the Committee awarded the Company's chief executive officer 48,904 deferred shares, 52,095 deferred shares and 67,010 deferred shares, respectively, under the Amended Performance Plan based on his performance during 2005, 2004 and 2003, respectively. The Company recognized \$2.0 million, \$0.8 million and \$2.6 million of compensation expense relating to such awards in 2005, 2004 and 2003, respectively.

Option activity with respect to the above plans was as follows:

	Year Ended December 31,				
	2005		2004		Number of Options
	Number of Options	Average Exercise Price	Number of Options	Average Exercise Price	
Options outstanding, beginning of year ..	5,306,946	\$28.26	4,683,067	\$23.70	3,765,1
Options granted .....	573,115	45.61	1,207,736	41.47	1,250,0
Options forfeited .....	(11,150)	32.27	(10,753)	38.56	(39,4
Options expired .....	(1,203)	25.75	--	--	(5,9
Options exercised .....	(777,510)	19.26	(573,104)	18.61	(286,7
Options outstanding, end of year .....	5,090,198	31.58	5,306,946	28.26	4,683,0
Exercisable options, end of year .....	2,144,326	24.23	2,743,918	22.70	3,140,6

Information about options outstanding at December 31, 2005 was as follows:

Range of Exercise Prices	Outstanding			Exercisable	
	Number of Options	Average Remaining Life	Average Exercise Price	Number of Options	Average Exercise Price
\$ 0.00 - \$14.47 ..	7,454	0.4	\$14.47	7,454	\$14.47
\$18.33 - \$26.29 ..	1,723,865	3.6	21.67	1,638,618	21.57
\$28.97 - \$41.81 ..	2,848,719	7.2	35.03	496,990	33.11
\$44.15 - \$47.41 ..	510,160	9.7	46.08	1,264	47.41
Total .....	5,090,198	6.2	31.58	2,144,326	24.23

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NOTE N - STOCK OPTIONS - (CONTINUED)

During 1996, the Company assumed 6.0 million SIG stock options (the "SIG Options") in connection with SIG's merger into the Company (the "SIG Merger"). Upon the exercise of the SIG Options, the holder is entitled to receive (i) .2099 of a share of the Company's Class A Common Stock for each SIG Option; plus (ii) an additional number of shares of the Company's Class A Common Stock equal to the quotient of (a) \$1.90 multiplied by the number of SIG Options being exercised increased by an interest component from the time of the SIG Merger to the exercise date, divided by (b) the average closing share price for the Company's Class A Common Stock for the ten days prior to the exercise date. The SIG Options were granted annually from 1992 to 1996, have an exercise price of \$0.02 and each grant vests over five years beginning in the fourth year after the grant date. All of the SIG Options expire on October 1, 2006. As of December 31, 2005, the weighted average contractual life of the outstanding SIG Options was 0.8 years.

Activity with respect to the outstanding SIG Options was as follows:

	Year Ended December 31,				
	2005		2004		
	Number of SIG Options	Equivalent Class A Shares	Number of SIG Options	Equivalent Class A Shares	Number of SIG Options
SIG Options - beginning of year .....	144,270	40,749	357,179	107,045	696,150
Options exercised .....	(96,945)	27,442	(212,050)	61,842	(334,560)
Options expired .....	--	--	(859)	--	(4,410)
	47,325	13,455	144,270	40,749	357,179
SIG Options - end of year .....	47,325	13,455	144,270	40,749	357,179
Exercisable SIG Options - end of year ..	47,325	13,455	144,270	40,749	301,490

NOTE O - COMPUTATION OF RESULTS PER SHARE

	Year Ended December 31,		
	2005	2004	2003
	(dollars in thousands, except per share data)		
<b>Numerator:</b>			
Income from continuing operations .....	\$126,684	\$121,400	\$95,200
(Loss) income from discontinued operations, net of income tax (benefit) expense .....	(13,350)	2,143	3,600
Net income .....	\$113,334	\$123,543	\$98,800
<b>Denominator:</b>			
Weighted average common shares outstanding .....	32,672	31,952	31,200

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Effect of dilutive securities .....	839	989	8
	-----	-----	-----
Weighted average common shares outstanding, assuming dilution ..	33,511	32,941	32,0
	=====	=====	=====
Basic results per share of common stock:			
Income from continuing operations .....	\$ 3.88	\$ 3.80	\$ 3.
(Loss) income from discontinued operations, net of income tax (benefit) expense .....	(0.41)	0.07	0.
	-----	-----	-----
Net income .....	\$ 3.47	\$ 3.87	\$ 3.
	=====	=====	=====
Diluted results per share of common stock:			
Income from continuing operations .....	\$ 3.78	\$ 3.68	\$ 2.
(Loss) income from discontinued operations, net of income tax (benefit) expense .....	(0.40)	0.07	0.
	-----	-----	-----
Net income .....	\$ 3.38	\$ 3.75	\$ 3.
	=====	=====	=====

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(CONTINUED)  
 DECEMBER 31, 2005

NOTE P - REINSURANCE

The Company assumes and cedes reinsurance from and to other insurers and reinsurers. The Company uses reinsurance to limit its maximum loss, provide greater diversification of risk and in connection with the exiting of certain lines of business. Reinsurance coverages are tailored to the specific risk characteristics of each type of product and the Company's retained amount varies by type of coverage. Generally, group life, disability and accident policies are reinsured on a coinsurance and risk premium basis. Property and casualty policies are reinsured on an excess of loss, per occurrence basis under general reinsurance agreements, or, in some instances, on an individual risk basis. Indemnity reinsurance treaties do not provide absolute protection to the Company since the ceding insurer remains responsible for policy claims to the extent that the reinsurer fails to pay such claims. To reduce this risk, the Company monitors the financial position of its reinsurers, including, among other things, the companies' financial ratings, and in certain cases receives collateral security from the reinsurer. Also, certain of the Company's reinsurance agreements require the reinsurer to set up security arrangements for the Company's benefit in the event of certain ratings downgrades. As of December 31, 2005, the individual or group ratings of all of the Company's significant reinsurers were either "B++" (Very Good) or higher by A.M. Best Company or had supplied collateral in an amount sufficient to support the amounts receivable.

At December 31, 2005 and 2004, the Company had reinsurance receivables of \$413.1 million and \$428.7 million, respectively. The Company's reinsurance payables were not material at December 31, 2005 and 2004. A summary of reinsurance activity follows:

Year Ended December 31,

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	2005	2004	2003
	(dollars in thousands)		
Premium income assumed.....	\$58,852	\$ 11,666	\$ 9,046
Premium income ceded.....	95,688	98,637	100,539
Benefits, claims and interest credited ceded..	95,088	127,862	132,788

NOTE Q - OTHER OPERATING EXPENSES

The Company's other operating expenses are comprised primarily of employee compensation expenses, premium taxes, licenses and fees and all other general and administrative expenses. Employee compensation expenses, principally consisting of salaries, bonuses, and costs associated with other employee benefits and stock-based compensation, were \$76.0 million, \$62.8 million, and \$56.1 million for the years ended December 31, 2005, 2004, and 2003, respectively. Premium taxes, licenses and fees were \$30.9 million, \$24.5 million, and \$23.7 million for the years ended December 31, 2005, 2004 and 2003, respectively. All other general and administrative expenses were \$50.7 million, \$38.4 million, and \$37.1 million for the years ended December 31, 2005, 2004 and 2003, respectively.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(CONTINUED)  
DECEMBER 31, 2005

NOTE R - SEGMENT INFORMATION

	Year Ended December 31,		
	2005	2004	2003
	(dollars in thousands)		
Revenues:			
Group employee benefit products (1) ...	\$1,091,875	\$ 916,883	\$ 788,870
Asset accumulation products .....	87,797	82,694	82,555
Other (2) .....	34,108	30,944	26,524
	1,213,780	1,030,521	897,949
Net realized investment gains .....	9,003	15,460	12,724
	\$1,222,783	\$1,045,981	\$ 910,673
	=====	=====	=====
Operating income			
Group employee benefit products (1) ...	\$ 187,279	\$ 155,976	\$ 134,547
Asset accumulation products .....	23,565	19,711	16,569
Other (2) .....	(15,826)	(8,217)	(7,812)
	195,018	167,470	143,304
Net realized investment gains .....	9,003	15,460	12,724
	-----	-----	-----

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	\$ 204,021	\$ 182,930	\$ 156,028
	=====	=====	=====
Net investment income (3):			
Group employee benefit products (1) ...	\$ 130,713	\$ 115,827	\$ 100,309
Asset accumulation products .....	84,577	79,359	78,397
Other (2) .....	8,279	7,258	7,631
	-----	-----	-----
	\$ 223,569	\$ 202,444	\$ 186,337
	=====	=====	=====
Amortization of cost of business required:			
Group employee benefit products (1) ..	\$ 62,120	\$ 57,155	\$ 50,330
Asset accumulation products .....	7,161	4,888	4,664
	-----	-----	-----
	\$ 69,281	\$ 62,043	\$ 54,994
	=====	=====	=====
Segment assets (3):			
Group employee benefit products .....	\$3,229,640	\$2,857,714	\$2,391,010
Asset accumulation products .....	1,860,875	1,818,098	1,661,860
Other (2) .....	185,655	153,655	124,662
	-----	-----	-----
	\$5,276,170	\$4,829,467	\$4,177,532
	=====	=====	=====

- (1) During the fourth quarter of 2005, the Company decided to exit its non-core property catastrophe reinsurance business. See Note S to the Consolidated Financial Statements. Prior period information has been restated to conform to the current period presentation.
- (2) Primarily consists of operations from integrated disability and absence management services and certain corporate activities.
- (3) Net investment income includes income earned on the assets of the insurance companies as well as on the assets of the holding company and is allocated among business lines in proportion to average reserves and the capital placed at risk for each segment. Segment assets include assets of the insurance companies as well as the assets of the holding company, which are allocated across business lines in proportion to average reserves and the capital placed at risk for each segment.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(CONTINUED)  
 DECEMBER 31, 2005

NOTE S - DISCONTINUED OPERATIONS

During the fourth quarter of 2005, the Company decided to exit its non-core property catastrophe reinsurance business, due to the volatility associated with such business and other strategic considerations, and has not thereafter entered into or renewed any assumed property reinsurance contracts. A substantial majority of these reinsurance contracts expired on or before December 31, 2005 and all of the remaining contracts will expire prior to the end of the third quarter of 2006. Although the Company will continue to collect modest amounts of premium and pay losses under terms of the the remaining contracts until their

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expiration, these amounts are not expected to be material to the Company's results of operations. For the years ended December 31, 2005, 2004 and 2003, the Company recognized premium income of \$17.4 million, \$9.5 million, and \$7.5 million, respectively, and incurred losses of \$37.9 million, \$4.7 million, and \$0.3 million, respectively, from this line of business. For the years ended December 31, 2005, 2004 and 2003, the Company recognized operating (loss) income of \$(13.4) million, \$2.1 million, and \$3.6 million, respectively, net of income tax (benefit) expense of \$(7.2) million, \$1.2 million, and \$2.0 million, respectively, from this line of business. The assets and liabilities related to the property catastrophe business were not material to the Company's consolidated financial position.

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SCHEDULE I

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
SUMMARY OF INVESTMENTS  
OTHER THAN INVESTMENTS IN RELATED PARTIES  
DECEMBER 31, 2005  
(DOLLARS IN THOUSANDS)

Type of Investment	Amortized Cost	Fair Value	Amount Shown in Balance Sheet
Fixed maturity securities available for sale:			
U.S. Government backed mortgage-backed securities...	\$ 606,517	\$ 606,779	\$ 606,779
Other mortgage-backed securities.....	233,372	235,763	235,763
U.S. Treasury and other U.S. Government guaranteed securities.....	422,618	421,738	421,738
Obligations of U.S. states, municipalities and political subdivisions.....	596,944	613,617	613,617
Corporate securities.....	1,349,205	1,366,867	1,366,867
Total fixed maturity securities.....	3,208,656	3,244,764	3,244,764
Equity securities:			
Common stocks.....	22,684	24,485	24,485
Non-redeemable preferred stocks.....	21,547	22,548	22,548
Total equity securities.....	44,231	47,033	47,033
Short-term investments.....	94,283	94,308	94,308
Other investments.....	522,579	526,499	526,499
Total investments.....	\$3,869,749	\$3,912,604	\$3,912,604

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
 CONDENSED FINANCIAL INFORMATION OF REGISTRANT  
 DELPHI FINANCIAL GROUP, INC. (PARENT COMPANY)  
 BALANCE SHEETS  
 (DOLLARS IN THOUSANDS)

	December 31,	
	2005	2004
<b>Assets:</b>		
Fixed maturity securities, available for sale.....	\$ 254	\$ 719
Short-term investments.....	3,690	4,176
Other invested assets.....	47,246	31,984
Investment in operating subsidiaries.....	1,263,956	1,121,455
Investment in investment subsidiaries.....	37,220	32,758
Cash.....	270	233
Amounts due from subsidiaries.....	1,923	12,466
Other assets.....	45,011	36,499
	-----	-----
Total assets.....	\$1,399,570	\$1,240,290
	=====	=====
<b>Liabilities:</b>		
Corporate debt.....	\$ 234,750	\$ 157,750
Junior subordinated deferrable interest debentures..	59,762	59,762
Other liabilities.....	72,019	82,930
	-----	-----
	366,531	300,442
	=====	=====
<b>Shareholders' Equity:</b>		
Class A Common Stock.....	313	304
Class B Common Stock.....	39	39
Additional paid-in capital.....	442,531	406,908
Accumulated other comprehensive income.....	20,264	57,371
Retained earnings.....	636,285	534,540
Treasury stock.....	(66,393)	(59,314)
	-----	-----
	1,033,039	939,848
	=====	=====
Total liabilities and shareholders' equity.....	\$1,399,570	\$1,240,290
	=====	=====

See notes to condensed financial statements.

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DELPHI FINANCIAL GROUP, INC. (PARENT COMPANY)  
STATEMENTS OF INCOME  
(DOLLARS IN THOUSANDS)

	Year Ended December 31,		
	2005	2004	2003
Revenue:			
Equity in undistributed earnings of subsidiaries....	\$192,650	\$190,700	\$124,155
Dividends from operating subsidiaries.....	1,600	1,600	2,600
Dividends from investment subsidiaries.....	--	--	47,340
Other income (loss).....	8,524	3,366	(5,189)
Realized investment (losses) gains.....	(1,193)	1,628	1,375
	-----	-----	-----
	201,581	197,294	170,281
	-----	-----	-----
Expenses:			
Operating expenses.....	16,446	9,555	6,958
Interest expense.....	22,114	20,038	19,811
	-----	-----	-----
	38,560	29,593	26,769
	-----	-----	-----
Income before income tax expense.....	163,021	167,701	143,512
Income tax expense.....	49,687	44,158	44,596
	-----	-----	-----
Net income.....	\$113,334	\$123,543	\$ 98,916
	=====	=====	=====

See notes to condensed financial statements.

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SCHEDULE II (CONTINUED)

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
CONDENSED FINANCIAL INFORMATION OF REGISTRANT (CONTINUED)  
DELPHI FINANCIAL GROUP, INC. (PARENT COMPANY)  
STATEMENTS OF CASH FLOWS  
(DOLLARS IN THOUSANDS)

	Year Ended December 31,		
	2005	2004	2003
Operating activities:			
Net income .....	\$ 113,334	\$ 123,543	\$ 98,916
Adjustments to reconcile net income to net cash (used) provided by operating activities:			
Equity in undistributed earnings of subsidiaries .....	(132,593)	(138,493)	(69,766)
Change in other assets and other liabilities .....	3,986	(9,107)	2,020



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Change in current and deferred income taxes .....	(11,833)	1,999	10,98
Amortization, principally of investments and debt issuance costs .....	1,249	1,438	1,10
Net realized losses (gains) on investments .....	1,193	(1,628)	(1,37)
Change in amounts due from/to subsidiaries .....	2,043	9,702	(32,76)
	-----	-----	-----
Net cash (used) provided by operating activities .....	(22,621)	(12,546)	9,12
	-----	-----	-----
Investing activities:			
Purchases of investments and loans made .....	(26,453)	(53,823)	(58,52)
Sales of investments and receipts from repayment of loans ..	2,362	43,119	45,62
Maturities of investments .....	--	1,904	2,37
Net change in short-term investments .....	486	10,573	(10,63)
Purchases of investments in subsidiaries .....	(37,000)	(11,000)	(20,00)
	-----	-----	-----
Net cash used by investing activities .....	(60,605)	(9,227)	(41,15)
	-----	-----	-----
Financing activities:			
Proceeds from issuance of 2033 Senior Notes .....	--	--	139,22
Proceeds from issuance of 2003 Junior Debentures .....	--	--	20,01
Borrowings under revolving credit facility .....	88,000	38,000	34,00
Principal payments under revolving credit facility .....	(11,000)	(24,000)	(71,00)
Repayments or repurchase of other corporate debt .....	--	--	(72,15)
Other financing activities .....	6,263	7,419	(18,10)
	-----	-----	-----
Net cash provided by financing activities .....	83,263	21,419	31,98
	-----	-----	-----
Increase (decrease) in cash .....	37	(354)	(5)
Cash at beginning of year .....	233	587	64
	-----	-----	-----
Cash at end of year .....	\$ 270	\$ 233	\$ 58
	=====	=====	=====

See notes to condensed financial statements.

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SCHEDULE II (CONTINUED)

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
CONDENSED FINANCIAL INFORMATION OF REGISTRANT (CONTINUED)  
DELPHI FINANCIAL GROUP, INC. (PARENT COMPANY)  
NOTES TO CONDENSED FINANCIAL STATEMENTS

The accompanying condensed financial statements should be read in conjunction with the consolidated financial statements and related notes of Delphi Financial Group, Inc. and Subsidiaries.

The Company received cash dividends from subsidiaries of \$1.6 million, \$1.6 million and \$50.2 million in 2005, 2004 and 2003, respectively.

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SCHEDULE III

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
 SUPPLEMENTARY INSURANCE INFORMATION  
 (DOLLARS IN THOUSANDS)

	Cost of Business Acquired	Future Policy Benefits and Unpaid Claim and Claim Expenses	Unearned Premiums	Policyholder Account Balances
	-----	-----	-----	-----
2005				
Group employee benefits products ..	\$187,541	\$1,702,950	\$109,289	\$ --
Asset accumulation products .....	60,597	84,534	--	1,008,787
Other .....	--	75,388	--	30,823
	-----	-----	-----	-----
Total .....	\$248,138	\$1,862,872	\$109,289	\$1,039,610
	=====	=====	=====	=====
2004				
Group employee benefits products ..	\$166,337	\$1,506,348	\$ 95,145	\$ --
Asset accumulation products .....	46,212	80,722	--	993,346
Other .....	--	76,833	--	31,231
	-----	-----	-----	-----
Total .....	\$212,549	\$1,663,903	\$ 95,145	\$1,024,577
	=====	=====	=====	=====
2003				
Group employee benefits products ..	\$148,990	\$1,339,382	\$ 74,067	\$ --
Asset accumulation products .....	34,675	74,801	--	929,922
Other .....	--	81,434	--	31,434
	-----	-----	-----	-----
Total .....	\$183,665	\$1,495,617	\$ 74,067	\$ 961,356
	=====	=====	=====	=====

	Premium and Fee Income (1)	Net Investment Income (2)	Benefits, Claims and Interest Credited to Policyholders	Amortization of Cost of Business Acquired	Op Ex
	-----	-----	-----	-----	-----
2005					
Group employee benefits products ..	\$961,162	\$130,713	\$674,118	\$62,120	
Asset accumulation products .....	3,220	84,577	49,856	7,161	
Other .....	25,829	8,279	1,233	--	
	-----	-----	-----	-----	
Total .....	\$990,211	\$223,569	\$725,207	\$69,281	
	=====	=====	=====	=====	
2004					
Group employee benefits products ..	\$801,056	\$115,827	\$563,277	\$57,155	
Asset accumulation products .....	3,335	79,359	51,836	4,888	
Other .....	23,686	7,258	(625)	--	
	-----	-----	-----	-----	
Total .....	\$828,077	\$202,444	\$614,488	\$62,043	
	=====	=====	=====	=====	
2003					
Group employee benefits products ..	\$688,561	\$100,309	\$474,472	\$50,330	
Asset accumulation products .....	4,158	78,397	54,841	4,664	

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Other .....	18,893	7,631	1,037	--
	-----	-----	-----	-----
Total .....	\$711,612	\$186,337	\$530,350	\$54,994
	=====	=====	=====	=====

- (1) Net written premiums for casualty insurance products totaled \$257.7 million, \$225.5 million and \$187.2 million for the years ended December 31, 2005, 2004, and 2003, respectively.
- (2) Net investment income includes income earned on the assets of the insurance companies as well as on the assets of the holding company and is allocated among business lines in proportion to average reserves and the capital placed at risk for each segment.
- (3) Other operating expenses include commissions.

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SCHEDULE IV

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
REINSURANCE  
(DOLLARS IN THOUSANDS)

	Gross Amount	Ceded to Other Companies	Assumed from Other Companies	Net Amount
	-----	-----	-----	-----
Life insurance in force as of December 31, 2005 .....	\$132,847,822	\$20,236,656	\$30,495	\$112,641,661
	=====	=====	=====	=====
Year ended December 31, 2005:				
Premium and fee income:				
Life insurance and annuity .....	\$ 319,889	\$ 32,562	\$ 511	\$ 287,838
Accident and health insurance ..	433,699	38,560	39,565	434,704
Casualty insurance .....	250,319	24,566	18,790	244,543
Other .....	23,126	--	--	23,126
	-----	-----	-----	-----
Total premium and fee income .....	\$ 1,027,033	\$ 95,688	\$58,866	\$ 990,211
	=====	=====	=====	=====
Life insurance in force as of December 31, 2004 .....	\$119,624,420	\$14,582,230	\$32,057	\$105,074,247
	=====	=====	=====	=====
Year ended December 31, 2004:				
Premium and fee income:				
Life insurance and annuity .....	\$ 303,603	\$ 37,007	\$ 586	\$ 267,182
Accident and health insurance ..	372,142	40,741	1,278	332,679
Casualty insurance .....	217,655	20,889	9,819	206,585
Other .....	21,631	--	--	21,631
	-----	-----	-----	-----
Total premium and fee income .....	\$ 915,031	\$ 98,637	\$11,683	\$ 828,077
	=====	=====	=====	=====
Life insurance in force as of December 31, 2003 .....	\$110,707,743	\$10,966,035	\$34,150	\$ 99,775,858
	=====	=====	=====	=====

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Year ended December 31, 2003:

Premium and fee income:				
Life insurance and annuity .....	\$ 274,892	\$ 27,100	\$ 1,122	\$ 248,914
Accident and health insurance ..	334,989	55,988	1,601	280,602
Casualty insurance .....	177,118	17,451	6,393	166,060
Other .....	16,036	--	--	16,036
	-----	-----	-----	-----
Total premium and fee income .....	\$ 803,035	\$ 100,539	\$ 9,116	\$ 711,612
	=====	=====	=====	=====

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SCHEDULE VI

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES  
 SUPPLEMENTAL INFORMATION CONCERNING  
 PROPERTY-CASUALTY INSURANCE OPERATIONS (1)  
 (DOLLARS IN THOUSANDS)

	December 31,	
	2005	2004
Deferred policy acquisition costs .....	\$ 13,379	\$ 11,379
Reserves for unpaid claims and claim expenses ..	746,479	645,948
Discount, if any, deducted from above (2) .....	368,234	311,833
Unearned premiums .....	101,980	89,843

  

	Year Ended December 31,		
	2005	2004	2003
Earned premiums .....	\$261,903	\$216,105	\$173,535
Net investment income .....	65,065	57,759	42,614
Claims and claim expenses incurred related to:			
Current year .....	141,785	103,444	82,372
Prior years (3) .....	56,698	30,868	20,541
Amortization of deferred policy acquisition costs ..	26,601	25,449	22,272
Paid claims and claim adjustment expenses .....	96,700	72,290	62,400
Net premiums written .....	273,219	236,675	194,752

(1) All years include the results from the Company's discontinued non-core property catastrophe reinsurance business.

(2) Based on discount rates ranging from 3.7% to 7.5%.

(3) In 2005 and 2004, the change in the provision for claims and claim expenses incurred in prior years reflects the accretion of discounted reserves and unfavorable claims development. In 2003, the change in the provision for claims and claim expenses incurred in prior years reflects

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the accretion of discounted reserves offset by favorable claims development. The Company's insurance policies do not provide for the retrospective adjustment of premiums based on claim experience.

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