



Trinity Universal Insurance Company and Affiliates
Management's Discussion and Analysis
For the Year Ended December 31, 2018

Overview

This discussion provides an assessment by management of the current financial condition, changes in financial condition and results of operations for Trinity Universal Insurance Company ("the Company"), its subsidiaries and affiliates with a 100% quota share reinsurance agreements. Information presented in this discussion supplements the financial statements, schedules and exhibits in the 2018 Annual Statements of these companies.

The Company is a Texas domiciled property and casualty insurance company that is a wholly owned subsidiary of Kemper Corporation ("Kemper"). Kemper is a publicly held holding company, which, through its subsidiaries, provides personal insurance products including automobile, homeowners, renters, fire and other property and casualty insurance to individuals and commercial automobile insurance to businesses.

For purposes of this Management's Discussion and Analysis, all references to Trinity include the combined operations of the companies shown in the following table for 2018:

<u>Company</u>	<u>NAIC Company Code</u>
Trinity Universal Insurance Company	19887
Infinity Insurance Company	22268
Infinity Assurance Insurance Company	39497
Infinity Auto Insurance Company	11738
Infinity Casualty Insurance Company	21792
Infinity County Mutual Insurance Company	13820
Infinity Indemnity Insurance Company	10061
Infinity Preferred Insurance Company	10195
Infinity Safeguard Insurance Company	16802
Infinity Security Insurance Company	38873
Infinity Select Insurance Company	20260
Infinity Standard Insurance Company	12599
Alpha Property and Casualty Insurance Company	38156
Charter Indemnity Company	37524
Capitol County Mutual Fire Insurance Company	29211
Financial Indemnity Company	19852
Kemper Financial Indemnity Company	39004
Kemper Independence Insurance Company	10914
Merastar Insurance Company	31968
Mutual Savings Fire Insurance Company	31178
Old Reliable Casualty Company	36625
Response Insurance Company	43044
Response Worldwide Direct Auto Insurance Company	20133
Response Worldwide Insurance Company	26050
Union National Fire Insurance Company	12998
United Casualty Insurance Company of America	11142
Unitrin Advantage Insurance Company	10881
Unitrin Auto and Home Insurance Company	16063
Unitrin County Mutual Insurance Company	29351
Unitrin Direct Insurance Company	10226
Unitrin Direct Property and Casualty Insurance Company	10915
Unitrin Preferred Insurance Company	25909
Unitrin Safeguard Insurance Company	40703
Valley Property and Casualty Insurance Company	10698
Warner Insurance Company	26085

On July 2, 2018, Kemper acquired 100% of the outstanding common stock of Infinity Property and Casualty Corporation ("Infinity"), pursuant to the terms of an Agreement and Plan of Merger, dated February 13, 2018, with total cash, stock and equity-based compensation consideration paid to Infinity shareholders of approximately \$1.5 billion (the "Infinity Merger"). On December 1, 2018, Trinity entered into a 100% quota share agreement with Infinity Insurance Company.

Business

Kemper is engaged, through its subsidiaries, in the property and casualty insurance and life and health insurance businesses. Kemper conducts its operations through three operating segments: Preferred Property & Casualty Insurance, Specialty Property & Casualty Insurance and Life & Health Insurance. The Company's operations and results are part of Kemper's Preferred Property & Casualty Insurance and Specialty Property & Casualty Insurance segments. Kemper conducts its operations solely in the United States.

Kemper's subsidiaries employ approximately 8,100 full-time associates supporting their operations, of which approximately 1,300 are employed in the Preferred Property & Casualty Insurance segment, approximately 2,600 are employed in the Specialty Property & Casualty Insurance Segment, approximately 3,300 are employed in the Life & Health Insurance segment and the remainder are employed in various corporate and other staff and shared functions.

Kemper's property & casualty insurance business operations are conducted primarily through the Preferred Property & Casualty Insurance and Specialty Property & Casualty Insurance segments. In addition, the Life and Health Insurance segment's career agents also sell contents coverage for personal property to its customers. Collectively, these segments provide preferred automobile, specialty automobile, homeowners, renters, fire, umbrella and other types of property and casualty insurance to individuals and commercial automobile insurance to businesses.

Property insurance indemnifies an insured with an interest in physical property for loss of, or damage to, such property. Casualty insurance primarily covers liability for damage to property of, or injury to, a person or entity other than the insured. In most cases, casualty insurance also obligates the insurance company to provide a defense for the insured in litigation arising out of events covered by the policy.

The Property & Casualty Insurance Companies distribute their products primarily through independent agents and brokers who are paid commissions for their services.

The Property & Casualty Insurance Companies conduct business in 50 states and the District of Columbia. As shown in the following table, four states provided 83% of the premium revenues in 2018.

State	Percentage of Total Premiums
California	58%
Florida	11%
Texas	11%
New York	4%

Kemper's business operations face a number of risks, including, but not limited to the following:

- Kemper's insurance subsidiaries are subject to significant regulation, and the evolving legal and regulatory landscape in which they operate could result in increased operating costs, reduced profitability and limited growth.
- Legal and regulatory proceedings are unpredictable and could produce one or more unexpected verdicts against the Company that could materially and adversely affect Kemper's financial results for any given period.
- Catastrophe losses could materially and adversely affect the Kemper's results of operations, liquidity and/or financial condition.
- Changes in the availability and cost of catastrophe reinsurance and in the ability of reinsurers to meet their obligations could result in Kemper's insurance subsidiaries retaining more risk and could adversely and materially affect the Company's results of operations, financial condition and/or liquidity.
- The extent to which Kemper's insurance subsidiaries can manage their catastrophe exposure through underwriting strategies may be limited by law or regulatory action and could adversely and materially affect the Company's results of operations, financial condition and/or liquidity.
- Estimating losses and loss adjustment expenses ("LAE") for determining property and casualty insurance reserves, or determining premium rates, is inherently uncertain, and the Company's results of operations may be materially impacted if the Company's insurance reserves or premium rates are insufficient.
- A downgrade in the ratings of Kemper or its insurance subsidiaries below A- could materially and adversely affect the Company.
- The insurance industry is highly competitive, making it difficult to grow profitability and within expectations of investors.
- Technology initiatives could present significant economic and competitive challenges to Kemper. Failure to complete and implement such initiatives in a timely manner could result in the loss of business and incurrence of internal use software development costs that may not be recoverable.
- Failure to maintain the security of personal data may result in lost business, reputational harm, legal costs and regulatory penalties.
- Failure to maintain the availability of critical systems may result in lost business, reputational harm, legal costs and regulatory penalties.
- Kemper's investment portfolio is exposed to a variety of risks that may negatively impact net investment income, the change in fair value of equity and convertible securities and cause realized and unrealized losses.
- The determination of the fair values of the Kemper's investments and whether a decline in the fair value of an investment is other-than-temporary are based on management's judgment and may prove to be materially different than the actual economic outcome.
- The ability of Kemper to service its debt, pay dividends to its shareholders and/or make repurchases of its stock may be materially impacted by lack of timely and/or sufficient dividends received from its subsidiaries.
- The expected benefits and synergies from mergers, acquisitions and/or divestitures may not be realized to the extent anticipated or within the anticipated time frames.
- Kemper will incur significant transaction and integration costs in connection with the Infinity Merger.
- To be successful, the combined company following the Infinity Merger must retain and motivate key employees, including those experienced with post-acquisition integration, and failure to do so could seriously harm the combined company.

Statements of Trinity and its affiliates

Balance Sheet as of December 31,

(\$ in thousands)

	<u>2018</u>	<u>2017</u>
Admitted Assets		
Cash and Investments	\$ 2,897,182	\$ 3,027,174
Premiums Receivable	929,822	808,728
Federal and Foreign Income Taxes Recoverable	14,207	12,312
Other Assets	220,449	133,326
Total Admitted Assets	<u>\$ 4,061,660</u>	<u>\$ 3,981,539</u>
Liabilities		
Loss and Loss Adjustment Expenses (LAE) Reserves	\$ 1,357,682	\$ 1,336,200
Commissions Payable	35,274	32,384
Taxes, Licenses, and Fees	11,885	8,289
Unearned Premiums	1,246,934	1,127,466
Remittance and Items Not Allocated	9,034	3,367
Amounts Withheld or Retained by Company	22,032	23,855
Other Liabilities	165,096	117,588
Total Liabilities	<u>2,847,937</u>	<u>2,649,149</u>
Surplus	<u>1,213,723</u>	<u>1,332,390</u>
Total Policyholder's Surplus and Liabilities	<u>\$ 4,061,660</u>	<u>\$ 3,981,539</u>

Statement of Operations for twelve months ended December 31,

(\$ in thousands)

	<u>2018</u>	<u>2017</u>
Statement of Income		
Premiums Earned	\$ 2,746,140	\$ 2,584,188
Losses Incurred	(1,662,010)	(1,735,740)
Loss Adjustment Expenses (LAE) Incurred	(294,410)	(292,604)
Underwriting Expenses Incurred	(768,254)	(699,983)
Net Underwriting Loss	21,465	(144,139)
Net Investment Gain	110,495	134,136
Other Income	106,743	99,756
Income before Taxes	238,703	89,753
Federal Income Taxes Incurred	(43,182)	(15,227)
Net Income	<u>\$ 195,521</u>	<u>\$ 74,526</u>

Surplus Progression

Surplus at the beginning of the year	\$ 1,332,390	\$ 1,451,634
Net Income	195,521	74,526
Change in Net Unrealized Capital Gains	(58,146)	1,022
Change in Deferred Income Tax	1,982	(53,787)
Change in Nonadmitted Assets	(24,122)	(7,992)
Change in Provision for Reinsurance	798	(1,373)
Change in Surplus Paid In	87,809	1,866
Dividends to Stockholders	(323,297)	(133,475)
Aggregate write-ins for gains and losses in surplus	788	(31)
Surplus at the end of the year	<u>\$ 1,213,723</u>	<u>\$ 1,332,390</u>

Changes in Financial Condition

On December 1, 2018, Infinity Insurance Company ("Infinity") entered a 100% quota share agreement with Trinity Universal Insurance Company. As part of the settlement of the quota share, Infinity paid an extraordinary dividend of \$574.5 million to its parent, Infinity Property and Casualty Corporation, Inc., in cash and securities on December 1, 2018. On February 14, 2019, Infinity Property and Casualty Corporation contributed \$85.0 million to Infinity, which was recorded as a receivable as of December 31, 2018.

Cash and investments decreased \$130.0 million or 4.3% during 2018, primarily due to transfer of assets to settle the merger transaction and the quota share initial transactions.

Premiums receivables increased \$121.1 million or 15.0% during 2018 primarily due to premium growth during the year in California, Florida, and Texas.

Federal and foreign income tax recoverable was \$12.3 million in 2017 compared to \$14.2 million in 2018 primarily due to the overall increase in taxable income in the fourth quarter of 2018 compared to annualized taxable income used for purposes of the estimated tax.

Other Assets increased by \$87.1 million or 65.3% during the twelve months ended December 31, 2018 primarily due to an increase in receivable from affiliates of \$86.1 due to a permitted practice from the state of Indiana related to a return of capital of \$85.0 million from Infinity Insurance Company's parent.

Loss and Loss adjustment expenses reserves increased \$21.4 million or 1.6% during the twelve months ended December 31, 2018 primarily due to the increase in business during 2018. Refer to the "Loss Reserves" section for a more detailed discussion of Loss and LAE reserves.

Unearned premium increased \$119.5 million or 10.6% in 2018 primarily as a result of premium growth during the year in California, Florida, and Texas.

Results of Operations

Premiums

The Company's net earned premium is as follows (\$ in thousands):

	Twelve months ended December 31,			
	2018	2017	Change	% Change
Gross written premium:				
Fire	51,272	53,082	(1,810)	(3.4)%
Allied lines	23,507	24,205	(698)	(2.9)%
Homeowners multiple peril	264,120	269,988	(5,868)	(2.2)%
Inland marine	7,769	8,320	(551)	(6.6)%
Earthquake	2,818	3,044	(226)	(7.4)%
Workers' compensation	1	-	1	NM
Other liability – occurrence	15,089	15,514	(425)	(2.7)%
Other liability – claims-made	139	96	43	44.8 %
Private passenger auto liability	2,103,662	1,318,680	784,982	59.5 %
Commercial auto liability	192,723	172,060	20,663	12.0 %
Auto physical damage	1,151,254	759,179	392,075	51.6 %
Burglary and theft	11,280	11,417	(137)	(1.2)%
Total gross written premium	3,823,634	2,635,585	1,188,049	45.1 %
Ceded reinsurance	(56,490)	(24,989)	(31,501)	126.1 %
Net written premium	3,767,144	2,610,596	1,156,548	44.3 %
Change in unearned premium	(272,741)	(26,408)	(246,333)	932.8 %
Net earned premium	<u>\$ 3,494,403</u>	<u>\$ 2,584,188</u>	<u>\$ 910,215</u>	<u>35.2 %</u>

Investment Income

The Company invests in high quality bonds along with common stocks, preferred stocks, short-term and intermediate-term maturities, with an objective of optimizing total return while allowing flexibility to react to changes in market conditions. Investment grade securities generally bear lower yields and lower degrees of risk than those that are unrated or non-investment grade. Management believes that a high quality investment portfolio is more likely to generate a stable and predictable investment return. Risks inherent in connection with fixed income securities include loss upon default and market price volatility. Factors which can affect the market price of securities include credit-worthiness, changes in interest rates, the number of market makers and investors and defaults by major issuers of securities.

The following table summarizes the Company's net investment income before realized gains at the end of the last two years:

<u>Dollars in Millions</u>	<u>2018</u>	<u>2017</u>
U.S. Government bonds	\$ 24,781.1	\$ 7,152.3
Bonds exempt from U.S. tax	15,747.2	27,770.2
Other Bonds	42,083.2	41,301.4
Preferred Stocks	1,888.2	2,067.4
Common Stocks (Unaffiliated)	5,371.1	3,812.1
Real Estate	6,595.4	6,001.3
Cash, cash equivalents and short-term investments	4,052.1	925.8
Other Invested Assets	34,406.3	39,330.0
Aggregate write-ins for investment income	61.8	12.3
Less: Investment Expenses	10,432.2	10,662.4
Net Investment Income	<u>\$ 124,554.2</u>	<u>\$ 117,710.4</u>

The 2018 net investment gain of \$110.5 million decreased 17.6% from \$134.1 million in 2017. The two major components were net investment income earned, which increased 3.6% from \$117.7 million in 2017 to \$121.9 million in 2018, and a decrease in net realized capital gains/losses, which totaled \$11.5 million of capital losses in 2018 compared with \$16.4 million of capital gains in 2017. Changes in investment income reflect fluctuations in market rates and changes in average invested assets.

Other Income and Expenses

In total, other income increased 7.0% from \$99.8 million in 2017 to \$106.7 million in 2018, primarily due to an increase in finance and service charges offset by an increase of amounts charged off.

Income Taxes

The effective tax rate for 2018 and 2017 was 17.7% and 18.1%, respectively. As a result of the overall decrease in tax rate used for purposes of estimated tax, the federal income tax recoverable was \$14.2 million in 2018 compared to \$12.3 million in 2017.

Loss Reserves

Loss and Loss Adjustment Expense Reserves

The Company's reserves for losses and LAE are reported using the Company's estimate of its ultimate liability for losses and LAE for claims that occurred prior to the end of any given accounting period but have not yet been paid. Loss and LAE Reserves at December 31, 2018 and 2017 were \$1,357.7 million and \$1,336.2 million, respectively.

Kemper's actuaries generally estimate reserves at least quarterly for most product lines and/or coverage levels using accident quarters or years spanning 10 or more years, depending on the product line and/or coverage level or emerging issues relating to them. Kemper's actuaries use a variety of generally accepted actuarial loss reserving estimation methodologies, including, but not limited to, the following:

- Incurred Loss Development Methodology;
- Paid Loss Development Methodology;
- Bornhuetter-Ferguson Incurred Loss Methodology;
- Bornhuetter-Ferguson Paid Loss Methodology; and
- Frequency and Severity Methodology.

Kemper's actuaries generally review the results of at least four of the estimation methodologies, two based on paid data and two based on incurred data, to initially estimate the ultimate losses and LAE for the current accident quarter or year and re-estimate the ultimate losses and LAE for previous accident quarters or years to determine if changes in the previous estimates of the ultimate losses and LAE are indicated by the most recent data. In some cases, the methodologies produce a cluster of estimates with a tight band of indicated possible outcomes. In other cases, however, the methodologies produce conflicting results and wider bands of indicated possible outcomes, and Kemper's actuaries perform additional analyses before making their final selections. However, such bands do not necessarily constitute a range of outcomes, nor does Kemper's management or Kemper's actuaries calculate a range of outcomes.

The key assumption in these estimation methodologies is that patterns observed in prior periods are indicative of how losses and LAE are expected to develop in the future and that such historical data can be used to predict and estimate ultimate losses and LAE. However, changes in Kemper's business processes, by their very nature, are likely to affect the development patterns, which means Kemper's actuaries must routinely evaluate the applicability of historical data in future projections. The ultimate impact of a single change in a business process is difficult to quantify and detect, and even more difficult if several changes to business processes occur over several years. Initially after a change is implemented, there are fewer data points, as compared to the historical data, for Kemper's actuaries to analyze. With fewer data points to analyze, Kemper's actuaries cannot be certain that observed differences from the historical data trends are a result of the change in business process or merely a random fluctuation in the data. As Kemper's actuaries observe more data points following the change in business process, Kemper's actuaries can gain more confidence in whether the change in business process is affecting the development pattern. The challenge for Kemper's actuaries is how much weight to place on the development patterns based on the older historical data and how much weight to place on the development patterns based on more recent data.

The Company's goal is to ensure that its total reserves for property and casualty insurance losses and LAE are adequate to cover all costs, while minimizing variation from the time reserves for losses and LAE are initially estimated until losses and LAE are fully developed. Changes in the Company's estimates of these losses and LAE, also referred to as "development," will occur over time and may be material. Favorable development is recognized and reported in the Financial Statements when the Company decreases its previous estimate of ultimate losses and LAE and results in an increase in net income in the period recognized, whereas adverse development is recognized and reported in the Financial Statements when the Company increases its previous estimate of ultimate losses and LAE and results in a decrease in net income.

Development of losses and LAE from prior accident years for the Company's operations was a favorable development of \$3.5 million for the twelve months ending December 31, 2018 and an adverse development of \$20.6 million for the twelve months ending December 31, 2017.

The Company's Property and Casualty Insurance Reserves are reported using the Company's estimate of its ultimate liability for losses and LAE for claims that occurred prior to the end of any given accounting period but have not yet been paid. Such estimates are based on individual case estimates for reported claims and estimates for Incurred But Not Reported ("IBNR") losses, including expected development on reported claims.

The determination of individual case reserves differs by line of business. For preferred personal automobile insurance, homeowners insurance and other personal insurance, case reserves are set by adjusters and are based on the adjusters' estimates of the amount for which the claims will ultimately be paid. For specialty personal automobile insurance and commercial automobile insurance, case reserves are set primarily using statistical reserves that are based on studies of historical average paid amounts by state, coverage and product. However, when such reserves exceed certain thresholds they are set manually by adjusters.

The key assumption in these estimation methodologies is that patterns observed in prior periods are indicative of how losses and LAE are expected to develop in the future and that such historical data can be used to predict and estimate ultimate losses and LAE. However, changes in the Company's business processes, by their very nature, are likely to affect the development patterns, which generally results in the historical development factors becoming less reliable over time in predicting how losses and LAE will ultimately develop. The Company's actuaries use professional judgment in determining how much weight to place on the development patterns based on the older historical data and how much weight to place on the development patterns based on more recent data. In some cases, the Company's actuaries make adjustments to the loss reserving estimation methodologies to estimate ultimate losses and LAE.

The Company's actuaries' quarterly selections are summed by product and/or coverage levels to create the actuarial indication of the ultimate losses and LAE. Paid amounts are then subtracted from the ultimates to compute the reserves for property and casualty insurance losses and LAE. These results are reviewed by the Company's corporate actuary and corporate management who apply their collective judgment and determine the appropriate estimated level of reserves to record. Numerous factors are considered in this determination process, including, but not limited to, the assessed reliability of key loss trends and assumptions that may be significantly influencing the current actuarial indications, changes in claim handling practices or other changes that affect the timing of payment or development patterns, changes in the mix of business, the maturity of the accident year, pertinent trends observed over the recent past, the level of volatility within a particular line of business, the improvement or deterioration of actuarial indications in the current period as compared to prior periods, and the amount of reserves related to third party pools for which the Company has limited access to the underlying data and, accordingly, relies on calculations provided by such pools.

The Company's goal is to ensure that its total reserves for property and casualty insurance losses and LAE are adequate to cover all costs, while sustaining minimal variation from the time reserves for losses and LAE are initially estimated until losses and LAE are fully developed. Changes in the Company's estimates of these losses and LAE over time, also referred to as "development," will occur and may be material.

Insurance reserves are estimated based on historical experience patterns and current economic trends. Actual loss experience and loss trends are likely to differ from these historical experience patterns and economic conditions. Loss experience and loss trends emerge over several years from the dates of loss inception. The Company monitors such emerging loss trends on a quarterly basis. Changes in such estimates are included in the Statement of Operations in the period of change.

Liquidity and Capital Resources

The Company generates liquidity to satisfy their obligations, primarily by collecting and investing premiums in advance of paying claims and generating investment income on their \$2.9 billion investment portfolio. Management believes that cash balances, cash flows generated from operations or borrowings, and maturities and sales of investments are adequate to meet the future liquidity needs of the Company.

The following table summarizes the Company's Cash Flow:

Cash Flow and Liquidity for twelve months ended December 31,		
(\$ in thousands)		
	<u>2018</u>	<u>2017</u>
Statement of Cash Flow		
Net Cash from Operations	\$ 277,384	\$ 142,752
Net Cash used in Investments	(539,177)	(10,363)
Net Cash used in Financing and Miscellaneous	259,680	(144,828)
Net Change in Cash, Cash Equivalents and Short-term Investments	<u>\$ (2,113)</u>	<u>\$ (12,439)</u>

In general, primary sources of cash include cash from operations and cash provided from the sale or maturity of invested assets. Primary uses of cash include the purchase of invested assets, stockholder dividend payments and federal tax payments. During 2018, cash flow from operations increased \$134.6 compared to 2017 primarily due to an increase in business. Net cash used in investments was \$539.2 million as investments were transferred to the parent companies to be used in settlement of the acquisition of Infinity and the in settlement of the quota share transactions as well as cash from maturing and sold securities. Cash used in financing increased primarily due to an increase in capital contributions.

Reinsurance

Kemper manages its exposure to catastrophes and other natural disasters through a combination of geographical diversification, restrictions on the amount and location of new business production in such regions, modifications of, and/or limitations to coverages and deductibles for certain perils in such regions and reinsurance. To limit its exposures to catastrophic events, Kemper maintains a catastrophe reinsurance program for all of its property and casualty insurance companies, including those not subject to the 100% quota share agreement. Coverage for the catastrophe reinsurance program is provided in various layers through multiple excess of loss reinsurance contracts and an aggregate excess property catastrophe reinsurance contract. The Kemper's insurance subsidiaries also purchase reinsurance from the Florida Hurricane Catastrophe Fund (the "FHCF") for hurricane losses in Florida at retentions lower than those for the Kemper's catastrophe reinsurance program.

Short-term Debt

The Company is a member of the Federal Home Loan Bank ("FHLB") of Dallas. As a requirement of membership in the FHLB, the Company maintains a certain level of investment in FHLB stock. Total holdings of FHLB of Dallas stock were \$3.3 million at both December 31, 2018 and December 31, 2017, respectively.

In June of 2018, the Company received advances of \$55.0 million from the FHLB of Dallas. The advances, which were repaid in full on July 13, 2018, were made to facilitate the funding of the acquisition of Infinity.

Subsidiary Dividends and Capital Contributions

Various state insurance laws restrict the ability of Kemper's insurance subsidiaries to pay dividends without regulatory approval. Such insurance laws generally restrict the amount of dividends paid in an annual period to the greater of statutory net income from the previous year or 10% of statutory capital and surplus. Kemper's direct insurance subsidiaries paid dividends of \$130.4 million, \$108.1 million and \$104.5 million to Kemper in 2018, 2017 and 2016, respectively. In 2019, Kemper estimates that its direct insurance subsidiaries would be able to pay \$351 million in dividends to Kemper without prior regulatory approval.

Subsequent Events

On February 14, 2019, Infinity Property and Casualty Corporation contributed \$83 million to Infinity Insurance Company, which was recorded as a receivable as of December 31, 2018.

This Management's Discussion and Analysis contains certain statements that may be deemed to be "forward-looking statements" which anticipate results based on management's estimates, assumptions and plans that are subject to uncertainty. Actual events and results may differ materially from those expressed in forward looking statement.