

KEMPER Corp  
Form 10-K  
February 15, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K

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

For the fiscal year ended December 31, 2012

OR

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

Commission file number: 001-18298

Kemper Corporation  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

95-4255452  
(I.R.S. Employer  
Identification No.)

One East Wacker Drive, Chicago, Illinois  
(Address of principal executive offices)  
(312) 661-4600

60601  
(Zip Code)

(Registrant's telephone number, including area code)

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

Title of each class

Name of each exchange on which registered

Common Stock, \$0.10 par value per share

New York Stock Exchange

Preferred Share Purchase Rights  
pursuant to Rights Agreement

New York Stock Exchange

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  No

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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 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.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of June 30, 2012, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$1.7 billion based on the closing sale price as reported on the New York Stock Exchange. Solely for purposes of this calculation, all executive officers and directors of the registrant are considered affiliates.

Registrant had 58,558,898 shares of common stock outstanding as of February 8, 2013.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held on May 1, 2013 are incorporated by reference into Part III.

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### Caution Regarding Forward-Looking Statements

This 2012 Annual Report on Form 10-K (the “2012 Annual Report”), including the accompanying consolidated financial statements of Kemper Corporation (“Kemper”) and its subsidiaries (individually and collectively referred to herein as the “Company”) and the notes thereto appearing in Item 8 herein (the “Consolidated Financial Statements”), the Management’s Discussion and Analysis of Financial Condition and Results of Operations appearing in Item 7 herein (the “MD&A”) and the other Exhibits and Financial Statement Schedules filed as a part hereof or incorporated by reference herein, may contain or incorporate by reference information that includes or is based on forward-looking statements within the meaning of the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements give expectations or forecasts of future events. The reader can identify these statements by the

fact that they do not relate strictly to historical or current facts. They use words such as “believe(s),” “goal(s),” “target(s),” “estimate(s),” “anticipate(s),” “forecast(s),” “project(s),” “plan(s),” “intend(s),” “expect(s),” “might,” “may” and other words of similar meaning in connection with a discussion of future operating, financial performance or financial condition. Forward-looking statements, in particular, include statements relating to future actions, prospective services or products, future performance or results of current and anticipated services or products, sales efforts, expenses, the outcome of contingencies such as legal proceedings, trends in operations and financial results.

Any or all forward-looking statements may turn out to be wrong, and, accordingly, readers are cautioned not to place undue reliance on such statements, which speak only as of the date of this 2012 Annual Report. These statements are based on current expectations and the current economic environment. They involve a number of risks and uncertainties that are difficult to predict. These statements are not guarantees of future performance; actual results could differ materially from those expressed or implied in the forward-looking statements. Forward-looking statements can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. The reader should consider the following list of general factors that could affect the Company’s future results and financial condition, as well as those discussed below under Item 1A., “Risk Factors,” in this 2012 Annual Report.

Among the general factors that could cause actual results and financial condition to differ materially from estimated results and financial condition are:

- The incidence, frequency, and severity of catastrophes occurring in any particular reporting period or geographic concentration, including natural disasters, pandemics and terrorist attacks or other man-made events;
- The frequency and severity of insurance claims (including those associated with catastrophe losses) and their impact on the adequacy of loss reserves;
- Changes in facts and circumstances affecting assumptions used in determining loss and loss adjustment expense (“LAE”) reserves;
- The impact of inflation on insurance claims, including, but not limited to, the effects attributed to scarcity of resources available to rebuild damaged structures, including labor and materials and the amount of salvage value recovered for damaged property;
- Changes in the pricing or availability of reinsurance, or in the financial condition of reinsurers and amounts recoverable therefrom;
- Orders, interpretations or other actions by regulators that impact the reporting, adjustment and payment of claims;
- The impact of residual market assessments and assessments for insurance industry insolvencies;
- Changes in industry trends and significant industry developments;
- Uncertainties related to regulatory approval of insurance rates, policy forms, license applications and similar matters;
- Developments related to insurance policy claims and coverage issues, including, but not limited to, interpretations or decisions by courts or regulators that may govern or influence such issues arising with respect to losses incurred in connection with hurricanes and other catastrophes;
- Changes in ratings by credit ratings agencies;
- Adverse outcomes in litigation or other legal or regulatory proceedings involving Kemper or its subsidiaries or affiliates;
- Developments in, and outcomes of, initiatives by state officials that could result in significant changes to unclaimed property laws and claims handling practices with respect to life insurance policies, especially to the extent that such initiatives result in retroactive application of new standards to existing life insurance policies;

Regulatory, accounting or tax changes that may affect the cost of, or demand for, the Company's products or services;

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Governmental actions, including, but not limited to, implementation of the provisions of the Patient Protection and Affordable Care Act, the Health Care and Education Reconciliation Act of 2010 (the “Health Care Acts”) and the Dodd-Frank Act (the “DFA”), new laws or regulations or court decisions interpreting existing laws and regulations or policy provisions;

Changes in distribution channels, methods or costs resulting from changes in laws or regulations, lawsuits or market forces;

Changes in general economic conditions, including performance of financial markets, interest rates, unemployment rates and fluctuating values of particular investments held by the Company;

The level of success and costs expended in realizing economies of scale and implementing significant business consolidations and technology initiatives;

Heightened competition, including, with respect to pricing, entry of new competitors and the development of new products by new and existing competitors;

Increased costs and risks related to data security;

Absolute and relative performance of the Company’s products or services; and

Other risks and uncertainties described from time to time in Kemper’s filings with the U.S. Securities and Exchange Commission (“SEC”).

No assurances can be given that the results contemplated in any forward-looking statements will be achieved or will be achieved in any particular timetable. The Company assumes no obligation to publicly correct or update any forward-looking statements as a result of events or developments subsequent to the date of this 2012 Annual Report. The reader is advised, however, to consult any further disclosures Kemper makes on related subjects in its filings with the SEC.

## PART I

### Item 1. Business.

Kemper is a diversified insurance holding company, with subsidiaries that provide life, health, automobile, homeowners and other insurance products to individuals and small businesses. Kemper's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments thereto are accessible free of charge through Kemper's website, kemper.com, as soon as reasonably practicable after such materials are filed with, or furnished to, the SEC.

#### (a) GENERAL DEVELOPMENT OF BUSINESS

##### Kemper Direct

During the third quarter of 2012, Kemper Direct ceased direct-to-consumer marketing activities, and the Company began an evaluation of strategic options for the business. In the fourth quarter of 2012, the Company concluded its evaluation and determined that, to optimize the value for the business, Kemper Direct would continue to solicit business for its worksite, affinity and renters programs and would place its direct-to-consumer operations in run-off.

##### Conversion of Fireside to General Business Corporation

On March 31, 2012, Kemper's subsidiary, Fireside Bank, converted from an industrial bank to a general business corporation and changed its name to Fireside Auto Finance, Inc. ("FAF"). Accordingly, FAF is no longer regulated by the Federal Depository Insurance Corporation or the California Department of Financial Institutions and may pay dividends or make other distributions without prior regulatory approval. On April 5, 2012, FAF distributed \$20 million of its capital to its parent company, Fireside Securities Corporation ("FSC"), which then, distributed the same amount to its parent company, Kemper. On June 22, 2012, FAF merged with FSC, with FAF being the surviving entity. Fireside Bank, FAF and FSC hereinafter are referred to as "Fireside." Fireside is reported as a discontinued operation in the Company's Consolidated Financial Statements.

##### Credit Agreements

On March 7, 2012, Kemper entered into a new, four-year, \$325.0 million, unsecured, revolving credit agreement, expiring March 7, 2016 (the "2016 Credit Agreement"), with a group of financial institutions. The 2016 Credit Agreement replaced Kemper's \$245.0 million, unsecured, revolving credit agreement that was scheduled to expire on October 30, 2012 (the "Former Credit Agreement") and was terminated on March 7, 2012. There were no borrowings under the Former Credit Agreement at either December 31, 2011 or at its termination. The 2016 Credit Agreement provides for fixed and floating rate advances for periods up to six months at various interest rates. The 2016 Credit Agreement contains various financial covenants, including limits on total debt to total capitalization, consolidated net worth and minimum risk-based capital ratios for Kemper's largest insurance subsidiaries, United Insurance Company of America ("United Insurance") and Trinity Universal Insurance Company ("Trinity"). Proceeds from advances under the 2016 Credit Agreement may be used for general corporate purposes, including repayment of existing indebtedness. There were no outstanding borrowings under the 2016 Credit Agreement at December 31, 2012, and, accordingly, \$325.0 million was available for future borrowings.

##### Kemper Common Stock Repurchases

In 2011, the Board of Directors approved a new common stock repurchase program. Under this program, Kemper is authorized to repurchase up to \$300 million worth of its common stock. The repurchase program does not have an expiration date. Repurchases may be made from time to time at prevailing prices in the open market or in privately-negotiated transactions, subject to market conditions and other factors. Repurchases will be financed through Kemper's general corporate funds. During 2012, Kemper repurchased 2.0 million shares of its common stock at an aggregate cost of \$60.7 million in open market transactions.

#### (b) BUSINESS SEGMENT FINANCIAL DATA

Financial information about Kemper's business segments for the years ended December 31, 2012, 2011 and 2010 is contained in the following sections of this 2012 Annual Report and is incorporated herein by reference: (i) Note 19, "Business Segments," to the Consolidated Financial Statements; and (ii) MD&A.

(c) DESCRIPTION OF BUSINESS

Kemper is a diversified insurance holding company, with subsidiaries that provide automobile, homeowners, life, health, and other insurance products to individuals and small businesses. The Company is engaged, through its subsidiaries, in the property and casualty insurance and life and health insurance businesses. The Company conducts its operations through four operating segments: Kemper Preferred, Kemper Specialty, Kemper Direct and Life and Health Insurance. The Company's operations are conducted solely in the United States.

Kemper's subsidiaries employ approximately 6,075 full-time associates supporting its operations, of which approximately 350 are employed in the Kemper Preferred segment, 200 are employed in the Kemper Specialty segment, 100 are employed in the Kemper Direct segment, 1,300 are shared by the Kemper Preferred, Kemper Specialty and Kemper Direct segments, 3,925 are employed in the Life and Health Insurance segment and the remainder are employed in various corporate and other staff functions.

Property and Casualty Insurance Business

General

The Company's property and casualty insurance business operations are conducted primarily through the Kemper Preferred, Kemper Specialty, and Kemper Direct segments. In addition, the Life and Health Insurance segment's career agents also sell property insurance to its customers. Collectively, these segments provide automobile, homeowners, renters, fire, and other types of property and casualty insurance to individuals and commercial automobile insurance to businesses.

Automobile insurance in these segments accounted for 52%, 54% and 56% of the Company's consolidated insurance premiums earned in 2012, 2011 and 2010, respectively. Automobile insurance in these segments accounted for 44%, 47% and 49% of Kemper's consolidated revenues from continuing operations in 2012, 2011 and 2010, respectively. Homeowners insurance in these segments accounted for 15%, 14% and 13% of the Company's consolidated insurance premiums earned in 2012, 2011 and 2010, respectively. Homeowners insurance in these segments accounted for 13%, 12% and 11% of the Company's consolidated revenues from continuing operations in 2012, 2011 and 2010, respectively.

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.

Kemper Preferred and Kemper Specialty distribute their products through independent agents who are paid commissions for their services. Kemper Direct distributes its products through employer-sponsored voluntary benefit programs and other affinity relationships and formerly marketed its products directly to consumers. Kemper Direct ceased direct-to-consumer marketing activities in the third quarter of 2012.

Kemper Preferred

Kemper Preferred, based in Jacksonville, Florida, conducts business in 38 states and the District of Columbia. In 2012, the following states provided over half of the premium revenues in this segment: New York (19%), North Carolina (13%), California (12%) and Texas (9%).

Kemper Preferred primarily sells preferred and standard risk automobile and homeowners insurance. Kemper Preferred's insurance products accounted for 57% of the aggregate insurance premium revenues of the Company's property and casualty insurance business in 2012. Its insurance products are marketed by approximately 2,900 independent insurance agents to individuals who have demonstrated favorable risk characteristics and loss history.

Kemper Specialty

Kemper Specialty, based in Dallas, Texas, conducts business in 21 states, principally in the southwest and western United States. In 2012, the following states provided more than three-fourths of the premium revenues in this segment: California (41%), Texas (19%), Washington (7%), Louisiana (6%) and Colorado (4%).

Kemper Specialty provides personal and commercial automobile insurance to value-minded consumers who have had difficulty obtaining standard or preferred risk insurance, usually because of their driving records, claims experience or premium payment



history. Kemper Specialty's insurance products accounted for 27% of the aggregate insurance premium revenues of the Company's property and casualty insurance business in 2012. Kemper Specialty's products are marketed through approximately 8,900 independent agents and brokers.

#### Kemper Direct

Kemper Direct, based in Chicago, Illinois, underwrites a broad spectrum of personal automobile insurance risks, ranging from preferred to non-standard. Kemper Direct also offers homeowners and renters insurance complementing its automobile insurance business. It currently distributes its products through employer-sponsored voluntary benefit programs and other affinity relationships. Prior to ceasing direct-to-consumer marketing activities in the third quarter of 2012, Kemper Direct also marketed its products directly to consumers through a variety of direct-to-consumer websites, including its own websites. The Kemper Direct segment's insurance products are available in 47 states and the District of Columbia. In 2012, the following states provided approximately two-thirds of the premium revenues in this segment: New York (17%), Florida (12%), California (11%), Georgia (6%), Connecticut (6%), Washington (6%), Pennsylvania (5%) and Texas (4%). Kemper Direct's insurance products accounted for 11% of the aggregate insurance premium revenues of the Company's property and casualty insurance business in 2012.

#### Property and Casualty Loss and Loss Adjustment Expense Reserves

The Company's reserves for losses and LAE for property and casualty insurance ("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. Property and Casualty Insurance Reserves by business segment at December 31, 2012 and 2011 were:

DOLLARS IN MILLIONS	2012	2011
Business Segments:		
Kemper Preferred	\$452.3	\$416.2
Kemper Specialty	215.9	225.9
Kemper Direct	177.8	223.9
Life and Health Insurance	7.0	8.3
Total Business Segments	853.0	874.3
Discontinued Operations	100.7	133.0
Unallocated Reserves	16.9	21.8
Total Property and Casualty Insurance Reserves	\$970.6	\$1,029.1

Certain reserves acquired in connection with a business acquisition from SCOR Reinsurance Company ("SCOR") in 2002 (the "Unallocated Reserves") are reinsured 100% by an insurance subsidiary of SCOR (see Note 6, "Property and Casualty Insurance Reserves," to the Consolidated Financial Statements). The Company does not allocate these reserves to its business segments.

In estimating the Company's Property and Casualty Insurance Reserves, the Company's actuaries exercise professional judgment and must consider, and are influenced by, many variables that are difficult to quantify. Accordingly, the process of estimating and establishing the Company's Property and Casualty Insurance Reserves is inherently uncertain and the actual ultimate net cost of claims may vary materially from the estimated amounts reserved. The reserving process is particularly imprecise for claims involving asbestos, environmental matters, construction defect and other emerging and/or long-tailed exposures that may not be discovered or reported until years after the insurance policy period has ended. Property and Casualty Insurance Reserves related to the Company's Discontinued Operations are predominantly long-tailed exposures, of which \$45.2 million was related to asbestos, environmental matters and construction defect exposures at December 31, 2012. See MD&A, "Critical Accounting Estimates," under the caption "Property and Casualty Insurance Reserves for Losses and Loss Adjustment Expenses" beginning on page 54 for a discussion of the Company's reserving process and the factors considered by the Company's actuaries in estimating the Company's Property and Casualty Insurance Reserves.

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 Consolidated 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 Consolidated Financial Statements when the Company increases its previous estimate of ultimate losses and LAE and results in a decrease in net income. The Company recognized total favorable development of \$31.5 million, \$33.1 million and \$24.9 million before tax in 2012, 2011 and 2010, respectively. Development for each of the Company's continuing business segments and Unitrin Business Insurance in 2012, 2011 and 2010 was:

DOLLARS IN MILLIONS	Favorable (Adverse) Development		
	2012	2011	2010
Continuing Operations:			
Kemper Preferred	\$4.8	\$19.1	\$23.8
Kemper Specialty	2.3	9.4	(4.1 )
Kemper Direct	17.8	3.9	6.8
Life and Health Insurance	0.3	2.6	(4.5 )
Total Favorable Development from Continuing Operations, Net	25.2	35.0	22.0
Discontinued Operations:			
Unitrin Business Insurance	6.3	(1.9 )	2.9
Total Favorable Development, Net	\$31.5	\$33.1	\$24.9

See MD&A, "Catastrophes," "Kemper Preferred," "Kemper Specialty," "Kemper Direct," and "Life and Health Insurance" for the impact of development on the results reported by the Company's business segments. Also see MD&A, "Critical Accounting Estimates," under the caption "Property and Casualty Insurance Reserves for Losses and Loss Adjustment Expenses" for additional information about the Company's reserving practices.

Development in Unitrin Business Insurance comprised all of the Company's development reported in discontinued operations. On June 1, 2008, the Company sold its Unitrin Business Insurance operations. The Company retained Property and Casualty Insurance Reserves for unpaid insured losses that occurred prior to the effective date of the sale. Development in Unitrin Business Insurance in 2012 is due primarily to the commutation of certain insurance liabilities that had been previously assumed.

See Note 6, "Property and Casualty Insurance Reserves," to the Consolidated Financial Statements for a tabular reconciliation for the three most recent annual periods setting forth the Company's Property and Casualty Insurance Reserves as of the beginning of each year, incurred losses and LAE for insured events of the current year, changes in incurred losses and LAE for insured events of prior years, payments of losses and LAE for insured events of the current year, payments of losses and LAE for insured events of prior years and the Company's Property and Casualty Insurance Reserves at the end of the year and additional information regarding the nature of adjustments to incurred losses and LAE for insured events of prior years.

#### Catastrophe Losses

Catastrophes and storms are inherent risks of the property and casualty insurance business. These catastrophic events and natural disasters include, without limitation, hurricanes, tornadoes, earthquakes, hailstorms, wildfires, high winds and winter storms. Such events result in insured losses that are, and are expected to be, a material factor in the results of operations and financial position of Kemper's property and casualty insurance companies. Further, because the level of insured losses that could occur in any one year cannot be accurately predicted, these losses contribute to material year-to-year fluctuations in the results of the operations and financial position of these companies. Specific types of catastrophic events are more likely to occur at certain times within the year than others. This factor adds an element of seasonality to property and casualty insurance claims. The occurrence and severity of catastrophic events cannot be accurately predicted in any year. However, some geographic locations are more susceptible to these events than others. The Company has endeavored to manage its direct insurance exposures in certain regions that are prone to naturally occurring catastrophic events through a combination of geographic diversification, restrictions on the amount and location of new business production in such regions, and reinsurance. The Company has adopted the

industry-wide catastrophe classifications of storms and other events promulgated by Insurance Services Office, Inc. (“ISO”) to track and report losses related to catastrophes. ISO classifies a disaster as a catastrophe when

the event causes \$25 million or more in direct losses to property and affects a significant number of policyholders and insurers. ISO-classified catastrophes are assigned a unique serial number recognized throughout the insurance industry. The discussions throughout this 2012 Annual Report utilize ISO's definition of catastrophes.

The process of estimating and establishing reserves for catastrophe losses is inherently uncertain and the actual ultimate cost of a claim, net of reinsurance recoveries, may vary materially from the estimated amount reserved. See Note 20, "Catastrophe Reinsurance," to the Consolidated Financial Statements for a discussion of the factors that influence the process of estimating and establishing reserves for catastrophes.

#### Reinsurance

The Company 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 certain regions, and reinsurance. To limit its exposures to catastrophic events, the Company maintains a primary catastrophe reinsurance program for its property and casualty insurance businesses. Coverage for the primary catastrophe reinsurance program is provided in various layers. In addition to this program, the Kemper Preferred segment purchases reinsurance for catastrophe losses in North Carolina at retentions lower than the Company's primary catastrophe reinsurance program. The Company also purchases reinsurance from the Florida Hurricane Catastrophe Fund (the "FHCF") for hurricane losses in Florida at retentions lower than those described below for the Company's primary catastrophe reinsurance program. See Note 20, "Catastrophe Reinsurance," to the Consolidated Financial Statements for information pertaining to the Company's primary catastrophe reinsurance programs for 2012, 2011 and 2010. The Company's catastrophe reinsurance program for 2013 is described below.

Coverage for the catastrophe reinsurance program effective January 1, 2013 is provided in various layers as presented below:

DOLLARS IN MILLIONS	Catastrophe Losses and LAE		Percentage of Coverage	
	In Excess of	Up to		
Kemper Preferred, Kemper Direct and Kemper Specialty Segments Retained	\$—	\$50.0	—	%
1st Layer of Coverage	50.0	100.0	65.0	
2nd Layer of Coverage	100.0	200.0	95.0	
3rd Layer of Coverage	200.0	350.0	90.0	
4th Layer of Coverage	350.0	450.0	50.0	

The estimated aggregate annual premium in 2013 for the program presented in the preceding table is \$23.4 million for the Kemper Preferred, Kemper Direct and Kemper Specialty catastrophe reinsurance program. In the event that the Company's incurred catastrophe losses and LAE covered by its catastrophe reinsurance program exceed the retention for a particular layer, the program requires one reinstatement of such coverage. In such an instance, the Company is required to pay a reinstatement premium to the reinsurers to reinstate the full amount of reinsurance available under such layer. The reinstatement premium is a percentage of the original premium based on the ratio of the losses in excess of the Company's retention to the reinsurers' coverage limit.

Prior to 2013, companies operating in the Life and Health Insurance segment participated in a catastrophe reinsurance program separate and apart from the catastrophe reinsurance programs covering the Kemper Preferred, Kemper Direct and Kemper Specialty segments. Over the last several years, the Life and Health Insurance segment has been reducing its exposure to catastrophic events through the intentional run-off of its dwelling insurance business. Accordingly, the Life and Health Insurance segment did not renew its catastrophe reinsurance program for 2013. See Note 20, "Catastrophe Reinsurance," to the Consolidated Financial Statements for information pertaining to the Life and Health Insurance segment's participation in the Company's catastrophe reinsurance programs for 2012, 2011 and 2010.

In addition to the catastrophe loss exposures caused by natural events described above, Kemper's property and casualty insurance companies are exposed to losses from catastrophic events that are not the result of acts of nature, such as acts of terrorism, the nature and level of which in any period cannot be accurately predicted. While there were no reported losses experienced by Kemper's property and casualty insurance companies in relation to the terrorist attacks on September 11, 2001, the companies have reinsurance coverage to address certain exposures to potential future terrorist attacks. The reinsurance coverage for certified events, as designated by the federal government, is from the

Terrorist Risk Insurance Act and the coverage for non-certified events is available in the catastrophe reinsurance program for Kemper's property and casualty

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insurance companies. However, certain perils, such as biological, chemical, nuclear pollution or contamination, are excluded from the Company's reinsurance coverage for non-certified events.

In addition to the catastrophe reinsurance programs described above, Kemper's property and casualty insurance companies utilize other reinsurance arrangements to limit their maximum loss, provide greater diversification of risk and minimize exposures on larger risks.

Under the various reinsurance arrangements, Kemper's property and casualty insurance companies are indemnified by reinsurers for certain losses incurred under insurance policies issued by the reinsurers. As indemnity reinsurance does not discharge an insurer from its direct obligations to policyholders on risks insured, Kemper's property and casualty insurance companies remain directly liable. However, so long as the reinsurers meet their obligations, the net liability for Kemper's property and casualty insurance companies is limited to the amount of risk that they retain. Kemper's property and casualty insurance companies purchase their reinsurance only from reinsurers rated "A-" or better by A. M. Best Co., Inc. ("A.M. Best"), at the time of purchase. A.M. Best is an organization that specializes in rating insurance and reinsurance companies.

For further discussion of the reinsurance programs, see Note 6, "Property and Casualty Insurance Reserves," Note 20, "Catastrophe Reinsurance," and Note 21, "Other Reinsurance," to the Consolidated Financial Statements.

#### Pricing

Pricing levels for property and casualty insurance are influenced by many factors, including the frequency and severity of claims, state regulation and legislation, competition, general business and economic conditions, including market rates of interest, inflation, expense levels, and judicial decisions. In addition, many state regulators require consideration of investment income when approving or setting rates, which reduces underwriting margins. See MD&A under the captions "Kemper Preferred," "Kemper Specialty" and "Kemper Direct."

#### Competition

Based on the most recent annual data published by A.M. Best as of the end of 2011, there were 1,326 property and casualty insurance groups in the United States. Kemper's property and casualty group was among the top 10% of property and casualty insurance groups in the United States as measured by net written premiums, policyholders' surplus and admitted assets in 2011. Among all personal lines automobile insurance writers, Kemper's property and casualty group was the 20th largest writer as measured by net written premiums in 2011.

In 2011, the property and casualty insurance industry's estimated net premiums written were \$447 billion, of which nearly 80% were accounted for by the top 50 groups of property and casualty insurance companies. Kemper's property and casualty insurance companies wrote less than 1% of the industry's estimated 2011 premium volume.

Property and casualty insurance is a highly competitive business, particularly with respect to personal automobile insurance. Kemper's property and casualty insurance companies compete on the basis of, among other measures, (i) using suitable pricing segmentation, (ii) maintaining underwriting discipline, (iii) selling to selected markets, (iv) utilizing technological innovations for the marketing and sale of insurance, (v) controlling expenses, (vi) maintaining adequate ratings from A.M. Best and other ratings agencies and (vii) providing quality services to agents and policyholders. See Item 1A., "Risk Factors," under the caption "The insurance industry is highly competitive."

#### Life and Health Insurance Business

The Company's Life and Health Insurance segment consists of Kemper's wholly-owned subsidiaries, United Insurance, The Reliable Life Insurance Company ("Reliable"), Union National Life Insurance Company ("Union National Life"), Mutual Savings Life Insurance Company ("Mutual Savings Life"), United Casualty Insurance Company of America ("United Casualty"), Union National Fire Insurance Company ("Union National Fire"), Mutual Savings Fire Insurance Company ("Mutual Savings Fire") and Reserve National Insurance Company ("Reserve National"). As discussed below, United Insurance, Reliable, Union National Life, Mutual Savings Life, United Casualty, Union National Fire and Mutual Savings Fire (the "Kemper Home Service Companies") distribute their products through a network of employee, or "career," agents. Reserve National distributes its products through a network of exclusive independent agents. These career agents and independent agents are paid commissions for their services.

In 2012, the following states provided approximately two-thirds of the premium revenues in this segment: Texas (21%), Louisiana (11%), Alabama (7%), Mississippi (6%), Illinois (4%), Florida (4%), Georgia (4%), North Carolina (4%) and Missouri (4%). Life insurance accounted for 19%, 18%, and 17% of the Company's consolidated insurance premiums earned in



2012, 2011 and 2010, respectively. Life insurance accounted for 16%, 16% and 15% of the Company's consolidated revenues from continuing operations in 2012, 2011 and 2010, respectively.

#### Kemper Home Service Companies

The Kemper Home Service Companies, based in St. Louis, Missouri, focus on providing individual life and supplemental accident and health insurance products to customers of modest incomes who desire basic protection for themselves and their families. Their leading product is ordinary life insurance, including permanent and term insurance. Face amounts of these policies are lower than those of policies typically sold to higher income customers by other companies in the life insurance industry. Approximately 79% of the Life and Health Insurance segment's premium revenues are generated by the Kemper Home Service Companies.

The Kemper Home Service Companies employ nearly 2,600 career agents to distribute their products in 25 states and the District of Columbia. These career agents are full-time employees who call on customers in their homes to sell insurance products, provide services related to policies in force and collect premiums, typically monthly. Premiums average about \$18 per policy per month. Permanent and term policies are offered primarily on a non-participating, guaranteed-cost basis. These career agents also distribute certain property insurance products for the Kemper Home Service Companies.

#### Reserve National

Reserve National, based in Oklahoma City, Oklahoma, is licensed in 35 states throughout the south, southwest and midwest, and specializes in the sale of Medicare Supplement insurance and limited health insurance coverages such as fixed indemnity, dental and vision, and accident-only plans, primarily to individuals in rural areas who often do not have access to a broad array of accident and health insurance products tailored to meet their individual and family needs. See MD&A, "Life and Health Insurance," "Regulation," under this Item 1 beginning on page 10 and Item 1A., "Risk Factors," under the caption "Reserve National's response to American health care reform may be unsuccessful," for a discussion of the impact of American health care reform on Reserve National.

Reserve National has approximately 260 independent agents appointed to market and distribute its products. These independent agents typically represent only Reserve National.

#### Reinsurance

Consistent with insurance industry practice, the Company's life and health insurance companies utilize reinsurance arrangements to limit their maximum loss, provide greater diversification of risk and minimize exposures on larger risks. Prior to 2013, the segment's reinsurance arrangements included excess of loss reinsurance coverage specifically designed to protect against losses arising from catastrophic events under the property insurance policies distributed by the Kemper Home Service Companies' agents and written by Kemper's subsidiaries, United Casualty, Union National Fire and Mutual Savings Fire, and reinsured by Kemper's subsidiary, Trinity, or written by Capitol County Mutual Fire Insurance Company ("Capitol"), a mutual insurance company owned by its policyholders, and its subsidiary, Old Reliable Casualty Company ("ORCC"), and reinsured by Trinity. Over the last several years, the segment has been intentionally reducing its exposure to catastrophic events through the run-off of its dwelling insurance business. Accordingly, except for catastrophe reinsurance provided by the FHCF, the Kemper Home Service Companies, Capitol and ORCC did not renew the primary catastrophe reinsurance program for 2013. The FHCF provides reinsurance for catastrophe losses in Florida. See Note 20, "Catastrophe Reinsurance," to the Consolidated Financial Statements for additional information pertaining to the segment's primary catastrophe reinsurance programs for 2012, 2011 and 2010.

#### Lapse Ratio

The lapse ratio is a measure of a life insurer's loss of in-force policies. For a given year, this ratio is commonly computed as the total face amount of individual life insurance policies lapsed, surrendered, expired and decreased during such year, less policies increased and revived during such year, divided by the total face amount of policies at the beginning of the year plus the face amount of policies issued and reinsurance assumed in the prior year. The Life and Health Insurance segment's lapse ratio for individual life insurance was 8%, 9% and 8% in 2012, 2011 and 2010, respectively.

The customer base served by the Kemper Home Service Companies and competing life insurance companies tends to have a higher incidence of lapse than other demographic segments of the population. Thus, to maintain or increase the level of its business, the Kemper Home Service Companies must write a high volume of new policies.



## Pricing

Premiums for life and health insurance products are based on assumptions with respect to mortality, morbidity, investment yields, expenses, and lapses and are also affected by state laws and regulations, as well as competition. Pricing assumptions are based on the experience of Kemper's life and health insurance subsidiaries, as well as the industry in general, depending on the factor being considered. The actual profit or loss produced by a product will vary from the anticipated profit if the actual experience differs from the assumptions used in pricing the product. Premiums for policies sold by the Kemper Home Service Companies are set at levels designed to cover the relatively high cost of "in home" servicing of such policies. As a result of such higher expenses, incurred claims as a percentage of earned premiums tend to be lower for companies utilizing this method of distribution than the life insurance industry average.

Premiums for Medicare supplement and other accident and health policies must take into account the rising costs of medical care. The annual rate of medical cost inflation has historically been higher than the general rate of inflation, necessitating frequent rate increases, most of which are subject to approval by state regulatory agencies.

## Competition

Based on the most recent data published by A.M. Best as of the end of 2011, there were 497 life and health insurance company groups in the United States. The Company's Life and Health Insurance segment ranked in the top 20% of life and health insurance company groups, as measured by admitted assets (86), net premiums written (91) and capital and surplus (83) for 2011.

Kemper's life and health insurance subsidiaries generally compete by using appropriate pricing, selling to selected markets, controlling expenses, maintaining adequate ratings from A.M. Best and providing competitive services to agents and policyholders.

## Investments

The quality, nature, and amount of the various types of investments that can be made by insurance companies are regulated by state laws. Depending on the state, these laws permit investments in qualified assets, including, but not limited to, municipal, state and federal government obligations, corporate bonds, real estate, preferred and common stocks, investment partnerships, limited liability investment companies and limited partnerships and mortgages where the value of the underlying real estate exceeds the amount of the loan.

The Company employs a total return investment strategy, with an emphasis on yield, while maintaining liquidity to meet both its short and long-term insurance obligations. See the discussions of the Company's investments under the headings "Investment Results," "Investment Quality and Concentrations," "Investments in Limited Liability Investment Companies and Limited Partnerships," "Liquidity and Capital Resources" and "Critical Accounting Estimates," in the MD&A, "Quantitative and Qualitative Disclosures about Market Risk," in Item 7A and Note 4, "Investments," Note 14, "Income from Investments," and Note 22, "Fair Value Measurements," to the Consolidated Financial Statements.

## Regulation

### Insurance Regulation

Kemper is subject to the insurance holding company laws of a number of states. Certain dividends and distributions by an insurance subsidiary are subject to approval by the insurance regulators of the state of incorporation of such subsidiary. Other significant transactions between an insurance subsidiary and its holding company or other subsidiaries of the holding company may require approval by insurance regulators in the state of incorporation of each of the insurance subsidiaries participating in such transactions.

Kemper's insurance subsidiaries are subject to extensive regulation in the states in which they do business. Such regulation pertains to a variety of matters, including, but not limited to, policy forms, premium rate plans, licensing of agents, licenses to transact business, trade practices, claims practices, investments and solvency. The majority of Kemper's insurance operations are in states requiring prior approval by regulators before proposed rates for property, casualty, or health insurance policies may be implemented. However, rates proposed for life insurance generally become effective immediately upon filing with a state, even though the same state may require prior rate approval for other types of insurance. Insurance regulatory authorities perform periodic examinations of an insurer's market conduct and other affairs. Kemper's health insurance subsidiaries are also subject to certain regulation by the federal government. For example, the Health Care Acts, and the regulations promulgated thereunder, have already established or will establish minimum loss ratios, rating restrictions, mandates for essential health



benefit coverages, and restrictions or prohibitions on pre-existing condition exclusions and annual and lifetime policy limits for health insurance policies.

Insurance companies are required to report their financial condition and results of operation in accordance with statutory accounting principles prescribed or permitted by state insurance regulators in conjunction with the National Association of Insurance Commissioners (the "NAIC"). State insurance regulators also prescribe the form and content of statutory financial statements, perform periodic financial examinations of insurers, set minimum reserve and loss ratio requirements, establish standards for the types and amounts of investments and require minimum capital and surplus levels. Such statutory capital and surplus requirements include risk-based capital ("RBC") rules promulgated by the NAIC. These RBC standards are intended to assess the level of risk inherent in an insurance company's business and consider items such as asset risk, credit risk, underwriting risk and other business risks relevant to its operations. In accordance with RBC formulas, a company's RBC requirements are calculated and compared to its total adjusted capital to determine whether regulatory intervention is warranted. At December 31, 2012, the total adjusted capital of each of Kemper's insurance subsidiaries exceeded the minimum levels required under RBC rules.

Kemper's insurance subsidiaries are required under the guaranty fund laws of most states in which they transact business to pay assessments up to prescribed limits to fund policyholder losses or liabilities of insolvent insurance companies. Kemper's insurance subsidiaries also are required to participate in various involuntary pools or assigned risk pools, principally involving windstorms and high risk drivers. In most states, the involuntary pool participation of Kemper's insurance subsidiaries is in proportion to their voluntary writings of related lines of business in such states. In addition to the regulatory requirements described above, a number of legislative and regulatory measures pending or recently approved may significantly affect the insurance business in a variety of ways. In particular, the NAIC adopted extensive modifications to its Model Insurance Holding Company System Regulatory Act and related regulation in December 2010. Several states have already adopted legislation that incorporates the principal aspects of the NAIC's proposed revisions, and it is reasonable to assume that the various other state legislatures and regulators will enact conforming revisions into law to maintain their accredited status with the NAIC. These modifications will, among other things, substantially expand the oversight and examination powers of state insurance regulators not only with respect to licensed insurance companies, but also with respect to their presently unregulated non-insurance affiliates, and impose new reporting requirements on the ultimate controlling persons of such insurance companies in respect of, among other things, enterprise risk to the organization as a whole, affiliated transactions, and any divestiture of controlling interests in an insurer. Other significant measures enacted in recent years include, among other things, tort reform, the Health Care Acts, the DFA, consumer privacy requirements, credit score regulation, producer compensation regulations, corporate governance requirements and financial services deregulation initiatives. State insurance laws intended primarily for the protection of policyholders contain certain requirements that must be met prior to any change of control of an insurance company or insurance holding company that is domiciled or, in some cases, an insurance company having such substantial business that it is deemed commercially domiciled, in that state. These requirements may include the advance filing of specific information with the state insurance regulators, a public hearing on the matter, and the review and approval of the change of control by such regulators. The Company has insurance subsidiaries domiciled in Alabama, California, Illinois, Louisiana, Missouri, New York, Oklahoma, Oregon, Texas or Wisconsin. In these states, except Alabama, "control" generally is presumed to exist through the direct or indirect ownership of 10% or more of the voting securities of an insurance company. Control is presumed to exist in Alabama with a 5% or more ownership interest in such securities. Any purchase of Kemper's shares that would result in the purchaser owning Kemper's voting securities in the foregoing percentages for the states indicated would be presumed to result in the acquisition of control of Kemper's insurance subsidiaries in those states. Therefore, acquisitions subject to the 10% threshold generally would require the prior approval of the insurance regulatory authorities in each state in which Kemper's insurance subsidiaries are domiciled or deemed to be commercially domiciled, including those in Alabama, while acquisitions subject to the 5% threshold generally would require the prior approval of only Alabama regulatory authorities. Similarly, consistent with the changes the NAIC adopted to the Model Insurance Holding Company System Regulatory Act, several states have enacted legislation that requires either the acquiring and/or divesting company to notify and receive insurance regulatory authority approval for a change in control. Other states are expected to adopt similar provisions to their holding company acts.

In addition, many states require pre-acquisition notification to the state insurance regulators of a change of control of an insurance company licensed in that state if specific market concentration thresholds would be triggered by the acquisition. While those pre-acquisition notification statutes generally do not authorize the state insurance regulators to disapprove the change of control, they do authorize the issuance of a cease and desist order with respect to the insurance company if certain conditions, such as undue market concentration, would result from the acquisition. These insurance regulatory requirements

may deter, delay or prevent transactions effecting control of the Company or the ownership of Kemper's voting securities, including transactions that could be advantageous to Kemper's shareholders.

#### Dodd-Frank Act

In July 2010, the DFA was enacted into law. The DFA brings about a profound increase in the regulation of the financial services industry. Among other things, the DFA forms within the Treasury Department a Federal Insurance Office that is charged with monitoring all aspects of the insurance industry, gathering data, and conducting a study on methods to modernize and improve the insurance regulatory system in the United States. A report on this study that was to be delivered to Congress within 18 months after enactment of the DFA is still forthcoming, and could be influential in reshaping the current state-based insurance regulatory system and/or introducing a direct federal role in such regulation.

#### Item 1A. Risk Factors.

Most issuers, including Kemper, are exposed to numerous risk factors that could cause actual results to differ materially from recent results or anticipated future results. The following discussion details the significant risk factors that are more specific to the Company. In addition to those described below, the Company's business, financial condition and results of operation could be materially affected by other factors not presently known by, or considered material to, the Company. Readers are advised to consider these factors along with the other information included in this 2012 Annual Report, and to consult any further disclosures Kemper makes on related subjects in its filings with the SEC.

Catastrophe losses, whether resulting from natural disasters, terrorism or other man-made events, and reinsurance risks could adversely affect the Company's results of operations, liquidity or financial condition.

Kemper's property and casualty insurance subsidiaries are subject to claims arising out of catastrophes that may have a significant effect on their results of operations, liquidity and financial condition. Catastrophes can be caused by various events, including, but not limited to, hurricanes, tornadoes, windstorms, earthquakes, hail storms, explosions, severe winter weather and wildfires and may include man-made events, such as terrorist attacks and hazardous material spills. The incidence, frequency and severity of catastrophes are inherently unpredictable, and may be impacted by the uncertain effects of climate change. The extent of the Company's losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Kemper's Life and Health Insurance subsidiaries are particularly exposed to risks of catastrophic mortality, such as pandemic or other events that result in large numbers of deaths. In addition, the occurrence of such an event in a concentrated geographic area could have a severe disruptive effect on the Company's workforce and business operations. The likelihood and severity of such events cannot be predicted and are difficult to estimate.

Kemper's insurance subsidiaries seek to reduce their exposure to catastrophe losses through underwriting strategies and the purchase of catastrophe reinsurance. Reinsurance does not relieve Kemper's insurance subsidiaries of their direct liability to their policyholders. As long as the reinsurers meet their obligations, the net liability for Kemper's insurance subsidiaries is limited to the amount of risk that they retain. While the Company's principal reinsurers are each rated "A-" or better by A.M. Best at the time reinsurance is purchased, the Company cannot be certain that reinsurers will pay the amounts due from them either now, in the future, or on a timely basis. A reinsurer's insolvency or inability to make payments under the terms of its reinsurance agreement with Kemper's insurance subsidiaries could have a material adverse effect on the Company's financial position, results of operations and liquidity.

In addition, market conditions beyond the Company's control determine the availability and cost of the reinsurance protection that Kemper's insurance subsidiaries may purchase. A decrease in the amount of reinsurance protection that Kemper's insurance subsidiaries purchase generally should decrease their cost of reinsurance, but increase their risk of loss. An increase in the amount of reinsurance protection that Kemper's insurance subsidiaries purchase generally should increase their cost of reinsurance, but decrease their risk of loss. However, if the amount of available reinsurance is reduced, Kemper's insurance subsidiaries could pay more for the same level, or a lower level, of reinsurance coverage. Accordingly, the Company may be forced to incur additional expenses for reinsurance or may not be able to obtain sufficient reinsurance on acceptable terms, which could adversely affect the ability of Kemper's insurance subsidiaries to write future insurance policies or result in their retaining more risk with respect to such insurance policies.



Estimating losses and 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.

The Company establishes loss and LAE reserves to cover estimated liabilities, which remain unpaid as of the end of each accounting period, and to investigate and settle all claims incurred under the property and casualty insurance policies that it has issued. Loss and LAE reserves are established for claims that have been reported to the Company as of the end of the accounting period, as well as for claims that have occurred but have not yet been reported to the Company. The estimates of loss and LAE reserves are based on the Company's assessment of the facts and circumstances known to it at the time, as well as estimates of the impact of future trends in the severity of claims, the frequency of claims and other factors. See MD&A, "Critical Accounting Estimates," under the caption "Property and Casualty Insurance Reserves for Losses and Loss Adjustment Expenses" beginning on page 54 for a discussion of the Company's reserving process and the factors considered by the Company's actuaries in estimating the Company's Property and Casualty Insurance Reserves.

As the process of estimating property and casualty insurance reserves is inherently uncertain, the reserves established by the Company are not precise estimates of liability and could prove to be inadequate to cover its ultimate losses and expenses for insured events that have occurred. The process of estimating loss reserves is complex and imprecise. The estimate of the ultimate cost of claims for insured events that have occurred must take into consideration many factors that are dependent on the outcome of future events associated with the reporting, investigation and settlement of claims. The impacts on the Company's estimates of property and casualty insurance reserves from these factors are difficult to assess accurately. A change in any one or more of the factors is likely to result in a projected ultimate loss that is different than the previous projected ultimate loss, and may have a material impact on the Company's estimate of the projected ultimate loss. Increases in the estimates of ultimate losses and LAE will decrease earnings, while decreases in such estimates will increase earnings, as reported by the Company in the results of its operations for the periods in which the changes to the estimates are made by the Company.

The Company's actuaries also consider trends in the severity and frequency of claims and other factors, when determining the premium rates to charge for its property and casualty insurance products. An unanticipated change in any one or more of these factors or trends, as well as a change in competitive conditions, may also result in inadequate premium rates charged for insurance policies issued by Kemper's property and casualty insurance subsidiaries in the future. Such pricing inadequacies could have a material impact on the Company's operating results.

Reserve National's response to American health care reform may be unsuccessful.

Reserve National's business model, which focuses on providing limited benefit and supplemental accident and health insurance coverages to persons who lack access to traditional private options, is likely to be adversely affected by the Health Care Acts. In response, Reserve National has begun adapting its business model by placing emphasis on designing and selling supplemental health insurance products that are not expected to be as severely impacted by the Health Care Acts and ceasing to issue health insurance products that are expected to be severely impacted. In particular, Reserve National has ceased issuing health insurance products that are subject to certain provisions that establish minimum loss ratios for health insurance policies significantly above the levels historically experienced by Reserve National. While this action is likely to mitigate Reserve National's risk, the minimum loss provisions could adversely impact its ability to achieve an adequate return on its renewal book of these affected products. The creation of health insurance exchanges beginning in 2014 may result in Reserve National losing a significant number of customers.

If Reserve National's sales of supplemental health insurance products are insufficient to offset the loss of business impacted by the Health Care Acts, a significant loss of business for Reserve National may result. A significant loss of business could have a material adverse effect on the financial condition, the results of operations and the valuation of Reserve National.

Kemper is dependent on receiving dividends from its subsidiaries to service its debt and to pay dividends to its shareholders.

As a holding company with no business operations of its own, Kemper depends on the dividend income that it receives from its subsidiaries as the primary source of funds to pay interest and principal on its outstanding debt obligations and to pay dividends to its shareholders. Kemper's insurance subsidiaries are subject to significant

regulatory restrictions under state insurance laws and regulations that limit their ability to declare and pay dividends. These laws and regulations impose minimum solvency and liquidity requirements on dividends between affiliated companies and require prior notice to, and may require approval from, state insurance regulators before dividends can be paid. The inability of one or more of Kemper's insurance subsidiaries to pay sufficient dividends to Kemper may materially affect Kemper's ability to timely pay its debt obligations or to pay dividends to its shareholders.

A significant downgrade in the ratings of Kemper or its insurance subsidiaries could adversely affect the Company. Third-party rating agencies assess the financial strength and rate the claims-paying ability of insurance companies based on criteria established by the rating agencies. Third-party ratings are important competitive factors in the insurance industry. Financial strength ratings are used to assess the financial strength and quality of insurers. A significant downgrade by a recognized rating agency in the ratings of Kemper's insurance subsidiaries, particularly those operating in the preferred and standard market or offering homeowners insurance, could result in a substantial loss of business if agents or policyholders of such subsidiaries move to other companies with higher claims-paying and financial strength ratings. Any substantial loss of business could have a material adverse effect on the financial condition and results of operations of such subsidiaries. A downgrade in Kemper's credit rating by Standard & Poor's ("S&P"), Moody's Investors Services ("Moody's") or Fitch Ratings ("Fitch") may reduce Kemper's ability to access the capital markets for general corporate purposes or refinance existing debt.

Kemper's insurance subsidiaries are subject to significant regulation by state insurance departments.

Kemper's insurance subsidiaries are subject to extensive regulation in the states in which they do business. Current regulations encompass a wide variety of matters, including policy forms, premium rates, licensing, trade practices, claims practices, investment standards, statutory capital and surplus requirements, reserve and loss ratio requirements, restrictions on transactions among affiliates and consumer privacy.

Insurance regulatory agencies conduct periodic examinations of Kemper's insurance subsidiaries and require the filing of annual and other reports relating to financial condition, holding company issues and other matters. If an insurance company fails to obtain required licenses or approvals, or if any of Kemper's insurance subsidiaries fail to comply with other regulatory requirements, the regulatory agencies can suspend or delay their operations or licenses, require corrective action, and impose penalties or other remedies available under the applicable laws and regulations.

These laws and regulations, and their interpretation by the various regulatory agencies and courts, are undergoing continual revision and expansion. The regulatory structures in the financial services industry have come under intense scrutiny as a result of the turmoil experienced by the financial markets. While it is not possible to predict how new legislation or regulations or new interpretations of existing laws and regulations may impact the operations of Kemper's subsidiaries, two recent developments have the potential to significantly impact such operations.

In July 2010, the DFA was enacted into law. For more information about the potential impact of the DFA on the Company's operations, see "Dodd-Frank Act" under "Regulation" in Item 1, beginning on page 12.

In addition, the NAIC adopted extensive modifications to its Model Insurance Holding Company System Regulatory Act and related regulation in December 2010. Several states have already adopted legislation that incorporates the principal aspects of the NAIC's proposed revisions, and it is reasonable to assume that the various other state legislatures and regulators will enact conforming revisions into law to maintain their accredited status with the NAIC. These modifications will, among other things, substantially expand the oversight and examination powers of state insurance regulators, not only with respect to licensed insurance companies, but also with respect to their presently unregulated non-insurance affiliates, and will impose new reporting requirements on the ultimate controlling persons of such insurance companies with respect to, among other things, enterprise risk to the organization as a whole, affiliated transactions, and any divestiture of controlling interests in an insurer.

These new developments (including regulations that have been or that are required to be promulgated under the DFA), as well as significant changes in, or new interpretations of, existing laws and regulations could make it more expensive for Kemper's subsidiaries to conduct their businesses and could materially affect the profitability of their operations and the Company's financial results. See the discussion in the risk factor above entitled "Reserve National's response to American health care reform may be unsuccessful" regarding the potential effect of the Health Care Acts on Reserve National's business model. For a more detailed discussion of the regulations applicable to Kemper's subsidiaries, see "Insurance Regulation" under "Regulation" in Item 1, beginning on page 10.

The Company is subject to interest rate risk and credit risk in its fixed maturity investment portfolio. One of the Company's primary market risk exposures is to changes in interest rates. A decline in market interest rates could have an adverse effect on the Company's investment income as it invests cash in new investments that may yield less than the portfolio's average rate. In a declining interest rate environment, borrowers may seek to refinance their borrowings at lower rates and, accordingly, prepay or redeem securities the Company holds as investments more quickly than the Company initially expected. Such prepayment or redemption action may cause the Company to reinvest the redeemed proceeds in lower yielding investments. An increase in market interest rates could also have an adverse effect on the value of the Company's investment portfolio, for example, by decreasing the fair values of the fixed income securities that comprise a substantial majority of its investment portfolio.

The Company's fixed maturity investment portfolio is subject to credit risk from the issuers of the securities in the portfolio. Deterioration in the financial conditions of the issuers could result in a decline in the fair value of the Company's fixed maturity investment portfolio. Deterioration in the financial conditions of the issuers could also result in issuer defaults and impact the Company's ability to recover the reported value of its fixed maturity investment portfolio. Accordingly, deterioration in the credit quality of the Company's investment portfolio could adversely affect the Company's operating results and financial position.

The Company's investments in limited liability investment companies and limited partnerships are concentrated in companies and partnerships that invest in distressed and mezzanine debt and secondary transactions.

At December 31, 2012, Kemper's insurance subsidiaries had \$253.0 million invested in limited liability investment companies and limited partnerships accounted for under the equity method of accounting ("Equity Method Limited Liability Investments") that invest in distressed and mezzanine debt of other companies and secondary transactions. In addition, Kemper's insurance subsidiaries had unfunded commitments to invest an additional \$141.5 million at December 31, 2012, including \$88.7 million of unfunded commitments related to investments reported as Other Equity Interests and included in Equity Securities in the Consolidated Balance Sheet, in limited liability investment companies and limited partnerships. Such unfunded commitments generally may be used to fund additional investments made, or losses incurred, by such limited liability investment companies and limited partnerships. The underlying investments of such limited liability investment companies and limited partnerships generally provide opportunities for higher returns, but at a higher risk than investment-grade investments. General economic swings influence the performance of the underlying investments in distressed and mezzanine debt and secondary transactions. Kemper's insurance subsidiaries have also made direct investments in the same or similar distressed and mezzanine debt securities of certain issuers in which such limited liability investment companies and limited partnerships have made investments, which could exacerbate any losses attributable to poor performance of any such investments. A severe and continued downturn in the economy may result in deterioration in the business prospects of the issuers of the underlying investments that could adversely affect the Company's operating results and financial position.

The insurance industry is highly competitive.

The Company's insurance businesses face significant competition, and its ability to compete is affected by a variety of issues relative to others in the industry, such as product pricing, service quality, financial strength and name recognition. Competitive success is based on many factors, including, but not limited to, the following:

- Competitiveness of prices charged for insurance policies;
- Selection of agents, web portals and other business partners;
- Compensation paid to agents;
- Underwriting discipline;
- Selectiveness of sales markets;
- Effectiveness of marketing materials;
- Product and technological innovation;
- Ability to detect and prevent fraudulent insurance claims;
- Ability to control operating expenses;
- Financial strength ratings; and
- Quality of services provided to agents and policyholders.

The inability to compete effectively in any of the Company's insurance businesses could materially reduce the Company's customer base and revenues and could adversely affect the future results and financial condition of the

Company.

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See “Competition” in Item 1 of Part I beginning on page 8 and page 10, for more information on the competitive rankings in the property and casualty insurance markets and the life and health insurance markets, respectively, in the United States.

The effects of an evolving legal and regulatory landscape on Kemper’s insurance subsidiaries are uncertain.

The legal and regulatory landscape within which Kemper’s insurance subsidiaries conduct their businesses is often unpredictable. As industry practices and regulatory, judicial, political, social and other conditions change, unexpected and unintended issues may emerge. These emerging practices, conditions and issues could adversely affect Kemper’s insurance subsidiaries in a variety of ways, including by expansion of coverages beyond their underwriting intent, by increasing the number or size of claims or accelerating the payment of claims. Industry practices that were considered legally-compliant and reasonable for years may suddenly be deemed unacceptable by virtue of an unexpected court or regulatory ruling or changes in regulatory enforcement policies and practices. Anticipating such shifts in the law and the impact they may have on the Company and its operations is a difficult task and there can be no assurances that the Company will not encounter such shifts in the future. The effects of such changes are hard to predict, but could materially affect the financial results of the Company.

Legal and regulatory proceedings are unpredictable.

Kemper and its subsidiaries are from time to time involved in lawsuits, regulatory inquiries, and other legal proceedings arising out of the ordinary course of their businesses. Some of these proceedings may involve matters particular to Kemper or one or more of its subsidiaries, while others may pertain to business practices in the industry in which Kemper and its subsidiaries operate. Some lawsuits may seek class action status that, if granted, could expose the Company to potentially significant liability by virtue of the size of the putative classes. These matters raise difficult factual and legal issues and are subject to uncertainties and complexities, and the outcomes of these matters are difficult to predict, and the amounts or ranges of potential loss at particular stages in the proceedings are in most cases difficult or impossible to ascertain. A further complication is that even where the possibility of an adverse outcome is deemed to be remote using traditional legal analysis, juries sometimes can and do substitute their subjective views in place of facts and established legal principles. Given the unpredictability of the legal and regulatory landscape in which the Company operates, there can be no assurance that one or more of these matters will not produce a result that could have a material adverse effect on the Company’s consolidated financial results for any given period.

For information about the Company’s pending litigation, see Item 3, “Legal Proceedings,” beginning on page 18.

Changes in state enforcement of unclaimed property laws and related insurance claims handling practices could have a significant effect on (including an acceleration of) the payment and/or escheatment of life insurance death benefits relative to what is currently contemplated by Kemper and significantly increase claims handling costs.

In recent years, many states have begun to aggressively enforce compliance with their respective unclaimed property laws to assure that companies are properly reporting and remitting such property. The treasurers of a large majority of states have engaged private firms to examine the practices and procedures of life insurance companies for the handling of unclaimed insurance benefits under life insurance policies, annuity contracts and retained asset accounts.

Certain other measures are also being taken or considered by state insurance regulators, both individually and collectively, through the auspices of the NAIC. Some state insurance regulators have held administrative hearings and/or have initiated market conduct examinations focused on claims handling and escheatment practices of life insurers. Based on published reports, at least six companies have entered into settlement agreements in which they commit to change their historic claims practices by agreeing to periodically search for deceased insureds, prior to the receipt of a death claim, by comparing their in-force policy records against a database of reported deaths maintained by the Social Security Administration (the “SSA Death Master File”). Separately, state legislators, through the auspices of the National Council of Insurance Legislators, have proposed model legislation which, if enacted by various states, could require life insurers to compare their in-force policy records against the SSA Death Master File, for the purpose of proactively identifying potentially deceased insureds for whom the life insurer has not yet received a death claim. Kentucky, New York, Maryland and Alabama have each enacted legislation of this type, with effective dates of January 1, 2013, June 17, 2013, October 1, 2013 and January 1, 2014, respectively. These statutes, if construed to apply to life insurance policies in force on the statutes’ effective dates, could have a significant effect on, including an acceleration of, the payment of life insurance benefits to beneficiaries or, in instances where beneficiaries could not be

located, the escheatment of such benefits to the states. A declaratory judgment action filed by the Company in November 2012 is pending in state court in Kentucky asking the court to construe the Kentucky statute such that it would only apply prospectively, i.e., only with respect to life insurance policies issued on or after the statute's effective date, consistent with the requirements of applicable Kentucky statutory law and Kentucky and federal constitutional provisions.

Kemper's life insurance companies are currently the subject of an unclaimed property compliance examination by a private firm retained by the treasurers of thirty-eight states. Kemper's life insurance companies have provided a significant amount of information to such firm. The results of this examination are not likely to be known for some time. One state insurance regulator has also commenced a market conduct exam of Kemper's life insurance companies for the purpose of verifying such companies' compliance with relevant regulations governing life insurance claims handling and escheatment practices.

Should these various efforts by state officials succeed in applying new claims handling and escheatment practices to existing life insurance policies, they could have a material adverse effect on the Company's profitability and financial position.

See Note 23, "Contingencies," to the Consolidated Financial Statements and the sections of the MD&A entitled "Life and Health Insurance" and "Liquidity and Capital Resources" for additional information on these matters.

Managing technology initiatives to address business developments and increasing data security regulations and risks present significant challenges to the Company.

While technological developments can streamline many business processes and ultimately reduce the cost of operations, technology initiatives can present short-term cost and implementation risks. In addition, proje