KEMPER Corp
Form 10-Q
November 08, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For Quarterly Period Ended September 30, 2012
OR
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Transition Period from to
Commission file number 0-18298

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

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of<br>incorporation or organization) | 95-4255452<br>(I.R.S. Employer<br>Identification No.) |
| One East Wacker Drive, Chicago, Illinois<br>(Address of principal executive offices) | 60601<br>(Zip Code) |

(312) 661-4600
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, non-accelerated filer or a smaller reporting company. See definition of "accelerated filer, large accelerated filer and smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer | x | Accelerated filer | ¨ |
| Non-accelerated filer | ¨ | Smaller Reporting Company | ¨ |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
58,353,230 shares of common stock, $0.10 par value, were outstanding as of October 31, 2012.

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Caution Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q, including Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), Quantitative and Qualitative Disclosures About Market Risk, Risk Factors and the accompanying unaudited Condensed Consolidated Financial Statements (including the notes thereto) of Kemper Corporation ("Kemper") and its subsidiaries (individually and collectively referred to herein as the "Company") 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 ot and terms 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 Quarterly Report on Form 10-Q. 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. Many such factors will be important in determining the Company's actual future results and financial condition. 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 under Item 1A., Risk Factors, of Part I of Kemper's Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission (the "SEC"), for the year ended December 31, 2011 (the "2011 Annual Report") as updated by Item 1A. of Part II of this Quarterly Report on Form 10-Q and Kemper's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012.

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 number 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 expenses ("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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Caution Regarding Forward-Looking Statements (continued)

- 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 and the Dodd-Frank Act, 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 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 Quarterly Report on Form 10-Q. The reader is advised, however, to consult any further disclosures Kemper makes on related subjects in its filings with the SEC.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
KEMPER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Dollars in millions, except per share amounts)
(Unaudited)

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | Sep 30, 2012 | Sep 30, 2011 | Sep 30, 2012 | Sep 30, 2011 |
| Revenues: | | | | |
| Earned Premiums | $1,586.3 | $1,637.1 | $527.3 | $543.0 |
| Net Investment Income | 223.0 | 222.7 | 70.4 | 58.6 |
| Other Income | 0.6 | 0.8 | 0.2 | 0.4 |
| Net Realized Gains (Losses) on Sales of Investments | 59.9 | 27.8 | 50.9 | (4.2) |
| Other-than-temporary Impairment Losses: | | | | |
| Total Other-than-temporary Impairment Losses | (4.1) | (6.7) | (3.2) | (5.0) |
| Portion of Losses Recognized in Other Comprehensive Income | — | — | — | — |
| Net Impairment Losses Recognized in Earnings | (4.1) | (6.7) | (3.2) | (5.0) |
| Total Revenues | 1,865.7 | 1,881.7 | 645.6 | 592.8 |
| Expenses: | | | | |
| Policyholders’ Benefits and Incurred Losses and Loss Adjustment Expenses | 1,169.1 | 1,269.0 | 368.7 | 399.6 |
| Insurance Expenses | 502.8 | 513.5 | 172.7 | 176.8 |
| Interest and Other Expenses | 65.4 | 62.0 | 22.7 | 21.4 |
| Total Expenses | 1,737.3 | 1,844.5 | 564.1 | 597.8 |
| Income (Loss) from Continuing Operations before Income Taxes | 128.4 | 37.2 | 81.5 | (5.0) |
| Income Tax Benefit (Expense) | (34.9) | (0.5) | (25.9) | 6.1 |
| Income from Continuing Operations | 93.5 | 36.7 | 55.6 | 1.1 |
| Income from Discontinued Operations | 8.0 | 13.5 | — | 0.9 |
| Net Income | $101.5 | $50.2 | $55.6 | $2.0 |
| Income from Continuing Operations Per Unrestricted Share: | | | | |
| Basic | $1.57 | $0.61 | $0.95 | $0.01 |
| Diluted | $1.56 | $0.61 | $0.95 | $0.01 |
| Net Income Per Unrestricted Share: | | | | |
| Basic | $1.71 | $0.83 | $0.95 | $0.03 |
| Diluted | $1.70 | $0.83 | $0.95 | $0.03 |
| Dividends Paid to Shareholders Per Share | $0.72 | $0.72 | $0.24 | $0.24 |

The Notes to the Condensed Consolidated Financial Statements are an integral part of these financial statements.

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KEMPER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in millions)
(Unaudited)

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | Sep 30, 2012 | Sep 30, 2011 | Sep 30, 2012 | Sep 30, 2011 |
| Net Income | $101.5 | $50.2 | $55.6 | $2.0 |
| Other Comprehensive Income Before Income Taxes: | | | | |
| Unrealized Holding Gains | 121.6 | 164.8 | 47.7 | 141.5 |
| Foreign Currency Translation Adjustments | 1.5 | 0.6 | 0.2 | — |
| Amortization of Unrecognized Postretirement Benefit Costs | 12.0 | 6.5 | 4.4 | 2.1 |
| Other Comprehensive Income Before Income Taxes | 135.1 | 171.9 | 52.3 | 143.6 |
| Other Comprehensive Income Tax Expense | (48.0) | (61.2) | (18.7) | (51.0) |
| Other Comprehensive Income | 87.1 | 110.7 | 33.6 | 92.6 |
| Total Comprehensive Income | $188.6 | $160.9 | $89.2 | $94.6 |

The Notes to the Condensed Consolidated Financial Statements are an integral part of these financial statements.

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KEMPER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in millions, except per share amounts)
(Unaudited)

| | Sep 30, 2012 | Dec 31, 2011 |
|---|---|---|
| Assets: | | |
| Investments: | | |
| Fixed Maturities at Fair Value (Amortized Cost: 2012 - $4,129.5; 2011 - $4,266.1) | $4,725.6 | $4,773.4 |
| Equity Securities at Fair Value (Cost: 2012 - $481.4; 2011 - $367.3) | 545.7 | 397.3 |
| Equity Method Limited Liability Investments at Cost Plus Cumulative Undistributed Earnings | 267.3 | 306.3 |
| Short-term Investments at Cost which Approximates Fair Value | 297.3 | 247.4 |
| Other Investments | 500.1 | 498.3 |
| Total Investments | 6,336.0 | 6,222.7 |
| Cash | 318.7 | 251.2 |
| Receivables from Policyholders | 385.6 | 379.2 |
| Other Receivables | 207.6 | 218.7 |
| Deferred Policy Acquisition Costs | 306.8 | 294.0 |
| Goodwill | 311.8 | 311.8 |
| Current and Deferred Income Tax Assets | 0.1 | 6.4 |
| Other Assets | 254.2 | 250.7 |
| Total Assets | $8,120.8 | $7,934.7 |
| Liabilities and Shareholders' Equity: | | |
| Insurance Reserves: | | |
| Life and Health | $3,149.8 | $3,102.7 |
| Property and Casualty | 981.8 | 1,029.1 |
| Total Insurance Reserves | 4,131.6 | 4,131.8 |
| Unearned Premiums | 674.3 | 666.2 |
| Liabilities for Income Taxes | 59.1 | 6.2 |
| Notes Payable at Amortized Cost (Fair Value: 2012 - $678.5; 2011 - $638.7) | 611.2 | 610.6 |
| Accrued Expenses and Other Liabilities | 440.1 | 403.3 |
| Total Liabilities | 5,916.3 | 5,818.1 |
| Shareholders' Equity: | | |
| Common Stock, $0.10 Par Value, 100 Million Shares Authorized; 58,353,230 Shares Issued and Outstanding at September 30, 2012 and 60,248,582 Shares Issued and Outstanding at December 31, 2011 | 5.8 | 6.0 |
| Paid-in Capital | 722.8 | 743.9 |
| Retained Earnings | 1,130.8 | 1,108.7 |
| Accumulated Other Comprehensive Income | 345.1 | 258.0 |
| Total Shareholders' Equity | 2,204.5 | 2,116.6 |
| Total Liabilities and Shareholders' Equity | $8,120.8 | $7,934.7 |

The Notes to the Condensed Consolidated Financial Statements are an integral part of these financial statements.

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KEMPER CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in millions)
(Unaudited)

| | Nine Months Ended | |
|---|---|---|
| | Sep 30, 2012 | Sep 30, 2011 |
| Operating Activities: | | |
| Net Income | $101.5 | $50.2 |
| Adjustments to Reconcile Net Income to Net Cash Provided (Used) by Operating Activities: | | |
| Increase in Deferred Policy Acquisition Costs | (12.7) | (10.2) |
| Amortization of Life Insurance in Force Acquired and Customer Relationships Acquired | 5.9 | 8.6 |
| Equity in Earnings of Equity Method Limited Liability Investments | (7.2) | (7.2) |
| Distribution of Accumulated Earnings of Equity Method Limited Liability Investments | 10.7 | — |
| Amortization of Investment Securities and Depreciation of Investment Real Estate | 11.3 | 12.2 |
| Net Realized Gains on Sales of Investments | (59.9) | (28.2) |
| Net Impairment Losses Recognized in Earnings | 4.1 | 6.7 |
| Net Gain on Sale of Portfolio of Automobile Loan Receivables | (12.9) | (4.5) |
| Benefit for Loan Losses | (2.0) | (34.1) |
| Depreciation of Property and Equipment | 11.1 | 10.4 |
| Decrease (Increase) in Other Receivables | 4.6 | (2.8) |
| Decrease in Insurance Reserves | (1.6) | (25.6) |
| Increase in Unearned Premiums | 8.1 | 8.5 |
| Change in Income Taxes | 10.5 | (12.1) |
| Decrease in Accrued Expenses and Other Liabilities | (1.0) | (8.3) |
| Other, Net | 29.1 | 26.3 |
| Net Cash Provided (Used) by Operating Activities | 99.6 | (10.1) |
| Investing Activities: | | |
| Sales and Maturities of Fixed Maturities | 784.7 | 547.8 |
| Purchases of Fixed Maturities | (574.0) | (577.1) |
| Sales of Equity Securities | 30.8 | 236.6 |
| Purchases of Equity Securities | (118.7) | (181.3) |
| Improvements of Investment Real Estate | (3.7) | (4.0) |
| Sales of Investment Real Estate | — | 0.3 |
| Return of Investment of Equity Method Limited Liability Investments | 31.8 | 47.7 |
| Acquisitions of Equity Method Limited Liability Investments | (18.5) | (17.5) |
| Decrease (Increase) in Short-term Investments | (49.9) | 282.1 |
| Net Proceeds from Sale of Portfolio of Automobile Loan Receivables | 17.7 | 220.7 |
| Receipts from Automobile Loan Receivables | 2.0 | 158.6 |
| Increase in Other Investments | (8.5) | (10.2) |
| Other, Net | (26.8) | (19.1) |
| Net Cash Provided by Investing Activities | 66.9 | 684.6 |
| Financing Activities: | | |
| Repayments of Certificates of Deposits | — | (321.8) |
| Proceeds from Issuance of Notes Payable | — | 95.0 |
| Repayments of Notes Payable | — | (30.0) |
| Common Stock Repurchases | (57.7) | (21.7) |
| Cash Dividends Paid to Shareholders | (42.9) | (43.7) |
| Cash Exercise of Stock Options | — | 0.1 |

| | | |
|---|---|---|
| Excess Tax Benefits from Share-based Awards | 0.2 | 0.2 |
| Other, Net | 1.4 | 1.2 |
| Net Cash Used by Financing Activities | (99.0 ) | (320.7 ) |
| Increase in Cash | 67.5 | 353.8 |
| Cash, Beginning of Year | 251.2 | 117.2 |
| Cash, End of Period | $318.7 | $471.0 |

The Notes to the Condensed Consolidated Financial Statements are an integral part of these financial statements.

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KEMPER CORPORATION AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

The Condensed Consolidated Financial Statements included herein have been prepared pursuant to the rules and regulations of the SEC and include the accounts of Kemper Corporation ("Kemper") and its subsidiaries (individually and collectively referred to herein as the "Company") and are unaudited. All significant intercompany accounts and transactions have been eliminated.

As discussed below, the Company adopted Accounting Standards Update ("ASU") 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts, on January 1, 2012 and retrospectively adjusted its financial statements for prior periods for the impact of the adoption. On January 1, 2012, the Company also implemented a new model for allocating capital and net investment income to its business segments. Accordingly, the Company has also reclassified certain amounts in its segment results in the retrospectively adjusted financial statements to conform to the current presentation. The Company accounts for Fireside Auto Finance, Inc. ("Fireside"), formerly known as Fireside Bank, and Kemper's former Unitrin Business Insurance operations as discontinued operations. See Note 2, "Discontinued Operations," to the Condensed Consolidated Financial Statements.

Certain financial information that is normally included in annual financial statements, including certain financial statement footnote disclosures, prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") is not required by the rules and regulations of the SEC for interim financial reporting and has been condensed or omitted. In the opinion of the Company's management, the Condensed Consolidated Financial Statements include all adjustments necessary for a fair presentation. The preparation of interim financial statements relies heavily on estimates. This factor and other factors, such as the seasonal nature of some portions of the insurance business, as well as market conditions, call for caution in drawing specific conclusions from interim results. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Company's Consolidated Financial Statements and related notes included in the 2011 Annual Report.

Accounting Standards Not Yet Adopted

The Financial Accounting Standards Board ("FASB") issues ASUs to amend the authoritative literature in the FASB Accounting Standards Codification ("ASC"). There have been seven ASUs issued in 2012 that amend the original text of the ASC. The ASUs are not expected to have a material impact on the Company.

Adoption of New Accounting Standards

In October 2010, the FASB issued ASU 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. The standard is effective for interim and annual reporting periods beginning after December 15, 2011. The provisions of the standard can be applied either prospectively or retrospectively. The standard amends ASC Topic 944, Financial Services—Insurance, and modifies the definition of the types of costs incurred by insurance entities that can be capitalized in the acquisition of new and renewal contracts. The Company adopted the standard on January 1, 2012 and applied its provisions retrospectively. The adoption of the standard reduced consolidated shareholders' equity by $99.5 million on January 1, 2012. The Company's financial statements have been retrospectively adjusted as if ASU 2010-26 had been adopted prior to all periods presented.

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KEMPER CORPORATION AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 1 - Basis of Presentation (continued)
The impact of the adoption of the new accounting standard on Income from Continuing Operations and Net Income and the related basic and diluted per share amounts for the nine and three months ended September 30, 2012 is presented below:

| (Dollars in Millions, Except Per Share Amounts) | Nine Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2012 |
|---|---|---|
| Decrease in: | | |
| Income from Continuing Operations | $(7.5) | $(2.5) |
| Net Income | $(7.5) | $(2.5) |
| Income from Continuing Operations per Unrestricted Share: | | |
| Basic | $(0.13) | $(0.04) |
| Diluted | $(0.13) | $(0.04) |
| Net Income Per Unrestricted Share: | | |
| Basic | $(0.13) | $(0.04) |
| Diluted | $(0.13) | $(0.04) |

The following line items presented in the Condensed Consolidated Statements of Income for the nine and three months ended September 30, 2011 were affected by the adoption of the new accounting standard:

| (Dollars in Millions, Except Per Share Amounts) | Nine Months Ended Sep 30, 2011 | | | Three Months Ended Sep 30, 2011 | | |
|---|---|---|---|---|---|---|
| | As Originally Reported | As Adjusted | Effect of Change | As Originally Reported | As Adjusted | Effect of Change |
| Insurance Expenses | $500.8 | $513.5 | $12.7 | $172.6 | $176.8 | $4.2 |
| Income Tax Benefit (Expense) | $(5.1) | $(0.5) | $4.6 | $4.6 | $6.1 | $1.5 |
| Income from Continuing Operations | $44.8 | $36.7 | $(8.1) | $3.8 | $1.1 | $(2.7) |
| Net Income | $58.3 | $50.2 | $(8.1) | $4.7 | $2.0 | $(2.7) |
| Income from Continuing Operations per Unrestricted Share: | | | | | | |
| Basic | $0.74 | $0.61 | $(0.13) | $0.06 | $0.01 | $(0.05) |
| Diluted | $0.74 | $0.61 | $(0.13) | $0.06 | $0.01 | $(0.05) |
| Net Income Per Unrestricted Share: | | | | | | |
| Basic | $0.96 | $0.83 | $(0.13) | $0.08 | $0.03 | $(0.05) |
| Diluted | $0.96 | $0.83 | $(0.13) | $0.08 | $0.03 | $(0.05) |

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements. The standard is effective for the first interim or annual period beginning on or after December 15, 2011. The new standard amends the existing fair value definition and enhances disclosure requirements. The Company adopted the standard in the first quarter of 2012 and, except for the additional disclosure requirements, the initial application of the standard did not have an impact on the Company.

Note 1 - Basis of Presentation (continued)

In September 2011, the FASB issued ASU 2011-08, Testing Goodwill for Impairment. The standard is effective for the first interim or annual period beginning on or after December 15, 2011. The standard amends ASC Topic 350, Intangibles—Goodwill and Other, and gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The Company adopted the standard in the first quarter of 2012. The initial application of the standard did not have an impact on the Company.

In December 2011, the FASB issued ASU 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. The standard deferred certain paragraphs in ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, related to the presentation of reclassification adjustments but also required companies to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. The Company adopted the standard in the first quarter of 2012. Other than the inclusion of the Condensed Consolidated Statement of Comprehensive Income, the initial application of the standard did not have an impact on the Company.

Note 2 - Discontinued Operations

The Company accounts for Fireside and the Company’s former Unitrin Business Insurance operations as discontinued operations. Summary financial information included in Income from Discontinued Operations for the nine and three months ended September 30, 2012 and 2011 is presented below:

| (Dollars in Millions, Except Per Share Amounts) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 |
|---|---|---|---|---|
| Interest, Loan Fees and Earned Discounts | $— | $31.8 | $— | $3.8 |
| Other Income | — | 1.4 | — | 1.1 |
| Net Gain on Sale of Loan Portfolios | 12.9 | 4.5 | 0.5 | 4.5 |
| Net Investment Income | — | 0.5 | — | — |
| Net Realized Gains on Sales of Investments | — | 0.4 | — | — |
| Total Revenues Included in Discontinued Operations | $12.9 | $38.6 | $0.5 | $9.4 |
| | | | | |
| Income (Loss) from Discontinued Operations before Income Taxes: | | | | |
| Fireside: | | | | |
| Results of Operations | $(0.2) | $17.8 | $— | $(2.0) |
| Net Gain on Sale of Loan Portfolios | 12.9 | 4.5 | 0.5 | 4.5 |
| Unitrin Business Insurance: | | | | |
| Change in Estimate of Retained Liabilities Arising from Discontinued Operations | 0.5 | (3.0) | (0.6) | (1.9) |
| Income (Loss) from Discontinued Operations before Income Taxes | 13.2 | 19.3 | (0.1) | 0.6 |
| Income Tax Benefit (Expense) | (5.2) | (5.8) | 0.1 | 0.3 |
| Income from Discontinued Operations | $8.0 | $13.5 | $— | $0.9 |
| | | | | |
| Income from Discontinued Operations Per Unrestricted Share: | | | | |
| Basic | $0.14 | $0.22 | $— | $0.02 |
| Diluted | $0.14 | $0.22 | $— | $0.02 |

During 2011, Fireside sold its active portfolio of automobile loan receivables at a gain of $4.5 million, net of transaction and other costs, while retaining its inactive portfolio of loans that had been previously charged-off (the

“Inactive Portfolio”). The Inactive Portfolio was not carried on the Company’s Condensed Consolidated Balance Sheet. During 2012, Fireside sold $283 million of loans in the Inactive Portfolio at a gain of $12.9 million, net of transaction, shutdown and other costs of $13.3 million, of which $4.7 million was unpaid at September 30, 2012.

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KEMPER CORPORATION AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 2 - Discontinued Operations (continued)
The Company has retained Property and Casualty Insurance Reserves for unpaid insured losses of its former Unitrin Business Insurance operations that occurred prior to June 1, 2008, the effective date of the sale of such operations. Property and Casualty Insurance Reserves reported in the Company’s Condensed Consolidated Balance Sheets include $110.0 million and $125.6 million at September 30, 2012 and December 31, 2011, respectively, for such retained liabilities. Changes in the Company’s estimate of such retained liabilities after the sale are reported as a separate component of the results of discontinued operations.
Note 3 - Investments
The amortized cost and estimated fair values of the Company’s Investments in Fixed Maturities at September 30, 2012 were:

| (Dollars in Millions) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Government and Government Agencies and Authorities | $406.3 | $50.6 | $(0.3) | $456.6 |
| States and Political Subdivisions | 1,280.6 | 155.4 | — | 1,436.0 |
| Corporate Securities: | | | | |
| Bonds and Notes | 2,399.8 | 393.2 | (6.4) | 2,786.6 |
| Redeemable Preferred Stocks | 38.6 | 3.3 | (0.2) | 41.7 |
| Mortgage and Asset-backed | 4.2 | 1.0 | (0.5) | 4.7 |
| Investments in Fixed Maturities | $4,129.5 | $603.5 | $(7.4) | $4,725.6 |

Included in the fair value of Mortgage and Asset-backed investments at September 30, 2012 are $2.9 million of collateralized debt obligations, $1.5 million of non-governmental residential mortgage-backed securities and $0.3 million of other asset-backed securities.
The amortized cost and estimated fair values of the Company’s Investments in Fixed Maturities at December 31, 2011 were:

| (Dollars in Millions) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Government and Government Agencies and Authorities | $439.4 | $52.3 | $— | $491.7 |
| States and Political Subdivisions | 1,705.0 | 148.4 | (0.8) | 1,852.6 |
| Corporate Securities: | | | | |
| Bonds and Notes | 2,040.1 | 311.6 | (9.4) | 2,342.3 |
| Redeemable Preferred Stocks | 76.7 | 5.1 | (0.1) | 81.7 |
| Mortgage and Asset-backed | 4.9 | 1.0 | (0.8) | 5.1 |
| Investments in Fixed Maturities | $4,266.1 | $518.4 | $(11.1) | $4,773.4 |

Included in the fair value of Mortgage and Asset-backed investments at December 31, 2011 are $2.9 million of collateralized debt obligations, $1.7 million of non-governmental residential mortgage-backed securities, $0.4 million of other asset-backed securities and $0.1 million of commercial mortgage-backed securities.
The amortized cost and estimated fair values of the Company’s Investments in Fixed Maturities at September 30, 2012 by contractual maturity were:

| (Dollars in Millions) | Amortized Cost | Fair Value |
|---|---|---|
| Due in One Year or Less | $49.8 | $49.9 |
| Due after One Year to Five Years | 549.1 | 581.8 |
| Due after Five Years to Ten Years | 1,045.6 | 1,160.7 |
| Due after Ten Years | 2,271.1 | 2,695.9 |
| Asset-backed Securities Not Due at a Single Maturity Date | 213.9 | 237.3 |

| | | |
|---|---|---|
| Investments in Fixed Maturities | $4,129.5 | $4,725.6 |

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Note 3 - Investments (continued)

The expected maturities of the Company’s Investments in Fixed Maturities may differ from the contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Investments in Asset-backed Securities Not Due at a Single Maturity Date at September 30, 2012 consisted of securities issued by the Government National Mortgage Association with a fair value of $209.9 million, securities issued by the Federal National Mortgage Association with a fair value of $22.0 million, securities issued by the Federal Home Loan Mortgage Corporation with a fair value of $0.7 million and securities of other issuers with a fair value of $4.7 million.

Other Receivables at September 30, 2012 includes a receivable of $5.1 million for sales of Investments in Fixed Maturities that settled in October 2012. Accrued Expenses and Other Liabilities at September 30, 2012 includes a payable of $23.3 million for purchases of Investments in Fixed Maturities that settled in October 2012. There were no unsettled sales or purchases of Investments in Fixed Maturities at December 31, 2011.

Gross unrealized gains and gross unrealized losses on the Company’s Investments in Equity Securities at September 30, 2012 were:

| | | Gross Unrealized | | |
|---|---|---|---|---|
| (Dollars in Millions) | Cost | Gains | Losses | Fair Value |
| Preferred Stocks: | | | | |
| Finance, Insurance and Real Estate | $80.4 | $4.5 | $(0.2) | $84.7 |
| Other Industries | 18.4 | 3.9 | (0.1) | 22.2 |
| Common Stocks: | | | | |
| Manufacturing | 66.5 | 23.9 | (0.2) | 90.2 |
| Other Industries | 65.0 | 13.0 | (0.9) | 77.1 |
| Other Equity Interests: | | | | |
| Exchange Traded Funds | 144.6 | 7.2 | — | 151.8 |
| Limited Liability Companies and Limited Partnerships | 106.5 | 15.0 | (1.8) | 119.7 |
| Investments in Equity Securities | $481.4 | $67.5 | $(3.2) | $545.7 |

Gross unrealized gains and gross unrealized losses on the Company’s Investments in Equity Securities at December 31, 2011 were:

| | | Gross Unrealized | | |
|---|---|---|---|---|
| (Dollars in Millions) | Cost | Gains | Losses | Fair Value |
| Preferred Stocks: | | | | |
| Finance, Insurance and Real Estate | $94.4 | $1.0 | $(8.7) | $86.7 |
| Other Industries | 18.0 | 2.6 | (0.1) | 20.5 |
| Common Stocks: | | | | |
| Manufacturing | 64.6 | 18.9 | (0.1) | 83.4 |
| Other Industries | 41.4 | 7.4 | (1.8) | 47.0 |
| Other Equity Interests: | | | | |
| Exchange Traded Funds | 66.0 | 0.6 | — | 66.6 |
| Limited Liability Companies and Limited Partnerships | 82.9 | 11.7 | (1.5) | 93.1 |
| Investments in Equity Securities | $367.3 | $42.2 | $(12.2) | $397.3 |

Note 3 - Investments (continued)
An aging of unrealized losses on the Company’s Investments in Fixed Maturities and Equity Securities at September 30, 2012 is presented below:

| | Less Than 12 Months | | 12 Months or Longer | | Total | |
|---|---|---|---|---|---|---|
| (Dollars in Millions) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Fixed Maturities: | | | | | | |
| U.S. Government and Government Agencies and Authorities | $40.0 | $(0.3) | $— | $— | $40.0 | $(0.3) |
| States and Political Subdivisions | — | — | 0.7 | — | 0.7 | — |
| Corporate Securities: | | | | | | |
| Bonds and Notes | 172.3 | (3.3) | 40.3 | (3.1) | 212.6 | (6.4) |
| Redeemable Preferred Stocks | — | — | 0.7 | (0.2) | 0.7 | (0.2) |
| Mortgage and Asset-backed | 0.1 | — | 2.5 | (0.5) | 2.6 | (0.5) |
| Total Fixed Maturities | 212.4 | (3.6) | 44.2 | (3.8) | 256.6 | (7.4) |
| Equity Securities: | | | | | | |
| Preferred Stocks: | | | | | | |
| Finance, Insurance and Real Estate | — | — | 2.3 | (0.2) | 2.3 | (0.2) |
| Other Industries | 0.9 | — | 3.7 | (0.1) | 4.6 | (0.1) |
| Common Stocks: | | | | | | |
| Manufacturing | 2.3 | (0.2) | — | — | 2.3 | (0.2) |
| Other Industries | 4.7 | (0.3) | 2.8 | (0.6) | 7.5 | (0.9) |
| Other Equity Interests: | | | | | | |
| Limited Liability Companies and Limited Partnerships | 8.0 | (0.8) | 11.1 | (1.0) | 19.1 | (1.8) |
| Total Equity Securities | 15.9 | (1.3) | 19.9 | (1.9) | 35.8 | (3.2) |
| Total | $228.3 | $(4.9) | $64.1 | $(5.7) | $292.4 | $(10.6) |

The Company regularly reviews its investment portfolio for factors that may indicate that a decline in fair value of an investment is other-than-temporary. The portions of the declines in the fair values of investments that are determined to be other-than-temporary are reported as losses in the Condensed Consolidated Statements of Income in the periods when such determinations are made.

Unrealized losses on fixed maturities, which the Company has determined to be temporary at September 30, 2012, were $7.4 million, of which $3.8 million is related to fixed maturities that were in an unrealized loss position for 12 months or longer. There were no unrealized losses at September 30, 2012 related to securities for which the Company has recognized credit losses in earnings in the preceding table under either the heading “Less Than 12 Months” or the heading “12 Months or Longer.” Included in the preceding table under the heading “12 Months or Longer” are unrealized losses of $0.1 million at September 30, 2012 related to securities for which the Company has previously recognized foreign currency losses in earnings. Investment-grade fixed maturity investments comprised $2.3 million and below-investment-grade fixed maturity investments comprised $5.1 million of the unrealized losses on investments in fixed maturities at September 30, 2012. Unrealized losses for below-investment-grade fixed maturities included unrealized losses totaling $0.1 million for one issuer that the Company previously recognized foreign currency impairment losses in earnings. For the other remaining below-investment-grade fixed maturity investments in an unrealized loss position, the unrealized loss amount, on average, was 4% of the amortized cost basis of the investment. At September 30, 2012, the Company did not have the intent to sell these investments and it was not more likely than not that the Company would be required to sell these investments before recovery of its amortized cost basis, which may be at maturity. Based on the Company’s evaluation at September 30, 2012 of the prospects of the issuers, including, but not limited to, the credit ratings of the issuers of the investments in the fixed maturities, and the Company’s intention to not sell and its determination that it would not be required to sell before recovery of the amortized cost of such investments, the Company concluded that the declines in the fair values of the Company’s investments in fixed maturities presented in the preceding table were temporary at the evaluation date.

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KEMPER CORPORATION AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 3 - Investments (continued)
For equity securities, the Company considers various factors when determining whether a decline in the fair value is other than temporary, including, but not limited to:
- The financial condition and prospects of the issuer;
- The length of time and magnitude of the unrealized loss;
- The volatility of the investment;
- Analyst recommendations and near term price targets;
- Opinions of the Company’s external investment managers;
- Market liquidity;
- Debt-like characteristics of perpetual preferred stocks and issuer ratings; and
- The Company’s intentions to sell or ability to hold the investments until recovery.

The majority of the Company’s preferred stocks in an unrealized loss position at September 30, 2012 were perpetual preferred stocks of financial institutions and public utilities. The Company considers the debt-like characteristics of perpetual preferred stocks along with issuer ratings when evaluating impairment. All such preferred stocks paid dividends at the stated dividend rate during the twelve-month period preceding the evaluation date. The Company concluded that the declines in the fair values of these perpetual preferred stocks were temporary in nature, largely driven by market conditions, and since the Company intends to hold the securities until recovery, these investments were not considered to be other-than-temporarily impaired at September 30, 2012. The Company concluded that the unrealized losses on its investments in common stocks at September 30, 2012 were temporary based on the relative short length and magnitude of the losses and overall market volatility. The Company’s investments in other equity interests include investments in limited liability partnerships that primarily invest in distressed debt, mezzanine debt and secondary transactions. By the nature of their underlying investments, the Company believes that its investments in the limited liability partnerships also exhibit debt-like characteristics which, among other factors, the Company considers when evaluating these investments for impairment. Based on evaluations of the factors in the preceding paragraph, the Company concluded that the declines in the fair values of the Company’s investments in equity securities were temporary at September 30, 2012.

Note 3 - Investments (continued)

An aging of unrealized losses on the Company's Investments in Fixed Maturities and Equity Securities at December 31, 2011 is presented below:

| (Dollars in Millions) | Less Than 12 Months Fair Value | Less Than 12 Months Unrealized Losses | 12 Months or Longer Fair Value | 12 Months or Longer Unrealized Losses | Total Fair Value | Total Unrealized Losses |
|---|---|---|---|---|---|---|
| Fixed Maturities: | | | | | | |
| U.S. Government and Government Agencies and Authorities | $1.3 | $— | $— | $— | $1.3 | $— |
| States and Political Subdivisions | 2.0 | — | 12.0 | (0.8) | 14.0 | (0.8) |
| Corporate Securities: | | | | | | |
| Bonds and Notes | 169.6 | (5.1) | 74.7 | (4.3) | 244.3 | (9.4) |
| Redeemable Preferred Stocks | 0.6 | (0.1) | 0.1 | — | 0.7 | (0.1) |
| Mortgage and Asset-backed | — | — | 2.7 | (0.8) | 2.7 | (0.8) |
| Total Fixed Maturities | 173.5 | (5.2) | 89.5 | (5.9) | 263.0 | (11.1) |
| Equity Securities: | | | | | | |
| Preferred Stocks: | | | | | | |
| Finance, Insurance and Real Estate | 54.9 | (8.1) | 2.2 | (0.6) | 57.1 | (8.7) |
| Other Industries | 1.8 | — | 2.8 | (0.1) | 4.6 | (0.1) |
| Common Stocks: | | | | | | |
| Manufacturing | 1.5 | (0.1) | 0.1 | — | 1.6 | (0.1) |
| Other Industries | 10.7 | (1.8) | — | — | 10.7 | (1.8) |
| Other Equity Interests: | | | | | | |
| Limited Liability Companies and Limited Partnerships | 17.1 | (1.5) | — | — | 17.1 | (1.5) |
| Total Equity Securities | 86.0 | (11.5) | 5.1 | (0.7) | 91.1 | (12.2) |
| Total | $259.5 | $(16.7) | $94.6 | $(6.6) | $354.1 | $(23.3) |

Unrealized losses on fixed maturities, which the Company determined to be temporary at December 31, 2011, were $11.1 million, of which $5.9 million is related to fixed maturities that were in an unrealized loss position for 12 months or longer. Unrealized losses at December 31, 2011 related to securities for which the Company has recognized credit losses in earnings in the preceding table under the heading "Less Than 12 Months" were insignificant. There were no unrealized losses at December 31, 2011 related to securities for which the Company has recognized credit losses in earnings in the preceding table under the heading "12 Months or Longer." Included in the preceding table under the heading "12 Months or Longer" are unrealized losses of $0.2 million at December 31, 2011 related to securities for which the Company has previously recognized foreign currency losses in earnings. Investment-grade fixed maturity investments comprised $5.7 million and below-investment-grade fixed maturity investments comprised $5.4 million of the unrealized losses on investments in fixed maturities at December 31, 2011. Unrealized losses for below-investment-grade fixed maturities included unrealized losses totaling $0.2 million for one issuer that the Company recognized foreign currency impairment losses in earnings for the year ended December 31, 2011. For the other remaining below-investment-grade fixed maturity investments in an unrealized loss position, the unrealized loss amount, on average, was less than 4% of the amortized cost basis of the investment. At December 31, 2011, the Company did not have the intent to sell these investments and it was not more likely than not that the Company would be required to sell these investments before recovery of its amortized cost basis, which may be at maturity. Based on the Company's evaluation at December 31, 2011 of the prospects of the issuers, including, but not limited to, the credit ratings of the issuers of the investments in the fixed maturities, and the Company's intention to not sell and its determination that it would not be required to sell before recovery of the amortized cost of such investments, the Company concluded that the declines in the fair values of the Company’s investments in fixed maturities presented in the preceding table were temporary at the evaluation date.

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Note 3 - Investments (continued)

The vast majority of the Company's preferred stocks in an unrealized loss position at December 31, 2011 were perpetual preferred stocks of financial institutions. The Company considers the debt-like characteristics of perpetual preferred stocks along with issuer ratings when evaluating impairment. All such preferred stocks paid dividends at the stated dividend rate during the twelve-month period preceding the evaluation date. The Company concluded that the declines in the fair values of these perpetual preferred stocks were temporary in nature, largely driven by market conditions, and since the Company intends to hold the securities until recovery, these investments were not considered to be other-than-temporarily impaired at December 31, 2011. The Company concluded that the unrealized losses on its investments in common stocks at December 31, 2011 were temporary based on the relative short length and magnitude of the losses. The Company's investments in other equity interests include investments in limited liability partnerships that primarily invest in distressed debt, mezzanine debt and secondary transactions. By the nature of their underlying investments, the Company believes that its investments in the limited liability partnerships also exhibit debt-like characteristics which, among other factors, the Company considers when evaluating these investments for impairment. Based on evaluations of the factors described above that the Company considers when determining whether a decline in the fair value of an investment in equity securities is other than temporary, the Company concluded that the declines in the fair values of the Company's investments in equity securities were temporary at December 31, 2011.

The following table sets forth the pre-tax amount of other-than-temporary-impairment ("OTTI") credit losses, recognized in Retained Earnings for Investments in Fixed Maturities held by the Company as of the dates indicated, for which a portion of the OTTI loss has been recognized in Accumulated Other Comprehensive Income, and the corresponding changes in such amounts.

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 |
|---|---|---|---|---|
| Balance at Beginning of Period | $3.9 | $2.4 | $3.6 | $2.1 |
| Reductions to Previously Recognized OTTI Credit Losses | (0.1) | (0.5) | — | (0.2) |
| Reductions for Investments Sold During Period | (0.2) | — | — | — |
| Balance at End of Period | $3.6 | $1.9 | $3.6 | $1.9 |

The carrying values of the Company's Other Investments at September 30, 2012 and December 31, 2011 were:

| (Dollars in Millions) | Sep 30, 2012 | Dec 31, 2011 |
|---|---|---|
| Loans to Policyholders at Unpaid Principal | $262.4 | $253.9 |
| Real Estate at Depreciated Cost | 232.6 | 239.4 |
| Trading Securities at Fair Value | 4.5 | 4.4 |
| Other | 0.6 | 0.6 |
| Total | $500.1 | $498.3 |

Note 4 - Property and Casualty Insurance Reserves

Property and Casualty Insurance Reserve activity for the nine months ended September 30, 2012 and 2011 was:

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Sep 30, 2011 |
|---|---|---|
| Property and Casualty Insurance Reserves: | | |
| Gross of Reinsurance and Indemnification at Beginning of Year | $1,029.1 | $1,118.7 |
| Less Reinsurance and Indemnification Recoverables at Beginning of Year | 74.5 | 78.1 |
| Property and Casualty Insurance Reserves - Net of Reinsurance and Indemnification at Beginning of Year | 954.6 | 1,040.6 |
| Incurred Losses and LAE Related to: | | |
| Current Year: | | |
| Continuing Operations | 925.0 | 1,038.4 |
| Prior Years: | | |
| Continuing Operations | (23.2) | (30.1) |
| Discontinued Operations | (0.5) | 1.9 |
| Total Incurred Losses and LAE Related to Prior Years | (23.7) | (28.2) |
| Total Incurred Losses and LAE | 901.3 | 1,010.2 |
| Paid Losses and LAE Related to: | | |
| Current Year: | | |
| Continuing Operations | 545.0 | 636.7 |
| Prior Years: | | |
| Continuing Operations | 382.0 | 399.9 |
| Discontinued Operations | 14.1 | 22.1 |
| Total Paid Losses and LAE Related to Prior Years | 396.1 | 422.0 |
| Total Paid Losses and LAE | 941.1 | 1,058.7 |
| Property and Casualty Insurance Reserves - Net of Reinsurance at End of Period | 914.8 | 992.1 |
| Plus Reinsurance Recoverables at End of Period | 67.0 | 71.5 |
| Property and Casualty Insurance Reserves - Gross of Reinsurance at End of Period | $981.8 | $1,063.6 |

Property and Casualty 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 Condensed Consolidated Statements of Income in the period of change.

For the nine months ended September 30, 2012, the Company reduced its property and casualty insurance reserves by $23.7 million to recognize favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE reserves developed favorably by $10.4 million and commercial lines insurance losses and LAE reserves developed favorably by $13.3 million. The commercial lines insurance losses and LAE reserves included favorable development of $12.8 million from continuing operations and $0.5 million from discontinued operations. Personal automobile insurance losses and LAE reserves developed adversely by $3.5 million, homeowners insurance losses and LAE reserves developed favorably by $11.2 million and other personal lines losses and LAE reserves developed favorably by $2.7 million. The commercial lines insurance losses and LAE reserves developed favorably from continuing operations due primarily to the emergence of more favorable loss patterns than expected for the four most recent accident years.

For the nine months ended September 30, 2011, the Company reduced its property and casualty insurance reserves by $28.2 million to recognize favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE reserves developed favorably by $27.6 million and commercial lines insurance losses and LAE reserves developed

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Note 4 - Property and Casualty Insurance Reserves (continued)
favorably by $0.6 million. The personal lines insurance losses and LAE reserves developed favorably due primarily to the emergence of more favorable loss patterns than expected for the 2010, 2009 and 2008 accident years.
The Company cannot predict whether losses and LAE will develop favorably or unfavorably from the amounts reported in the Company's Condensed Consolidated Financial Statements. The Company believes that any such development will not have a material effect on the Company's consolidated shareholders' equity, but could have a material effect on the Company's consolidated financial results for a given period.
Note 5 - Notes Payable
Total debt outstanding at September 30, 2012 and December 31, 2011 was:

| (Dollars in Millions) | Sep 30, 2012 | Dec 31, 2011 |
|---|---|---|
| Senior Notes at Amortized Cost: | | |
| 6.00% Senior Notes due May 15, 2017 | $357.2 | $356.8 |
| 6.00% Senior Notes due November 30, 2015 | 248.5 | 248.2 |
| Mortgage Note Payable at Amortized Cost | 5.5 | 5.6 |
| Notes Payable at Amortized Cost | $611.2 | $610.6 |

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 which 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") 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 September 30, 2012, and accordingly, $325.0 million was available for future borrowings.
In the first quarter of 2012, the Company wrote off $0.5 million of unamortized issuance costs related to the Former Credit Agreement.
Interest Expense, including facility fees, accretion of discount and write-off of unamortized credit agreement issuance costs, for the nine and three months ended September 30, 2012 and 2011 was:

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| (Dollars in Millions) | Sep 30, 2012 | Sep 30, 2011 | Sep 30, 2012 | Sep 30, 2011 |
| Notes Payable under Revolving Credit Agreements | $1.6 | $1.5 | $0.3 | $0.6 |
| Senior Notes Payable: | | | | |
| 6.00% Senior Notes due May 15, 2017 | 16.6 | 16.5 | 5.5 | 5.5 |
| 6.00% Senior Notes due November 30, 2015 | 11.6 | 11.5 | 3.9 | 3.8 |
| Mortgage Note Payable | 0.3 | 0.3 | 0.1 | 0.1 |
| Interest Expense before Capitalization of Interest | 30.1 | 29.8 | 9.8 | 10.0 |
| Capitalization of Interest | (1.6) | (1.8) | (0.2) | (0.7) |
| Total Interest Expense | $28.5 | $28.0 | $9.6 | $9.3 |

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Note 5 - Notes Payable (continued)
Interest paid, including facility fees and credit agreement issuance costs, for the nine and three months ended September 30, 2012 and 2011 was:

| (Dollars in Millions) | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | Sep 30, 2012 | Sep 30, 2011 | Sep 30, 2012 | Sep 30, 2011 |
| Notes Payable under Revolving Credit Agreements | $1.9 | $0.5 | $0.2 | $0.3 |
| Senior Notes Payable: | | | | |
| 6.00% Senior Notes due May 15, 2017 | 10.8 | 10.8 | — | — |
| 6.00% Senior Notes due November 30, 2015 | 7.5 | 7.8 | — | — |
| Mortgage Note Payable | 0.3 | 0.3 | 0.1 | 0.1 |
| Total Interest Paid | $20.5 | $19.4 | $0.3 | $0.4 |

Note 6 - Long-term Equity-based Compensation Plans
On May 4, 2011, Kemper's shareholders approved the 2011 Omnibus Equity Plan ("Omnibus Plan"). The Omnibus Plan replaced the Company's previous employee stock option plans, director stock option plan and restricted stock plan (collectively, the "Prior Plans"). Awards previously granted under the Prior Plans remain outstanding in accordance with their original terms. Beginning May 4, 2011, equity-based compensation awards may only be granted under the Omnibus Plan. A maximum number of 10,000,000 shares of Kemper common stock may be issued under the Omnibus Plan (the "Share Authorization"). As of September 30, 2012, there were 9,249,581 common shares available for future grants under the Omnibus Plan, of which 561,825 shares were reserved for future grants based upon the achievement of performance goals under the terms of outstanding performance-based restricted stock awards.
The design of the Omnibus Plan provides for fungible use of shares to determine the number of shares available for future grants, with a fungible conversion factor of three to one, such that the Share Authorization will be reduced at two different rates, depending on the type of award granted. Each share of Kemper common stock issuable upon the exercise of stock options or stock appreciation rights will reduce the number of shares available for future grant under the Share Authorization by one share, while each share of Kemper common stock issued pursuant to "full value awards" will reduce the number of shares available for future grant under the Share Authorization by three shares. "Full value awards" are awards, other than stock options or stock appreciation rights, that are settled by the issuance of shares of Kemper common stock and include restricted stock, restricted stock units, performance shares, performance units, if settled with stock, and other stock-based awards.
Outstanding awards under the Omnibus Plan and Prior Plans at September 30, 2012 consisted of stand-alone stock options, tandem stock option and stock appreciation rights, time-vested restricted stock and performance-based restricted stock. Recipients of restricted stock are entitled to full dividend and voting rights on the same basis as all other outstanding shares of Kemper common stock and all awards are subject to forfeiture until certain restrictions have lapsed. Equity-based compensation expense was $4.8 million and $4.4 million for the nine months ended September 30, 2012 and 2011, respectively. Total unamortized compensation expense related to nonvested awards at September 30, 2012 was $6.4 million, which is expected to be recognized over a weighted-average period of 1.4 years.

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Note 6 - Long-term Equity-based Compensation Plans (continued)
The Company uses the Black-Scholes option pricing model to estimate the fair value of each option on the date of grant. The assumptions used in the Black-Scholes pricing model for options granted during the nine months ended September 30, 2012 and 2011 were as follows:

| | Nine Months Ended Sep 30, 2012 | | | Sep 30, 2011 | | |
|---|---|---|---|---|---|---|
| Range of Valuation Assumptions | | | | | | |
| Expected Volatility | 29.36 | %- | 53.84 % | 41.26 | %- | 55.16 % |
| Risk-free Interest Rate | 0.16 | - | 1.26 | 1.30 | - | 2.87 |
| Expected Dividend Yield | 2.92 | - | 3.26 | 3.15 | - | 3.38 |
| Weighted-Average Expected Life in Years | | | | | | |
| Employee Grants | 1 | - | 7 | 3.5 | - | 7 |
| Director Grants | 6 | | | 6 | | |

Option and stock appreciation right activity for the nine months ended September 30, 2012 is presented below:

| | Shares Subject to Options | Weighted-Average Exercise Price Per Share ($) | Weighted-Average Remaining Contractual Life (in Years) | Aggregate Intrinsic Value ($ in Millions) |
|---|---|---|---|---|
| Outstanding at Beginning of the Year | 3,632,398 | $40.70 | | |
| Granted | 265,451 | 29.81 | | |
| Exercised | (15,199) | 22.08 | | |
| Forfeited or Expired | (452,846) | 48.36 | | |
| Outstanding at September 30, 2012 | 3,429,804 | $38.93 | 4.42 | $7.2 |
| Vested and Expected to Vest at September 30, 2012 | 3,394,413 | $39.04 | 4.38 | $7.1 |
| Exercisable at September 30, 2012 | 2,944,739 | $40.79 | 3.73 | $5.7 |

The weighted-average grant-date fair values of options granted during the nine months ended September 30, 2012 and 2011 were $9.40 per option and $9.11 per option, respectively. Total intrinsic value of stock options exercised was $0.1 million for both the nine months ended September 30, 2012 and 2011. Cash received from option exercises and the total tax benefits realized for tax deductions from option exercises were insignificant for both the nine months ended September 30, 2012 and 2011. Information pertaining to options and stock appreciation rights outstanding at September 30, 2012 is presented below:

| Range of Exercise Prices | | | Outstanding Shares Subject to Options | Weighted-Average Exercise Price Per Share ($) | Weighted-Average Remaining Contractual Life (in Years) | Exercisable Shares Subject to Options | Weighted-Average Exercise Price Per Share ($) |
|---|---|---|---|---|---|---|---|
| $10.00 | - | $15.00 | 204,500 | $13.55 | 6.35 | 204,500 | $13.55 |
| 15.01 | - | 20.00 | 8,000 | 16.48 | 6.60 | 8,000 | 16.48 |
| 20.01 | - | 25.00 | 313,750 | 23.74 | 7.52 | 176,312 | 23.64 |
| 25.01 | - | 30.00 | 636,000 | 28.56 | 8.29 | 292,373 | 28.03 |
| 30.01 | - | 35.00 | 6,614 | 31.92 | 6.09 | 2,614 | 31.18 |
| 35.01 | - | 40.00 | 340,577 | 37.25 | 5.19 | 340,577 | 37.25 |
| 40.01 | - | 45.00 | 400,084 | 43.56 | 1.81 | 400,084 | 43.56 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 45.01 | - | 50.00 | 1,185,747 | 48.62 | 2.72 | 1,185,747 | 48.62 |
| 50.01 | - | 55.00 | 334,532 | 50.85 | 1.28 | 334,532 | 50.85 |
| 10.00 | - | 55.00 | 3,429,804 | 38.93 | 4.42 | 2,944,739 | 40.79 |

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Note 6 - Long-term Equity-based Compensation Plans (continued)

The grant-date fair values of time-based restricted stock awards are determined using the closing price of Kemper common stock on the date of grant. Activity related to nonvested time-based restricted stock for the nine months ended September 30, 2012 was as follows:

| | Time-Based Restricted Shares | Weighted-Average Grant-Date Fair Value Per Share |
|---|---|---|
| Nonvested Balance at Beginning of the Year | 116,784 | $23.33 |
| Granted | 72,125 | 29.90 |
| Vested | (42,824) | 24.41 |
| Forfeited | (14,979) | 25.79 |
| Nonvested Balance at End of Period | 131,106 | $26.31 |

Prior to February 3, 2009, only awards of time-vested restricted stock had been granted. Beginning on February 3, 2009, in addition to time-vested restricted stock granted to certain employees and officers, the Company began awarding performance-based restricted stock to certain officers and employees. The initial number of shares awarded to each participant of a performance-based restricted stock award represents the shares that would vest if the performance goals were achieved at the "target" performance level. The final payout of these awards will be determined based on Kemper's total shareholder return over a three-year performance period relative to a peer group comprised of all the companies in the S&P Supercomposite Insurance Index.

Performance-based restricted stock awards are earned over a three-year performance period. If, at the end of the performance period, the Company's relative performance:

- exceeds the "target" performance level, additional shares of stock will be issued to the award recipient;
- is below the "target" performance level, only a portion of the shares of performance-based restricted stock originally issued to the award recipient will vest; or
- is below a "minimum" performance level, none of the shares of performance-based restricted stock originally issued to the award recipient will vest.

The grant date fair values of the performance-based restricted stock awards are determined using the Monte Carlo simulation method. Activity related to nonvested performance-based restricted stock for the nine months ended September 30, 2012 was as follows:

| | Performance-Based Restricted Shares | Weighted-Average Grant-Date Fair Value Per Share |
|---|---|---|
| Nonvested Balance at Beginning of the Year | 172,875 | $29.86 |
| Granted | 68,575 | 36.65 |
| Vested | (51,596) | 14.04 |
| Forfeited | (2,579) | 30.68 |
| Nonvested Balance at End of Period | 187,275 | $36.70 |

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Note 6 - Long-term Equity-based Compensation Plans (continued)

The number of additional shares that would be granted if the Company were to meet or exceed the maximum performance levels related to the outstanding performance-based shares was 187,275 shares (as “full value awards,” the equivalent of 561,825 shares under the Share Authorization) at September 30, 2012. The number of additional shares that would be granted if the Company were to meet or exceed the maximum performance levels related to the outstanding performance-based shares for the 2012, 2011, and 2010 three-year performance periods was 68,475 common shares, 63,725 common shares and 55,075 common shares, respectively, at September 30, 2012. For the 2009 three-year performance period, the Company exceeded target performance levels with a payout percentage of 183%. Accordingly, an additional 40,727 shares of stock were issued to award recipients on January 31, 2012 (the “2009 Additional Shares”). The preceding table excludes activity related to the 2009 Additional Shares.

The total fair value of restricted stock, including the 2009 Additional Shares, that vested during the nine months ended September 30, 2012 was $4.0 million and the tax benefits for tax deductions realized from the vesting on such restricted stock was $1.4 million. The total fair value of restricted stock that vested during the nine months ended September 30, 2011 was $1.4 million and the tax benefits for tax deductions realized from the vesting on such restricted stock was $0.5 million.

Note 7 - Income from Continuing Operations Per Unrestricted Share

The Company’s awards of restricted stock contain a right to receive non-forfeitable dividends and participate in the undistributed earnings with common shareholders. Accordingly, the Company is required to apply the two-class method of computing basic and diluted earnings per share. A reconciliation of the numerator and denominator used in the calculation of Basic Income from Continuing Operations Per Unrestricted Share and Diluted Income from Continuing Operations Per Unrestricted Share for the nine and three months ended September 30, 2012 and 2011 is as follows:

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | Sep 30, 2012 | Sep 30, 2011 | Sep 30, 2012 | Sep 30, 2011 |
| (Dollars in Millions) | | | | |
| Income from Continuing Operations | $93.5 | $36.7 | $55.6 | $1.1 |
| Less Income from Continuing Operations Attributed to Restricted Shares | 0.5 | 0.2 | 0.3 | — |
| Income from Continuing Operations Attributed to Unrestricted Shares | 93.0 | 36.5 | 55.3 | 1.1 |
| Dilutive Effect on Income of Equity-based Compensation Equivalent Shares | — | — | — | — |
| Diluted Income from Continuing Operations Attributed to Unrestricted Shares | $93.0 | $36.5 | $55.3 | $1.1 |
| (Shares in Thousands) | | | | |
| Weighted-Average Unrestricted Shares Outstanding | 59,155.5 | 60,312.6 | 58,299.7 | 60,141.4 |
| Equity-based Compensation Equivalent Shares | 146.6 | 106.2 | 171.9 | 88.0 |
| Weighted-Average Unrestricted Shares and Equivalent Shares Outstanding Assuming Dilution | 59,302.1 | 60,418.8 | 58,471.6 | 60,229.4 |
| (Per Unrestricted Share in Whole Dollars) | | | | |
| Basic Income from Continuing Operations Per Unrestricted Share | $1.57 | $0.61 | $0.95 | $0.01 |
| Diluted Income from Continuing Operations Per Unrestricted Share | $1.56 | $0.61 | $0.95 | $0.01 |

Options outstanding to purchase 2.8 million and 2.5 million shares of Kemper common stock were excluded from the computation of Equity-based Compensation Equivalent Shares and Weighted-Average Unrestricted Shares and Equivalent Shares Outstanding Assuming Dilution for the nine and three months ended September 30, 2012, respectively, because their exercise prices exceeded the average market price. Options outstanding to purchase 3.4 million and 3.3 million shares of Kemper common stock were excluded from the computation of Equity-based Compensation Equivalent Shares and Weighted-Average Unrestricted Shares and Equivalent Shares Outstanding Assuming Dilution for the nine and three months ended September 30, 2011, respectively, because their exercise prices exceeded the average market price.

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Note 8 - Other Comprehensive Income and Accumulated Other Comprehensive Income

The components of Other Comprehensive Income Before Income Taxes for the nine and three months ended September 30, 2012 and 2011 was:

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 |
|---|---|---|---|---|
| Other Comprehensive Income Before Income Taxes: | | | | |
| Unrealized Holding Gains Arising During the Period Before Reclassification Adjustment | $180.2 | $192.0 | $98.3 | $138.0 |
| Reclassification Adjustment for Amounts Included in Net Income | (58.6) | (27.2) | (50.6) | 3.5 |
| Unrealized Holding Gains | 121.6 | 164.8 | 47.7 | 141.5 |
| Foreign Currency Translation Adjustments Arising During the Period Before Reclassification Adjustment | 1.5 | 0.6 | 0.2 | — |
| Reclassification Adjustment for Amounts Included in Net Income | — | — | — | — |
| Foreign Currency Translation Adjustments | 1.5 | 0.6 | 0.2 | — |
| Amortization of Unrecognized Postretirement Benefit Costs | 12.0 | 6.5 | 4.4 | 2.1 |
| Other Comprehensive Income Before Income Taxes | $135.1 | $171.9 | $52.3 | $143.6 |

The components of Other Comprehensive Income Tax Benefit (Expense) for the nine and three months ended September 30, 2012 and 2011 was:

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 |
|---|---|---|---|---|
| Income Tax Benefit (Expense): | | | | |
| Unrealized Holding (Gains) Losses Arising During the Period Before Reclassification Adjustment | $(63.8) | $(68.4) | $(34.8) | $(49.2) |
| Reclassification Adjustment for Amounts Included in Net Income | 20.6 | 9.6 | 17.8 | (1.2) |
| Unrealized Holding (Gains) Losses | (43.2) | (58.8) | (17.0) | (50.4) |
| Foreign Currency Translation Adjustments Arising During the Period Before Reclassification Adjustment | (0.5) | (0.2) | (0.1) | — |
| Reclassification Adjustment for Amounts Included in Net Income | — | — | — | — |
| Foreign Currency Translation Adjustment | (0.5) | (0.2) | (0.1) | — |
| Amortization of Unrecognized Postretirement Benefit Costs | (4.3) | (2.2) | (1.6) | (0.6) |
| Other Comprehensive Income Tax Benefit (Expense) | $(48.0) | $(61.2) | $(18.7) | $(51.0) |

The components of Accumulated Other Comprehensive Income at September 30, 2012 and December 31, 2011 were:

| (Dollars in Millions) | Sep 30, 2012 | Dec 31, 2011 |
|---|---|---|
| Unrealized Gains on Investments, Net of Income Taxes: | | |
| Available for Sale Fixed Maturities with Portion of OTTI Recognized in Earnings | $1.6 | $1.5 |
| Other Unrealized Gains on Investments | 424.0 | 345.7 |
| Foreign Currency Translation Adjustments, Net of Income Taxes | 0.7 | (0.3) |
| Net Unrecognized Postretirement Benefit Costs, Net of Income Taxes | (81.2) | (88.9) |
| Accumulated Other Comprehensive Income | $345.1 | $258.0 |

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Note 9 - Income Taxes
Current and Deferred Income Tax Assets at September 30, 2012 and December 31, 2011 were:

| (Dollars in Millions) | Sep 30, 2012 | Dec 31, 2011 |
|---|---|---|
| Current Income Tax Assets | $0.1 | $2.5 |
| Deferred Income Tax Assets | 6.7 | 10.7 |
| Valuation Allowance for State Income Taxes | (6.7) | (6.8) |
| Current and Deferred Income Tax Assets | $0.1 | $6.4 |

The components of Liabilities for Income Taxes at September 30, 2012 and December 31, 2011 were:

| (Dollars in Millions) | Sep 30, 2012 | Dec 31, 2011 |
|---|---|---|
| Current Income Tax Liabilities | $8.3 | $— |
| Deferred Income Tax Liabilities | 44.5 | — |
| Unrecognized Tax Benefits | 6.3 | 6.2 |
| Liabilities for Income Taxes | $59.1 | $6.2 |

During the first quarter of 2012, the Internal Revenue Service (“IRS”) began an audit of the Company’s 2009 and 2010 federal income tax returns. The Company reported a capital loss and a net operating loss in its 2009 federal income tax return and a net operating loss in its 2010 federal income tax return. The Company has carried these losses back to earlier tax years. Even though the Company has already received the refunds from carrying these losses back to such earlier tax years, approval by the Joint Committee on Taxation (“JCT”) is still required by law. The JCT has requested that the IRS perform an audit of these years before approving the refunds. In connection with the audit, the Company extended the federal statute of limitations related to the 2007 and 2008 tax years until December 31, 2013. The Company does not anticipate a material modification to the filed returns or the refunds that were received.

During the third quarter of 2012, the Illinois Department of Revenue began an audit of the 2009 and 2010 tax years. The Company does not anticipate a material modification to the filed returns.

Income taxes paid were $29.4 million for the nine months ended September 30, 2012. Income taxes paid, net of income tax refunds received of $24.9 million, were $18.2 million for the nine months ended September 30, 2011.

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KEMPER CORPORATION AND SUBSIDIARIES
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Note 10 - Pension Benefits and Postretirement Benefits Other Than Pensions

The components of Pension Expense for the nine and three months ended September 30, 2012 and 2011 were:

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| (Dollars in Millions) | Sep 30, 2012 | Sep 30, 2011 | Sep 30, 2012 | Sep 30, 2011 |
| Service Cost Earned | $8.2 | $7.7 | $2.6 | $2.6 |
| Interest Cost on Projected Benefit Obligation | 16.8 | 17.2 | 5.6 | 5.7 |
| Expected Return on Plan Assets | (22.3) | (18.3) | (7.4) | (6.1) |
| Amortization of Accumulated Unrecognized Actuarial Loss | 14.1 | 7.0 | 4.7 | 2.3 |
| Total Pension Expense Recognized | $16.8 | $13.6 | $5.5 | $4.5 |

The components of Postretirement Benefits Other than Pensions Expense for the nine and three months ended September 30, 2012 and 2011 were:

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| (Dollars in Millions) | Sep 30, 2012 | Sep 30, 2011 | Sep 30, 2012 | Sep 30, 2011 |
| Service Cost on Benefits Earned | $0.2 | $0.1 | $0.1 | $— |
| Interest Cost on Projected Benefit Obligation | 1.2 | 1.4 | 0.4 | 0.5 |
| Amortization of Accumulated Unrecognized Actuarial Gain | (0.9) | (0.5) | (0.3) | (0.2) |
| Total Postretirement Benefits Other than Pensions Expense | $0.5 | $1.0 | $0.2 | $0.3 |

Note 11 - Business Segments

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 Kemper Preferred segment provides preferred and standard risk personal automobile insurance, homeowners insurance and other personal insurance through independent agents. The Kemper Specialty segment provides automobile insurance to individuals and businesses in the non-standard and specialty market through independent agents. The non-standard automobile insurance market consists of individuals and companies that have difficulty obtaining standard or preferred risk insurance, usually because of their adverse driving records or claim or credit histories. Kemper Direct provides personal automobile, homeowners and renters insurance through a variety of direct-to-consumer websites, including its own websites, marketing partners, employer and other affinity relationships. The Life and Health Insurance segment provides individual life, accident, health and property insurance.

Segment Revenues for the nine and three months ended September 30, 2012 and 2011 were:

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| (Dollars in Millions) | Sep 30, 2012 | Sep 30, 2011 | Sep 30, 2012 | Sep 30, 2011 |
| Revenues: | | | | |
| Kemper Preferred: | | | | |
| Earned Premiums | $655.9 | $642.8 | $222.9 | $216.5 |
| Net Investment Income | 33.6 | 37.8 | 10.8 | 8.2 |
| Other Income | 0.3 | 0.2 | 0.1 | 0.1 |
| Total Kemper Preferred | 689.8 | 680.8 | 233.8 | 224.8 |
| Kemper Specialty: | | | | |
| Earned Premiums | 317.3 | 336.7 | 103.9 | 111.0 |
| Net Investment Income | 14.4 | 17.5 | 4.5 | 3.7 |
| Other Income | 0.2 | 0.4 | 0.1 | 0.2 |
| Total Kemper Specialty | 331.9 | 354.6 | 108.5 | 114.9 |
| Kemper Direct: | | | | |
| Earned Premiums | 131.2 | 171.8 | 40.3 | 54.4 |
| Net Investment Income | 10.7 | 13.6 | 3.4 | 2.8 |
| Other Income | — | 0.1 | — | 0.1 |
| Total Kemper Direct | 141.9 | 185.5 | 43.7 | 57.3 |
| Life and Health Insurance: | | | | |
| Earned Premiums | 481.9 | 485.8 | 160.2 | 161.1 |
| Net Investment Income | 153.5 | 147.3 | 48.1 | 42.5 |
| Other Income | 0.1 | 0.1 | — | — |
| Total Life and Health Insurance | 635.5 | 633.2 | 208.3 | 203.6 |
| Total Segment Revenues | 1,799.1 | 1,854.1 | 594.3 | 600.6 |
| Net Realized Gains (Losses) on Sales of Investments | 59.9 | 27.8 | 50.9 | (4.2) |
| Net Impairment Losses Recognized in Earnings | (4.1) | (6.7) | (3.2) | (5.0) |
| Other | 10.8 | 6.5 | 3.6 | 1.4 |
| Total Revenues | $1,865.7 | $1,881.7 | $645.6 | $592.8 |

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Note 11 - Business Segments (continued)
Segment Operating Profit (Loss) for the nine and three months ended September 30, 2012 and 2011 was:

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 |
|---|---|---|---|---|
| Segment Operating Profit (Loss): | | | | |
| Kemper Preferred | $4.4 | $(56.5) | $10.4 | $(16.1) |
| Kemper Specialty | 2.5 | 18.9 | 3.2 | 7.1 |
| Kemper Direct | (6.9) | (19.6) | 1.6 | (3.8) |
| Life and Health Insurance | 102.7 | 104.6 | 29.4 | 29.9 |
| Total Segment Operating Profit | 102.7 | 47.4 | 44.6 | 17.1 |
| Corporate and Other Operating Loss | (30.1) | (31.3) | (10.8) | (12.9) |
| Total Operating Profit | 72.6 | 16.1 | 33.8 | 4.2 |
| Net Realized Gains (Losses) on Sales of Investments | 59.9 | 27.8 | 50.9 | (4.2) |
| Net Impairment Losses Recognized in Earnings | (4.1) | (6.7) | (3.2) | (5.0) |
| Income (Loss) from Continuing Operations before Income Taxes | $128.4 | $37.2 | $81.5 | $(5.0) |

Segment Net Operating Income (Loss) for the nine and three months ended September 30, 2012 and 2011 was:

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 |
|---|---|---|---|---|
| Segment Net Operating Income (Loss): | | | | |
| Kemper Preferred | $8.5 | $(30.3) | $8.4 | $(8.3) |
| Kemper Specialty | 4.0 | 15.4 | 2.7 | 5.7 |
| Kemper Direct | (2.7) | (10.4) | 1.5 | (1.7) |
| Life and Health Insurance | 66.5 | 67.7 | 19.2 | 19.7 |
| Total Segment Net Operating Income | 76.3 | 42.4 | 31.8 | 15.4 |
| Corporate and Other Net Operating Loss | (19.1) | (19.4) | (7.2) | (8.3) |
| Consolidated Net Operating Income | 57.2 | 23.0 | 24.6 | 7.1 |
| Unallocated Net Income (Loss) From: | | | | |
| Net Realized Gains (Losses) on Sales of Investments | 38.9 | 18.0 | 33.0 | (2.7) |
| Net Impairment Losses Recognized in Earnings | (2.6) | (4.3) | (2.0) | (3.3) |
| Income from Continuing Operations | $93.5 | $36.7 | $55.6 | $1.1 |

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Note 11 - Business Segments (continued)
Earned Premiums by product line for the nine and three months ended September 30, 2012 and 2011 were:

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| (Dollars in Millions) | Sep 30, 2012 | Sep 30, 2011 | Sep 30, 2012 | Sep 30, 2011 |
| Life | $296.0 | $297.1 | $98.4 | $98.0 |
| Accident and Health | 124.2 | 124.6 | 41.3 | 41.9 |
| Property and Casualty: | | | | |
| Personal Lines: | | | | |
| Automobile | 794.6 | 854.7 | 261.3 | 281.4 |
| Homeowners | 236.6 | 226.4 | 80.8 | 76.6 |
| Other Personal | 103.2 | 104.5 | 34.5 | 35.0 |
| Total Personal Lines | 1,134.4 | 1,185.6 | 376.6 | 393.0 |
| Commercial Automobile | 31.7 | 29.8 | 11.0 | 10.1 |
| Total Earned Premiums | $1,586.3 | $1,637.1 | $527.3 | $543.0 |

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Note 12 - Fair Value Measurements
The Company classifies its investments in Fixed Maturities and Equity Securities as available for sale and reports these investments at fair value. The Company classifies certain investments in mutual funds included in Other Investments as trading securities and reports these investments at fair value. The Company has no material liabilities that are measured and reported at fair value.
The valuation of assets measured at fair value in the Company's Condensed Consolidated Balance Sheet at September 30, 2012 is summarized below:

| (Dollars in Millions) | Fair Value Measurements<br>Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
|---|---|---|---|---|
| Fixed Maturities: | | | | |
| U.S. Government and Government Agencies and Authorities | $138.9 | $317.7 | $— | $456.6 |
| States and Political Subdivisions | — | 1,436.0 | — | 1,436.0 |
| Corporate Securities: | | | | |
| Bonds and Notes | — | 2,475.5 | 311.1 | 2,786.6 |
| Redeemable Preferred Stocks | — | 36.9 | 4.8 | 41.7 |
| Mortgage and Asset-backed | — | 4.5 | 0.2 | 4.7 |
| Total Investments in Fixed Maturities | 138.9 | 4,270.6 | 316.1 | 4,725.6 |
| Equity Securities: | | | | |
| Preferred Stocks: | | | | |
| Finance, Insurance and Real Estate | — | 84.7 | — | 84.7 |
| Other Industries | — | 15.3 | 6.9 | 22.2 |
| Common Stocks: | | | | |
| Manufacturing | 82.4 | 5.6 | 2.2 | 90.2 |
| Other Industries | 71.0 | 1.2 | 4.9 | 77.1 |
| Other Equity Interests: | | | | |
| Exchange Traded Funds | 151.8 | — | — | 151.8 |
| Limited Liability Companies and Limited Partnerships | — | — | 119.7 | 119.7 |
| Total Investments in Equity Securities | 305.2 | 106.8 | 133.7 | 545.7 |
| Other Investments: | | | | |
| Trading Securities | 4.5 | — | — | 4.5 |
| Total | $448.6 | $4,377.4 | $449.8 | $5,275.8 |

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(Unaudited)

Note 12 - Fair Value Measurements (continued)

The valuation of assets measured at fair value in the Company's Condensed Consolidated Balance Sheet at December 31, 2011 is summarized below:

| (Dollars in Millions) | Fair Value Measurements Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
|---|---|---|---|---|
| Fixed Maturities: | | | | |
| U.S. Government and Government Agencies and Authorities | $153.6 | $338.1 | $— | $491.7 |
| States and Political Subdivisions | — | 1,852.6 | — | 1,852.6 |
| Corporate Securities: | | | | |
| Bonds and Notes | — | 2,107.2 | 235.1 | 2,342.3 |
| Redeemable Preferred Stocks | — | 75.6 | 6.1 | 81.7 |
| Mortgage and Asset-backed | — | 4.8 | 0.3 | 5.1 |
| Total Investments in Fixed Maturities | 153.6 | 4,378.3 | 241.5 | 4,773.4 |
| Equity Securities: | | | | |
| Preferred Stocks: | | | | |
| Finance, Insurance and Real Estate | — | 86.7 | — | 86.7 |
| Other Industries | — | 14.9 | 5.6 | 20.5 |
| Common Stocks: | | | | |
| Manufacturing | 74.7 | 5.0 | 3.7 | 83.4 |
| Other Industries | 42.8 | — | 4.2 | 47.0 |
| Other Equity Interests: | | | | |
| Exchange Traded Funds | 66.6 | — | — | 66.6 |
| Limited Liability Companies and Limited Partnerships | — | — | 93.1 | 93.1 |
| Total Investments in Equity Securities | 184.1 | 106.6 | 106.6 | 397.3 |
| Other Investments: | | | | |
| Trading Securities | 4.4 | — | — | 4.4 |
| Total | $342.1 | $4,484.9 | $348.1 | $5,175.1 |

The Company's investments in Fixed Maturities that are classified as Level 1 in the two preceding tables primarily consist of U.S. Treasury Bonds and Notes. The Company's investments in Equity Securities that are classified as Level 1 in the two preceding tables consist of either investments in publicly-traded common stocks or exchange traded funds. The Company's investments in Fixed Maturities that are classified as Level 2 in the two preceding tables primarily consist of investments in corporate bonds and redeemable preferred stocks, states and political subdivisions, and bonds and mortgage-backed securities of U.S. government agencies. The Company's investments in Equity Securities that are classified as Level 2 in the two preceding tables primarily consist of investments in preferred stocks. The Company uses a leading, nationally recognized provider of market data and analytics to price the vast majority of the Company's Level 2 measurements. The provider utilizes evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information. Because many fixed maturity securities do not trade on a daily basis, the provider's evaluated pricing applications apply available information through processes such as benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing to prepare evaluations. In addition, the provider uses model processes to develop prepayment and interest rate scenarios. The pricing provider’s models and processes also take into account market convention. For each asset class, teams of its evaluators gather information from market sources and integrate relevant credit information, perceived market movements and sector

Note 12 - Fair Value Measurements (continued)

news into the evaluated pricing applications and models. The Company generally validates the measurements obtained from its primary pricing provider by comparing them with measurements obtained from one additional pricing provider that provides either prices from recent market transactions or quotes in inactive markets or evaluations based on its own proprietary models.

The Company investigates significant differences related to the values provided. On completion of its investigation, management exercises judgment to determine the price selected and whether adjustments, if any, to the price obtained from the Company's primary pricing provider would warrant classification of the price as Level 3. In instances where a measurement cannot be obtained from either pricing provider, the Company generally will evaluate bid prices from one or more binding quotes obtained from market makers to value investments in inactive markets and classified by the Company as Level 2. The Company generally classifies securities when it receives non-binding quotes or indications as Level 3 securities unless the Company can validate the quote or indication against recent transactions in the market. For securities classified as Level 3, the Company either uses valuations provided by third party fund managers, third party appraisers, the Company's own internal valuations or net asset values provided for Limited Liability Companies and Limited Partnerships. These valuations typically employ valuation techniques, including earnings multiples based on comparable public securities, comparable market yields as well as industry specific non-earnings based multiples or discounted cash flow models. Valuations classified as Level 3 by the Company generally consist of investments in various private placement securities of non-rated entities. In rare cases, if the private placement security has only been outstanding for a short amount of time, the Company, after considering the initial assumptions used in acquiring an investment, considers the original purchase price as representative of the fair value.

The majority of Investments in Fixed Maturities that are classified as Level 3 are priced using a market yield approach. A market yield approach uses a risk free rate plus a credit spread depending on the underlying credit profile of the security. For floating rate securities, the risk free rate used in the market yield is the contractual floating rate of the security. For each individual security, the Company or the Company's third party appraiser gathers information from market sources, relevant credit information, perceived market movements and sector news and determines an appropriate market yield for each security. The market yield selected is then used to discount the future cash flows of the security to determine the fair value. The Company separately evaluates market yields based upon asset class to assess the reasonableness of the recorded fair value. For Investments in Fixed Maturities that are classified as Level 3, the two primary asset classes are senior debt and junior debt. Senior debt includes those securities that receive first priority in a liquidation and junior debt includes any fixed maturity security with other than first priority in a liquidation.

The table below presents quantitative information about the significant unobservable inputs utilized by the Company in determining fair values for the vast majority of investments in fixed maturities classified as Level 3.

| (Dollars in Millions) | Unobservable Input | Total Fair Value | Range of Unobservable Inputs | | Weighted Average Market Yield | |
|---|---|---|---|---|---|---|
| Senior Debt | Market Yield | $ 142.5 | 1.2% | - 17.0% | 6.6 | % |
| Junior Debt | Market Yield | $ 147.9 | 9% | - 25.1% | 14.8 | % |

For Investments in Fixed Maturities, an increase in the market yield used in the fair value of a security will decrease the fair value of the security whereas a decrease in the market yield will increase the fair value of a security although the fair value increase is generally limited to par for callable securities.

At September 30, 2012, the Company had unfunded commitments to invest an additional $89.6 million in certain private equity funds and mezzanine debt funds that will be included in Other Equity Interests.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

Note 12 - Fair Value Measurements (continued)
Information by security type pertaining to the changes in the fair value of the Company's investments classified as Level 3 for the nine months ended September 30, 2012 is presented below:

| (Dollars in Millions) | Fixed Maturities Corporate Bonds and Notes | Redeemable Preferred Stocks | Mortgage and Asset-backed | Equity Securities Preferred and Common Stocks | Other Equity Interests | Total |
|---|---|---|---|---|---|---|
| Balance at Beginning of Period | $235.1 | $6.1 | $0.3 | $13.5 | $93.1 | $348.1 |
| Total Gains (Losses): | | | | | | |
| Included in Condensed Consolidated Statement of Income | 3.5 | — | — | 3.2 | 0.3 | 7.0 |
| Included in Other Comprehensive Income | 2.2 | 0.3 | — | (0.3) | 3.1 | 5.3 |
| Purchases | 123.1 | — | — | 1.3 | 33.5 | 157.9 |
| Settlements | (52.2) | (1.6) | (0.1) | — | (10.3) | (64.2) |
| Sales | (0.5) | — | — | (3.7) | — | (4.2) |
| Transfers into Level 3 | 6.0 | — | — | — | — | 6.0 |
| Transfers out of Level 3 | (6.1) | — | — | — | — | (6.1) |
| Balance at End of Period | $311.1 | $4.8 | $0.2 | $14.0 | $119.7 | $449.8 |

Information by security type pertaining to the changes in the fair value of the Company's investments classified as Level 3 for the three months ended September 30, 2012 is presented below:

| (Dollars in Millions) | Fixed Maturities Corporate Bonds and Notes | Redeemable Preferred Stocks | Mortgage and Asset-backed | Equity Securities Preferred and Common Stocks | Other Equity Interests | Total |
|---|---|---|---|---|---|---|
| Balance at Beginning of Period | $276.3 | $4.6 | $0.2 | $13.4 | $109.9 | $404.4 |
| Total Gains (Losses): | | | | | | |
| Included in Condensed Consolidated Statement of Income | 1.4 | — | — | — | — | 1.4 |
| Included in Other Comprehensive Income | 1.5 | 0.2 | — | 0.5 | 6.1 | 8.3 |
| Purchases | 37.6 | — | — | 0.1 | 6.5 | 44.2 |
| Settlements | (10.8) | — | — | — | (2.8) | (13.6) |
| Sales | — | — | — | — | — | — |
| Transfers into Level 3 | 5.1 | — | — | — | — | 5.1 |
| Balance at End of Period | $311.1 | $4.8 | $0.2 | $14.0 | $119.7 | $449.8 |

The Company's policy is to recognize transfers between levels as of the end of the reporting period. There were no transfers between Levels 1 and 2 for the nine and three months ended September 30, 2012. The transfers into Level 3 and out of Level 3 for the nine months ended September 30, 2012 were due to changes in the availability of market observable inputs. The transfers into Level 3 for the three months ended September 30, 2012 was due to changes in the availability of market observable inputs. There were no transfers out of Level 3 for the three months ended September 30, 2012.

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Note 12 - Fair Value Measurements (continued)
Information by security type pertaining to the changes in the fair value of the Company's investments classified as Level 3 for the nine months ended September 30, 2011 is presented below:

| (Dollars in Millions) | Fixed Maturities Corporate Bonds and Notes | Redeemable Preferred Stocks | Mortgage and Asset-backed | Equity Securities Preferred and Common Stocks | Other Equity Interests | Total |
|---|---|---|---|---|---|---|
| Balance at Beginning of Period | $146.2 | $4.5 | $0.4 | $14.7 | $75.2 | $241.0 |
| Total Gains (Losses): | | | | | | |
| Included in Condensed Consolidated Statement of Income | 1.0 | — | — | 4.6 | 0.3 | 5.9 |
| Included in Other Comprehensive Income | 2.5 | — | — | (5.5) | (16.6) | (19.6) |
| Purchases | 76.1 | — | — | 1.5 | 23.9 | 101.5 |
| Settlements | (44.1) | — | (0.1) | (0.4) | (10.6) | (55.2) |
| Sales | (0.5) | — | — | (5.7) | — | (6.2) |
| Transfers into Level 3 | 5.4 | — | — | — | — | 5.4 |
| Balance at End of Period | $186.6 | $4.5 | $0.3 | $9.2 | $72.2 | $272.8 |

Information by security type pertaining to the changes in the fair value of the Company's investments classified as Level 3 for the three months ended September 30, 2011 is presented below:

| (Dollars in Millions) | Fixed Maturities Corporate Bonds and Notes | Redeemable Preferred Stocks | Mortgage and Asset-backed | Equity Securities Preferred and Common Stocks | Other Equity Interests | Total |
|---|---|---|---|---|---|---|
| Balance at Beginning of Period | $174.8 | $6.4 | $0.3 | $8.5 | $80.1 | $270.1 |
| Total Gains (Losses): | | | | | | |
| Included in Condensed Consolidated Statement of Income | 0.6 | — | — | (0.1) | 0.3 | 0.8 |
| Included in Other Comprehensive Income | 1.1 | (1.9) | — | (0.2) | (13.7) | (14.7) |
| Purchases | 20.1 | — | — | 1.0 | 8.3 | 29.4 |
| Settlements | (15.4) | — | — | — | (2.8) | (18.2) |
| Transfers into Level 3 | 5.4 | — | — | — | — | 5.4 |
| Balance at End of Period | $186.6 | $4.5 | $0.3 | $9.2 | $72.2 | $272.8 |

Transfers into Level 2 from Level 1 were $2.2 million for the nine months ended September 30, 2011. There were no transfers into Level 1 from Level 2 for the nine months ended September 30, 2011. There were no transfers between Levels 1 and 2 for the three months ended September 30, 2011. Transfers into Level 3 for the nine and three months ended September 30, 2011 were due to changes in the availability of market observable inputs. There were no transfers out of Level 3 for the nine and three months ended September 30, 2011.
The fair value of notes payable is estimated using quoted prices for similar liabilities in markets that are not active. The inputs used in the valuation are considered Level 2 measurements.

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Note 13 - Contingencies
In the ordinary course of its businesses, the Company is involved in legal proceedings, including lawsuits, regulatory examinations and inquiries. Except with regard to the matter discussed below, based on currently available information , the Company does not believe that it is reasonably possible that any of its pending legal proceedings will have a material effect on the Company’s financial statements.
Certain state insurance regulators, legislators and treasurers are involved in an array of initiatives that could result in significant changes to unclaimed property laws and claims handling practices with respect to life insurance policies. These initiatives seek, in various ways, to impose a new duty on the part of life insurers to proactively search for deaths of their insureds. For example, Kentucky, Maryland and Alabama have each enacted legislation, with effective dates of January 1, 2013, October 1, 2013 and January 1, 2014, respectively, that would require life insurers to compare their in-force policy records against the database of reported deaths maintained by the Social Security Administration (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. If state officials are successful in applying this new standard retroactively to existing life insurance policies, it will fundamentally alter the responsibilities of the parties to such contracts by effectively eliminating contract terms that condition claim settlement and payment on the receipt of notice and “due proof of death” of an insured. The outcome of the various state initiatives could have a significant effect on, including acceleration of, the payment and/or escheatment of policy benefits and significantly increase claims handling costs.
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-five states. 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. It is the Company’s position that state officials lack authority to establish new procedures that change existing contracts. On November 8, 2012, the Company filed a declaratory judgment action in the Circuit Court of Franklin County, Kentucky asking the court to construe the Kentucky Unclaimed Life Insurance Benefit Act (the “Kentucky Act”) such that it would only apply prospectively, i.e., only with respect to those life insurance policies issued on or after the effective date of the Kentucky Act, consistent with the requirements of applicable Kentucky statutory law and Kentucky and federal constitutional provisions.
The Company cannot predict which states, if any, may enact legislation of this type or the outcome of other initiatives by state officials. The Company does not use, nor does it believe it is required under applicable law or the terms of its life insurance policies to use, the SSA Death Master File. The Company cannot reasonably estimate the amount of loss, if any, that the Company would recognize if it were not to ultimately prevail in this matter.
Note 14 - Related Parties
One of Kemper’s directors, Mr. Fayez Sarofim, is the Chairman of the Board, President and the majority shareholder of Fayez Sarofim & Co. (“FS&C”), a registered investment advisory firm. Kemper’s subsidiary, Trinity, had $128.3 million in assets managed by FS&C at September 30, 2012, under an agreement with FS&C whereby FS&C provides investment management services with respect to certain assets of Trinity for a fee based on the fair market value of the assets under management. Such agreement is terminable by either party at any time upon 30 days advance written notice. Investment expenses incurred in connection with such agreement were $0.2 million for the nine months ended September 30, 2012. Investment expenses incurred in connection with such agreement were $0.2 million for the nine months ended September 30, 2011.
FS&C also provides investment management services with respect to certain funds of the Company’s defined benefit pension plan. The Company’s defined benefit pension plan had $123.9 million in assets managed by FS&C at September 30, 2012, under an agreement with FS&C whereby FS&C provides investment management services with respect to certain assets of the defined benefit pension plan for a fee based on the fair market value of the assets under

management. Such agreement is terminable by either party at any time upon 30 days advance written notice. Investment expenses incurred in connection with such agreement were $0.2 million for the nine months ended September 30, 2012. Investment expenses incurred in connection with such agreement were $0.2 million for the nine months ended September 30, 2011.

Note 14 - Related Parties (continued)

With respect to the Company's defined contribution plans, one of the alternative investment choices afforded to participating employees is the Dreyfus Appreciation Fund, an open-end, diversified managed investment fund. FS&C provides investment management services to the Dreyfus Appreciation Fund as a sub-investment advisor. According to published reports filed by FS&C with the SEC, the Dreyfus Appreciation Fund pays monthly fees to FS&C according to a graduated schedule computed at an annual rate based on the value of the Dreyfus Appreciation Fund's average daily net assets. The Company does not compensate FS&C for services provided to the Dreyfus Appreciation Fund. Participants in the Company's defined contribution plans had allocated $21.6 million for investment in the Dreyfus Appreciation Fund at September 30, 2012, representing 7.0% of the total amount invested in the Company's defined contribution plans at September 30, 2012.

The Company believes that the services described above have been provided on terms no less favorable to the Company than could have been negotiated with non-affiliated third parties.

Note 15 - Relationships with Mutual Insurance Companies

Trinity and Capitol County Mutual Fire Insurance Company ("Capitol") are parties to a quota share reinsurance agreement whereby Trinity assumes 100% of the business written by Capitol. Capitol is a mutual insurance company and, accordingly, is owned by its policyholders. In the second quarter of 2012, Capitol requested regulatory approval to amend such agreement with Trinity, effective April 1, 2012, whereby ceded losses for dwelling coverage were capped. In the third quarter of 2012, Capitol received such regulatory approval. Incurred losses and LAE assumed by Trinity were reduced by $2.6 million in the third quarter of 2012 in conjunction with such amendment. Trinity and Old Reliable Casualty Company ("ORCC"), a subsidiary of Capitol, are also parties to a quota share reinsurance agreement whereby Trinity assumes 100% of the business written by ORCC.

Five employees of the Company serve as directors of Capitol's five member board of directors. Nine employees of the Company also serve as directors of ORCC's nine member board of directors. Kemper's subsidiary, United, provides claims and administrative services to Capitol and ORCC. In addition, agents appointed by Kemper's subsidiary, The Reliable Life Insurance Company, and who are employed by United, are also appointed by Capitol and ORCC to sell property insurance products for the Company's Life and Health Insurance segment. The Company also provides certain investment services to Capitol and ORCC.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Summary of Results

Net Income

Net Income was $101.5 million ($1.71 per unrestricted common share) for the nine months ended September 30, 2012, compared to $50.2 million ($0.83 per unrestricted common share) for the same period in 2011. Net Income was $55.6 million ($0.95 per unrestricted common share) for the three months ended September 30, 2012, compared to $2.0 million ($0.03 per unrestricted common share) for the same period in 2011.

Income from Continuing Operations was $93.5 million ($1.57 per unrestricted common share) for the nine months ended September 30, 2012, compared to $36.7 million ($0.61 per unrestricted common share) for the same period in 2011. Income from Continuing Operations was $55.6 million ($0.95 per unrestricted common share) for the three months ended September 30, 2012, compared to $1.1 million ($0.01 per unrestricted common share) for the same period in 2011.

A reconciliation of Segment Net Operating Income to Net Income for the nine and three months ended September 30, 2012 and 2011 is presented below:

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Increase (Decrease) | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 | Increase (Decrease) |
|---|---|---|---|---|---|---|
| Segment Net Operating Income (Loss): | | | | | | |
| Kemper Preferred | $8.5 | $(30.3) | $38.8 | $8.4 | $(8.3) | $16.7 |
| Kemper Specialty | 4.0 | 15.4 | (11.4) | 2.7 | 5.7 | (3.0) |
| Kemper Direct | (2.7) | (10.4) | 7.7 | 1.5 | (1.7) | 3.2 |
| Life and Health Insurance | 66.5 | 67.7 | (1.2) | 19.2 | 19.7 | (0.5) |
| Total Segment Net Operating Income | 76.3 | 42.4 | 33.9 | 31.8 | 15.4 | 16.4 |
| Corporate and Other Net Operating Loss | (19.1) | (19.4) | 0.3 | (7.2) | (8.3) | 1.1 |
| Consolidated Net Operating Income | 57.2 | 23.0 | 34.2 | 24.6 | 7.1 | 17.5 |
| Net Income (Loss) From: | | | | | | |
| Net Realized Gains (Losses) on Sales of Investments | 38.9 | 18.0 | 20.9 | 33.0 | (2.7) | 35.7 |
| Net Impairment Losses Recognized in Earnings | (2.6) | (4.3) | 1.7 | (2.0) | (3.3) | 1.3 |
| Income from Continuing Operations | 93.5 | 36.7 | 56.8 | 55.6 | 1.1 | 54.5 |
| Income from Discontinued Operations | 8.0 | 13.5 | (5.5) | — | 0.9 | (0.9) |
| Net Income | $101.5 | $50.2 | $51.3 | $55.6 | $2.0 | $53.6 |

Revenues

Earned Premiums were $1,586.3 million for the nine months ended September 30, 2012, compared to $1,637.1 million in 2011, a decrease of $50.8 million. Earned Premiums for the nine months ended September 30, 2012 decreased by $40.6 million, $19.4 million and $3.9 million in the Kemper Direct, Kemper Specialty and Life and Health Insurance segments, respectively, and increased by $13.1 million in the Kemper Preferred segment. Earned Premiums were $527.3 million for the three months ended September 30, 2012, compared to $543.0 million in 2011, a decrease of $15.7 million. Earned Premiums for the three months ended September 30, 2012 decreased by $14.1 million, $7.1 million and $0.9 million in the Kemper Direct, Kemper Specialty and Life and Health Insurance segments, respectively, and increased by $6.4 million in the Kemper Preferred segment.

Net Investment Income increased by $0.3 million for the nine months ended September 30, 2012, compared to the same period in 2011, due primarily to higher Interest and Dividends on Fixed Maturities, partially offset by higher investment expenses. Net Investment Income increased by $11.8 million for the three months ended September 30, 2012, compared to the same period in 2011, due primarily to lower net investment losses from Equity Method Limited Liability Investments and higher Dividends on Equity Securities, partially offset by lower Interest and Dividends on Fixed Maturities and higher investment expenses.

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Summary of Results (continued)
Net Realized Gains on Sales of Investments were $59.9 million for the nine months ended September 30, 2012, compared to $27.8 million in 2011. Net Realized Gains on Sales of Investments were $50.9 million for the three months ended September 30, 2012, compared to Net Realized Losses on Sales of Investments of $4.2 million in 2011. In the third quarter of 2012, the Company sold $320.1 million of municipal securities at a gain of $44.9 million to take advantage of attractive pricing for such securities and for tax planning and other portfolio management purposes. Net Impairment Losses Recognized in Earnings were $4.1 million for the nine months ended September 30, 2012, compared to $6.7 million for the same period in 2011. Net Impairment Losses Recognized in Earnings were $3.2 million for the three months ended September 30, 2012, compared to $5.0 million for the same period in 2011. The Company wrote down investments in real estate by $3.1 million in the third quarter of 2012, compared to $4.9 million in the same period in 2011. The Company cannot predict if or when similar investment gains or losses may occur in the future.
Catastrophes
Catastrophe losses and LAE (excluding loss and LAE reserve development from prior accident years) were $79.5 million and $12.3 million for the nine and three months ended September 30, 2012, respectively, compared to $156.7 million and $42.7 million for the same periods in 2011. Catastrophe losses and LAE (excluding loss and LAE reserve development) by business segment for the nine and three months ended September 30, 2012 and 2011 are presented below:

| (Dollars in Millions) | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | Sep 30, 2012 | Sep 30, 2011 | Sep 30, 2012 | Sep 30, 2011 |
| Kemper Preferred | $62.7 | $137.8 | $9.4 | $40.9 |
| Kemper Specialty | 4.7 | 3.7 | 0.9 | 0.7 |
| Kemper Direct | 4.8 | 6.2 | 0.4 | 2.2 |
| Life and Health Insurance | 7.3 | 9.0 | 1.6 | (1.1) |
| Total Catastrophe Losses and LAE | $79.5 | $156.7 | $12.3 | $42.7 |

The number of catastrophic events and catastrophe losses and LAE (excluding loss and LAE reserve development) by range of loss for the nine months ended September 30, 2012 and 2011 are presented below:

| (Dollars in Millions) | Nine Months Ended | | | |
|---|---|---|---|---|
| | Sep 30, 2012 | | Sep 30, 2011 | |
| | Number of Events | Losses and LAE | Number of Events | Losses and LAE |
| Range of Losses and LAE Per Event: | | | | |
| Below $5 | 18 | $21.5 | 21 | $36.7 |
| $5 - $10 | 6 | 46.7 | 2 | 16.3 |
| $10 - $15 | 1 | 11.3 | 1 | 10.8 |
| $15 - $20 | — | — | 2 | 35.9 |
| $20 - $25 | — | — | 1 | 24.9 |
| Greater Than $25 | — | — | 1 | 32.1 |
| Total | 25 | $79.5 | 28 | $156.7 |

As shown in the preceding table, catastrophe losses and LAE decreased for the nine months ended September 30, 2012 due primarily to lower severity of losses below $5 million per event and lower frequency of losses in excess of $15 million per event, partially offset by higher frequency of losses ranging from $5 million to $10 million per event. The six events in the $5 million to $10 million range and one event in the $10 million to $15 million range for the nine months ended September 30, 2012 were related to hail or wind events in either Texas, Colorado or the Midwest and mid-Atlantic states. Events below $5 million for the nine months ended September 30, 2011 are due primarily to spring storms. In the second quarter of 2011, the United States experienced a high volume of spring storms, including a record level of tornadoes in April resulting in two events in the $15 million to $20 million range and one event which was $32.1 million. In the third quarter of 2011, the Company incurred claims related to one event in the $20 million to $25 million range which was Hurricane Irene. Catastrophe losses and LAE for the nine months ended September 30, 2011 include $24.9 million related to Hurricane Irene, of which $23.7 million is included in the Kemper Preferred segment.

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Catastrophes (continued)

In late October 2012, Sandy, a named superstorm and at one point a level two hurricane while over the Atlantic ocean, caused a significant amount of damage in several northeastern states. The Company has received a substantial number of claims, largely from exposures in the state of New York, and is in the early stages of assessing damage. Even though the Company has inspected a small percentage of the claims reported to date and expects that it will take several weeks to inspect most of the affected areas to reasonably estimate its losses from Sandy, the Company currently expects such losses to be material to its fourth quarter 2012 operating results.

Loss and LAE Reserve Development

Increases (decreases) in the Company's property and casualty loss and LAE reserves for the nine and three months ended September 30, 2012 and 2011 to recognize adverse (favorable) loss and LAE reserve development from prior accident years in continuing operations, hereinafter also referred to as "reserve development" in the discussion of segment results, is presented below:

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 |
|---|---|---|---|---|
| Kemper Preferred: | | | | |
| Non-catastrophe | $(3.1) | $(11.6) | $(0.8) | $(7.9) |
| Catastrophe | (6.0) | (3.8) | (1.6) | (1.5) |
| Total | (9.1) | (15.4) | (2.4) | (9.4) |
| Kemper Specialty: | | | | |
| Non-catastrophe | (2.5) | (7.0) | (2.9) | (3.2) |
| Catastrophe | 0.1 | 0.1 | — | — |
| Total | (2.4) | (6.9) | (2.9) | (3.2) |
| Kemper Direct: | | | | |
| Non-catastrophe | (11.3) | (6.3) | (5.3) | (5.3) |
| Catastrophe | (0.2) | 0.4 | (0.1) | — |
| Total | (11.5) | (5.9) | (5.4) | (5.3) |
| Life and Health Insurance: | | | | |
| Non-catastrophe | (0.3) | (0.9) | — | — |
| Catastrophe | 0.1 | (1.0) | (0.2) | (0.3) |
| Total | (0.2) | (1.9) | (0.2) | (0.3) |
| Decrease in Total Loss and LAE Reserves Related to Prior Years: | | | | |
| Non-catastrophe | (17.2) | (25.8) | (9.0) | (16.4) |
| Catastrophe | (6.0) | (4.3) | (1.9) | (1.8) |
| Decrease in Total Loss and LAE Reserves Related to Prior Years | $(23.2) | $(30.1) | $(10.9) | $(18.2) |

See MD&A, "Critical Accounting Estimates," of the 2011 Annual Report for additional information pertaining to the Company's process of estimating property and casualty insurance reserves for losses and LAE, development of property and casualty insurance losses and LAE, estimated variability of property and casualty insurance reserves for losses and LAE, and a discussion of some of the variables that may impact development of property and casualty insurance losses and LAE and the estimated variability of property and casualty insurance reserves for losses and LAE.

Non-GAAP Financial Measures

Underlying Losses and LAE and Underlying Combined Ratio

The following discussions for the Kemper Preferred, Kemper Specialty and Kemper Direct segments use the non-GAAP financial measures of (i) Underlying Losses and LAE and (ii) Underlying Combined Ratio. Underlying Losses and LAE (also referred to in the discussion as "Current Year Non-catastrophe Losses and LAE") exclude the impact of catastrophe losses, and loss and LAE reserve development from prior years from the Company's Incurred

Losses and LAE, which is the most directly

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Non-GAAP Financial Measures (continued)
comparable GAAP financial measure. The Underlying Combined Ratio is computed by adding the Current Year Non-catastrophe Losses and LAE Ratio with the Incurred Expense Ratio. The most directly comparable GAAP financial measure is the combined ratio, which uses total incurred losses and LAE, including the impact of catastrophe losses, and loss and LAE reserve development from prior years. The Company believes Underlying Losses and LAE and the Underlying Combined Ratio are useful to investors and are used by management to reveal the trends in the Company's Property and Casualty insurance businesses that may be obscured by catastrophe losses and prior year reserve development. These catastrophe losses may cause the Company's loss trends to vary significantly between periods as a result of their incidence of occurrence and magnitude and can have a significant impact on incurred losses and LAE and the combined ratio. Prior year reserve developments are caused by unexpected loss development on historical reserves. Because reserve development relates to the re-estimation of losses from earlier periods, it has no bearing on the performance of the Company's insurance products in the current period. The Company believes it is useful for investors to evaluate these components separately and in the aggregate when reviewing the Company's underwriting performance.

Consolidated Net Operating Income

Consolidated Net Operating Income is an after-tax, non-GAAP financial measure and is computed by excluding from Income from Continuing Operations the after-tax impact of (i) Net Realized Gains (Losses) on Sales of Investments, (ii) Net Impairment Losses Recognized in Earnings related to investments and (iii) other significant non-recurring or infrequent items that may not be indicative of ongoing operations. Significant non-recurring items are excluded when (a) the nature of the charge or gain is such that it is reasonably unlikely to recur within two years, and (b) there has been no similar charge or gain within the prior two years. The most directly comparable GAAP financial measure is Income from Continuing Operations.

The Company believes that Consolidated Net Operating Income provides investors with a valuable measure of its ongoing performance because it reveals underlying operational performance trends that otherwise might be less apparent if the items were not excluded. Net Realized Gains (Losses) on Sales of Investments and Net Impairment Losses Recognized in Earnings related to investments included in the Company's results may vary significantly between periods and are generally driven by business decisions and external economic developments such as capital market conditions that impact the values of the Company's investments, the timing of which is unrelated to the insurance underwriting process. Significant non-recurring items are excluded because, by their nature, they are not indicative of the Company's business or economic trends.

These non-GAAP financial measures should not be considered a substitute for the comparable GAAP financial measures, as they do not fully recognize the overall underwriting profitability of the Company's businesses.

A reconciliation of Consolidated Net Operating Income to Income from Continuing Operations for the nine and three months ended September 30, 2012 and 2011 is presented below:

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 |
|---|---|---|---|---|
| Consolidated Net Operating Income | $57.2 | $23.0 | $24.6 | $7.1 |
| Net Income (Loss) From: | | | | |
| Net Realized Gains (Losses) on Sales of Investments | 38.9 | 18.0 | 33.0 | (2.7) |
| Net Impairment Losses Recognized in Earnings | (2.6) | (4.3) | (2.0) | (3.3) |
| Income from Continuing Operations | $93.5 | $36.7 | $55.6 | $1.1 |

There were no applicable significant non-recurring items that the Company excluded from the calculation of Consolidated Net Operating Income for the nine and three months ended September 30, 2012 and 2011.

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Kemper Preferred

Selected financial information for the Kemper Preferred segment follows:

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 |
|---|---|---|---|---|
| Net Premiums Written | $677.9 | $657.6 | $237.9 | $233.3 |
| Earned Premiums: | | | | |
| Automobile | $385.1 | $383.0 | $130.5 | $128.5 |
| Homeowners | 229.4 | 219.6 | 78.4 | 74.3 |
| Other Personal | 41.4 | 40.2 | 14.0 | 13.7 |
| Total Earned Premiums | 655.9 | 642.8 | 222.9 | 216.5 |
| Net Investment Income | 33.6 | 37.8 | 10.8 | 8.2 |
| Other Income | 0.3 | 0.2 | 0.1 | 0.1 |
| Total Revenues | 689.8 | 680.8 | 233.8 | 224.8 |
| Incurred Losses and LAE related to: | | | | |
| Current Year: | | | | |
| Non-catastrophe Losses and LAE | 448.8 | 435.8 | 154.0 | 148.9 |
| Catastrophe Losses and LAE | 62.7 | 137.8 | 9.4 | 40.9 |
| Prior Years: | | | | |
| Non-catastrophe Losses and LAE | (3.1) | (11.6) | (0.8) | (7.9) |
| Catastrophe Losses and LAE | (6.0) | (3.8) | (1.6) | (1.5) |
| Total Incurred Losses and LAE | 502.4 | 558.2 | 161.0 | 180.4 |
| Insurance Expenses | 183.0 | 179.1 | 62.4 | 60.5 |
| Operating Profit (Loss) | 4.4 | (56.5) | 10.4 | (16.1) |
| Income Tax Benefit (Expense) | 4.1 | 26.2 | (2.0) | 7.8 |
| Segment Net Operating Income (Loss) | $8.5 | $(30.3) | $8.4 | $(8.3) |
| | | | | |
| Ratios Based On Earned Premiums | | | | |
| Current Year Non-catastrophe Losses and LAE Ratio | 68.4% | 67.8% | 69.1% | 68.7% |
| Current Year Catastrophe Losses and LAE Ratio | 9.6 | 21.4 | 4.2 | 18.9 |
| Prior Years Non-catastrophe Losses and LAE Ratio | (0.5) | (1.8) | (0.4) | (3.6) |
| Prior Years Catastrophe Losses and LAE Ratio | (0.9) | (0.6) | (0.7) | (0.7) |
| Total Incurred Loss and LAE Ratio | 76.6 | 86.8 | 72.2 | 83.3 |
| Incurred Expense Ratio | 27.9 | 27.9 | 28.0 | 27.9 |
| Combined Ratio | 104.5% | 114.7% | 100.2% | 111.2% |
| Underlying Combined Ratio | | | | |
| Current Year Non-catastrophe Losses and LAE Ratio | 68.4% | 67.8% | 69.1% | 68.7% |
| Incurred Expense Ratio | 27.9 | 27.9 | 28.0 | 27.9 |
| Underlying Combined Ratio | 96.3% | 95.7% | 97.1% | 96.6% |
| Non-GAAP Measure Reconciliation | | | | |
| Underlying Combined Ratio | 96.3% | 95.7% | 97.1% | 96.6% |
| Current Year Catastrophe Losses and LAE Ratio | 9.6 | 21.4 | 4.2 | 18.9 |
| Prior Years Non-catastrophe Losses and LAE Ratio | (0.5) | (1.8) | (0.4) | (3.6) |
| Prior Years Catastrophe Losses and LAE Ratio | (0.9) | (0.6) | (0.7) | (0.7) |
| Combined Ratio as Reported | 104.5% | 114.7% | 100.2% | 111.2% |

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Kemper Preferred (continued)

Catastrophe Frequency and Severity

| | Nine Months Ended | | | |
|---|---|---|---|---|
| | Sep 30, 2012 | | Sep 30, 2011 | |
| (Dollars in Millions) | Number of Events | Losses and LAE | Number of Events | Losses and LAE |
| Range of Losses and LAE Per Event: | | | | |
| Below $5 | 20 | $28.9 | 21 | $33.0 |
| $5 - $10 | 4 | 33.8 | 2 | 14.6 |
| $10 - $15 | — | — | 3 | 35.2 |
| $20 - $25 | — | — | 1 | 23.7 |
| Greater Than $25 | — | — | 1 | 31.3 |
| Total | 24 | $62.7 | 28 | $137.8 |

Insurance Reserves

| (Dollars in Millions) | Sep 30, 2012 | Dec 31, 2011 |
|---|---|---|
| Insurance Reserves: | | |
| Automobile | $274.2 | $274.7 |
| Homeowners | 116.0 | 106.2 |
| Other Personal | 38.5 | 35.3 |
| Insurance Reserves | $428.7 | $416.2 |
| Insurance Reserves: | | |
| Loss Reserves: | | |
| Case | $267.0 | $259.0 |
| Incurred but Not Reported | 100.0 | 92.9 |
| Total Loss Reserves | 367.0 | 351.9 |
| LAE Reserves | 61.7 | 64.3 |
| Insurance Reserves | $428.7 | $416.2 |

Earned Premiums in the Kemper Preferred segment increased by $13.1 million for the nine months ended September 30, 2012, compared to the same period in 2011, due primarily to higher volume, partially offset by lower average premium. Earned Premiums in the Kemper Preferred segment increased by $6.4 million for the three months ended September 30, 2012, compared to the same period in 2011, due primarily to higher volume, and to a lesser extent, higher average premium. Earned premiums on automobile insurance increased by $2.1 million and $2.0 million for the nine and three months ended September 30, 2012, respectively, compared to the same periods in 2011, due primarily to higher volume, partially offset by lower average premium. Earned premiums on homeowners insurance increased by $9.8 million and $4.1 million for the nine and three months ended September 30, 2012, respectively, compared to the same periods in 2011, due primarily to higher volume and, to a lesser extent, higher average premium. Earned premiums on other personal insurance increased by $1.2 million and $0.3 million for the nine and three months ended September 30, 2012, respectively, compared to the same periods in 2011, due primarily to higher volume.

Net Investment Income in the Kemper Preferred segment decreased by $4.2 million for the nine months ended September 30, 2012, compared to the same period in 2011, due primarily to lower net investment income from Equity Method Limited Liability Investments, lower dividend income from common stock and other equity interests, partially offset by a higher level of allocated investments. Net investment income from Equity Method Limited Liability Investments was $2.7 million for the nine months ended September 30, 2012, compared to $7.2 million for the same period in 2011.

Net Investment Income in the Kemper Preferred segment increased by $2.6 million for the three months ended September 30, 2012, compared to the same period in 2011, due primarily to higher net investment income from Equity Method Limited Liability Investments. Net investment income from Equity Method Limited Liability Investments was $0.5 million for the three months ended September 30, 2012, compared to a net investment loss of $2.1 million for the same period in 2011.

Kemper Preferred (continued)

Operating results in the Kemper Preferred segment increased by $60.9 million before taxes for the nine months ended September 30, 2012, compared to the same period in 2011, due primarily to lower incurred catastrophe losses and LAE, partially offset by lower levels of favorable loss and LAE reserve development, lower Net Investment Income and higher underlying losses and LAE as a percentage of earned premiums. Underlying losses and LAE exclude the impact of catastrophes and loss and LAE reserve development. Underlying losses and LAE as a percentage of earned premiums were 68.4% for the nine months ended September 30, 2012, compared to 67.8% for the same period in 2011. Kemper Preferred continues to take actions intended to improve profitability, including additional rate increases, enhanced pricing segmentation, higher deductibles, in particular for wind or hail events, and other underwriting actions.

Operating results in the Kemper Preferred segment increased by $26.5 million before taxes for the three months ended September 30, 2012, compared to the same period in 2011, due primarily to lower incurred catastrophe losses and LAE and higher Net Investment Income, partially offset by lower levels of favorable loss and LAE reserve development.

Automobile insurance incurred losses and LAE were $292.1 million, or 75.9% of automobile insurance earned premiums, for the nine months ended September 30, 2012, compared to $284.9 million, or 74.4% of automobile insurance earned premiums, for the same period in 2011. Automobile insurance incurred losses as a percentage of automobile earned premiums increased by 1.5% due primarily to higher underlying losses and LAE as a percentage of automobile insurance earned premiums and an unfavorable impact from a change in loss and LAE reserve development, partially offset by lower incurred catastrophe losses and LAE (excluding development). Underlying losses and LAE as a percentage of automobile insurance earned premiums were 73.6% for the nine months ended September 30, 2012, compared to 71.4% for the same period in 2011. Underlying losses and LAE as a percentage of automobile insurance earned premiums increased due primarily to higher severity in physical damage, property damage and uninsured and underinsured motorist coverages and higher frequency in bodily injury coverages, partially offset by lower frequency in comprehensive coverages and lower severity in personal injury protection and bodily injury coverages. Unfavorable loss and LAE reserve development was $2.7 million for the nine months ended September 30, 2012, compared to favorable loss and LAE reserve development of $2.4 million for the same period in 2011. Catastrophe losses and LAE (excluding development) were $6.1 million for the nine months ended September 30, 2012, compared to $13.9 million in 2011.

Automobile insurance incurred losses and LAE were $100.6 million, or 77.1% of automobile insurance earned premiums, for the three months ended September 30, 2012, compared to $95.4 million, or 74.2% of automobile insurance earned premiums, for the same period in 2011. Automobile insurance incurred losses and LAE as a percentage of automobile earned premiums increased by 2.9% due primarily to higher underlying losses and LAE as a percentage of automobile insurance earned premiums and an unfavorable impact from a change in loss and LAE reserve development from prior years, partially offset by lower incurred catastrophe losses and LAE (excluding development). Underlying losses and LAE as a percentage of automobile insurance earned premiums were 75.8% for the three months ended September 30, 2012, compared to 73.2% in 2011. Underlying losses and LAE for the three months ended September 30, 2012 included $0.4 million of unfavorable development from the first two quarters of 2012. Underlying losses and LAE for the three months ended September 30, 2011 included $1.1 million of favorable development from the first two quarters of 2011. Excluding such development, underlying losses and LAE as a percentage of automobile insurance earned premiums were 75.5% for the three months ended September 30, 2012, compared to 74.1% in 2011, an increase of 1.4%, due primarily to higher severity in physical damage and uninsured and underinsured motorist coverages, partially offset by lower severity in personal injury protection coverages. Unfavorable loss and LAE reserve development from prior years was $1.0 million for the three months ended September 30, 2012, compared to favorable loss and LAE reserve development from prior years of $2.9 million in 2011. Catastrophe losses and LAE (excluding development) were $0.6 million for the three months ended September 30, 2012, compared to $4.3 million in 2011.

Homeowners insurance incurred losses and LAE were $187.8 million, or 81.9% of homeowners insurance earned premiums, for the nine months ended September 30, 2012, compared to $251.7 million, or 114.6% of homeowners insurance earned premiums, for the same period in 2011. Homeowners insurance incurred losses and LAE as a percentage of homeowners insurance earned premiums decreased due primarily to lower catastrophe losses and LAE (excluding development), the impact of higher levels of favorable catastrophe loss and LAE reserve development, lower underlying losses and LAE as a percentage of homeowners insurance earned premiums, partially offset by an unfavorable impact from a change in non-catastrophe loss and LAE reserve development. Catastrophe losses and LAE (excluding development) on homeowners insurance were $53.6 million for the nine months ended September 30, 2012, compared to $118.3 million in 2011. Catastrophe losses and LAE incurred for the nine months ended September 30, 2012 were due in part to several hail storms throughout the United States, with the largest catastrophe losses and LAE incurred in Texas and Colorado. For the nine months ended September 30, 2011, the catastrophe losses were primarily related to Hurricane Irene and several severe tornadoes and other storms throughout the United States. Favorable catastrophe loss and LAE reserve development was $5.7 million for the nine months ended

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Kemper Preferred (continued)

September 30, 2012, compared to $4.0 million in 2011. Underlying losses and LAE as a percentage of homeowners insurance earned premiums were 62.6% for the nine months ended September 30, 2012, compared to 65.4% in 2011. Underlying losses and LAE as a percentage of homeowners insurance earned premiums decreased by 2.8% due primarily to lower non-catastrophe storm losses partially offset by higher fire losses. Favorable non-catastrophe loss and LAE reserve development was $3.6 million for the nine months ended September 30, 2012, compared to $6.3 million in 2011.

Homeowners insurance incurred losses and LAE were $53.2 million, or 67.9% of homeowners insurance earned premiums, for the three months ended September 30, 2012, compared to $79.2 million, or 106.6% of homeowners insurance earned premiums, for the same period in 2011. Homeowners insurance incurred losses and LAE decreased by $26.0 million for the three months ended September 30, 2012 due primarily to lower catastrophe losses and LAE (excluding development) and lower underlying losses and LAE as a percentage of homeowners insurance earned premiums, partially offset by lower levels of favorable non-catastrophe loss and LAE reserve development. Catastrophe losses and LAE (excluding development) were $8.7 million for the three months ended September 30, 2012, compared to $34.5 million in 2011. Underlying losses and LAE as a percentage of homeowners insurance earned premiums were 61.0% for the three months ended September 30, 2012, compared to 65.7% in 2011. Underlying losses and LAE as a percentage of homeowners insurance earned premiums decreased due primarily to lower non-catastrophe storm losses and lower fire losses. Favorable non-catastrophe loss and LAE reserve development was $1.6 million for the three months ended September 30, 2012, compared to $2.6 million in 2011.

Other personal insurance incurred losses and LAE were $22.5 million for the nine months ended September 30, 2012, compared to $21.6 million for the same period in 2011. Other personal insurance incurred losses and LAE increased by $0.9 million due primarily to higher underlying losses and LAE, partially offset by lower catastrophe losses and LAE (excluding reserve development). Underlying losses and LAE were $21.9 million for the nine months ended September 30, 2012, compared to $18.6 million in 2011. Catastrophe losses and LAE (excluding development) were $3.0 million for the nine months ended September 30, 2012, compared to $5.6 million in 2011. Favorable loss and LAE reserve development was $2.4 million for the nine months ended September 30, 2012, compared to $2.6 million for the same period in 2011.

Other personal insurance incurred losses and LAE were $7.2 million for the three months ended September 30, 2012, compared to $5.8 million for the same period in 2011. Other personal insurance incurred losses and LAE increased by $1.4 million due primarily to lower levels of favorable loss and LAE reserve development and higher underlying losses and LAE, partially offset by lower catastrophe losses and LAE (excluding development). Favorable loss and LAE reserve development was $0.2 million for the three months ended September 30, 2012, compared to $2.3 million in 2011. Underlying losses and LAE were $7.3 million for the three months ended September 30, 2012, compared to $6.0 million in 2011. Catastrophe losses and LAE (excluding development) were $0.1 million for the three months ended September 30, 2012, compared to $2.1 million in 2011.

Insurance Expenses increased by $3.9 million for the nine months ended September 30, 2012, compared to the same period in 2011, due primarily to higher acquisition expenses related to increased new business production and a refund received in 2011 from a wind pool that did not recur in 2012. Insurance Expenses increased by $1.9 million for the three months ended September 30, 2012, compared to the same period in 2011, due primarily to higher acquisition expenses related to increased new business production.

The Kemper Preferred segment reported Segment Net Operating Income of $8.5 million and $8.4 million for the nine and three months ended September 30, 2012, respectively, compared to Segment Net Operating Loss of $30.3 million and $8.3 million for the same periods in 2011. The Kemper Preferred segment’s effective income tax rate differs from the federal statutory income tax rate due primarily to tax-exempt investment income and dividends received deductions. Tax-exempt investment income and dividends received deductions were $16.0 million for the nine months ended September 30, 2012, compared to $18.6 million for the same period in 2011. Tax-exempt investment income and dividends received deductions were $4.6 million for the three months ended September 30, 2012, compared to $6.1 million for the same period in 2011.

Kemper Specialty

Selected financial information for the Kemper Specialty segment follows:

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 |
|---|---|---|---|---|
| Net Premiums Written | $320.2 | $338.2 | $103.9 | $109.3 |
| Earned Premiums: | | | | |
| Personal Automobile | $285.6 | $306.9 | $92.9 | $100.9 |
| Commercial Automobile | 31.7 | 29.8 | 11.0 | 10.1 |
| Total Earned Premiums | 317.3 | 336.7 | 103.9 | 111.0 |
| Net Investment Income | 14.4 | 17.5 | 4.5 | 3.7 |
| Other Income | 0.2 | 0.4 | 0.1 | 0.2 |
| Total Revenues | 331.9 | 354.6 | 108.5 | 114.9 |
| Incurred Losses and LAE related to: | | | | |
| Current Year: | | | | |
| Non-catastrophe Losses and LAE | 259.4 | 270.9 | 84.2 | 86.8 |
| Catastrophe Losses and LAE | 4.7 | 3.7 | 0.9 | 0.7 |
| Prior Years: | | | | |
| Non-catastrophe Losses and LAE | (2.5) | (7.0) | (2.9) | (3.2) |
| Catastrophe Losses and LAE | 0.1 | 0.1 | — | — |
| Total Incurred Losses and LAE | 261.7 | 267.7 | 82.2 | 84.3 |
| Insurance Expenses | 67.7 | 68.0 | 23.1 | 23.5 |
| Operating Profit | 2.5 | 18.9 | 3.2 | 7.1 |
| Income Tax Benefit (Expense) | 1.5 | (3.5) | (0.5) | (1.4) |
| Segment Net Operating Income | $4.0 | $15.4 | $2.7 | $5.7 |
| | | | | |
| Ratios Based On Earned Premiums | | | | |
| Current Year Non-catastrophe Losses and LAE Ratio | 81.8 % | 80.5 % | 81.0 % | 78.2 % |
| Current Year Catastrophe Losses and LAE Ratio | 1.5 | 1.1 | 0.9 | 0.6 |
| Prior Years Non-catastrophe Losses and LAE Ratio | (0.8) | (2.1) | (2.8) | (2.9) |
| Prior Years Catastrophe Losses and LAE Ratio | — | — | — | — |
| Total Incurred Loss and LAE Ratio | 82.5 | 79.5 | 79.1 | 75.9 |
| Incurred Expense Ratio | 21.3 | 20.2 | 22.2 | 21.2 |
| Combined Ratio | 103.8 % | 99.7 % | 101.3 % | 97.1 % |
| Underlying Combined Ratio | | | | |
| Current Year Non-catastrophe Losses and LAE Ratio | 81.8 % | 80.5 % | 81.0 % | 78.2 % |
| Incurred Expense Ratio | 21.3 | 20.2 | 22.2 | 21.2 |
| Underlying Combined Ratio | 103.1 % | 100.7 % | 103.2 % | 99.4 % |
| Non-GAAP Measure Reconciliation | | | | |
| Underlying Combined Ratio | 103.1 % | 100.7 % | 103.2 % | 99.4 % |
| Current Year Catastrophe Losses and LAE Ratio | 1.5 | 1.1 | 0.9 | 0.6 |
| Prior Years Non-catastrophe Losses and LAE Ratio | (0.8) | (2.1) | (2.8) | (2.9) |
| Prior Years Catastrophe Losses and LAE Ratio | — | — | — | — |
| Combined Ratio as Reported | 103.8 % | 99.7 % | 101.3 % | 97.1 % |

Kemper Specialty (continued)
Insurance Reserves

| (Dollars in Millions) | Sep 30, 2012 | Dec 31, 2011 |
|---|---|---|
| Insurance Reserves: | | |
| Personal Automobile | $167.4 | $166.6 |
| Commercial Automobile | 40.8 | 51.5 |
| Other | 7.4 | 7.8 |
| Insurance Reserves | $215.6 | $225.9 |
| Insurance Reserves: | | |
| Loss Reserves: | | |
| Case | $132.7 | $135.1 |
| Incurred but Not Reported | 45.6 | 47.7 |
| Total Loss Reserves | 178.3 | 182.8 |
| LAE Reserves | 37.3 | 43.1 |
| Insurance Reserves | $215.6 | $225.9 |

Earned Premiums in the Kemper Specialty segment decreased by $19.4 million and $7.1 million for the nine and three months ended September 30, 2012, respectively, compared to the same periods in 2011, due to lower earned premiums on personal automobile insurance, partially offset by higher earned premiums on commercial automobile insurance. Personal automobile insurance earned premiums decreased by $21.3 million and $8.0 million for the nine and three months ended September 30, 2012, respectively, due to lower volume, partially offset by higher average premium. Personal automobile insurance policies in force were approximately 275,000 at September 30, 2012, compared to 302,000 at the beginning of 2012. Commercial automobile insurance earned premiums increased by $1.9 million and $0.9 million for the nine and three months ended September 30, 2012, respectively, due primarily to higher volume.

Net Investment Income in the Kemper Specialty segment decreased by $3.1 million for the nine months ended September 30, 2012, compared to the same period in 2011, due primarily to lower net investment income from Equity Method Limited Liability Investments and lower dividend income from common stocks and other equity interests. Net Investment Income increased by $0.8 million for the three months ended September 30, 2012, compared to the same period in 2011, due primarily to higher net investment income from Equity Method Limited Liability Investments. The Kemper Specialty segment reported net investment income of $1.2 million from Equity Method Limited Liability Investments for the nine months ended September 30, 2012, compared to $3.3 million in 2011. The Kemper Specialty segment reported net investment income of $0.3 million from Equity Method Limited Liability Investments for the three months ended September 30, 2012, compared to a loss of $1.0 million in 2011.

The Kemper Specialty segment reported Operating Profit of $2.5 million and $3.2 million for the nine and three months ended September 30, 2012, respectively, compared to $18.9 million and $7.1 million for the same periods in 2011. Operating Profit in the Kemper Specialty segment decreased for both the nine and three months ended September 30, 2012, compared to the same periods in 2011, due primarily to lower levels of favorable loss and LAE reserve development, higher underlying losses and LAE as a percentage of earned premiums and higher underwriting expenses as a percentage of earned premiums.

Personal automobile insurance incurred losses and LAE were $249.9 million, or 87.5% of personal automobile insurance earned premiums, for the nine months ended September 30, 2012, compared to $248.2 million, or 80.9% of personal automobile insurance earned premiums, for the same period in 2011. Personal automobile insurance incurred losses and LAE as a percentage of personal automobile insurance earned premiums increased due primarily to an unfavorable impact from a change in loss and LAE reserve development and higher underlying losses and LAE as a percentage of personal automobile earned premiums. Unfavorable loss and LAE reserve development on personal automobile insurance was $10.4 million for the nine months ended September 30, 2012 and was related primarily to the 2011 and 2010 accident years. Favorable loss and LAE reserve development was $4.3 million for the nine months ended September 30, 2011. Catastrophe losses and LAE (excluding development) were $4.6 million for the nine months ended September 30, 2012, compared to $3.7 million in 2011. Underlying losses and LAE as a percentage of personal automobile insurance earned premiums were 82.2% for the nine months ended September 30, 2012, compared to 81.1% in 2011, and increased due primarily to higher LAE as a percentage of personal automobile earned premiums.

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Kemper Specialty (continued)

Personal automobile insurance incurred losses and LAE were $75.6 million, or 81.4% of personal automobile insurance earned premiums, for the three months ended September 30, 2012, compared to $78.6 million, or 77.9% of personal automobile insurance earned premiums, for the same period in 2011. Personal automobile insurance incurred losses and LAE as a percentage of personal automobile insurance earned premiums increased due primarily to lower levels of favorable loss and LAE reserve development and higher underlying losses and LAE as a percentage of personal automobile insurance earned premiums. Loss and LAE reserve development from prior years had a favorable effect of $0.9 million for the three months ended September 30, 2012 and was related primarily to the 2011 and 2010 accident years. Loss and LAE reserve development from prior years had a favorable effect of $2.4 million for the three months ended September 30, 2011. Catastrophe losses and LAE were $0.9 million for the three months ended September 30, 2012, compared to $0.6 million in 2011. Underlying losses and LAE as a percentage of personal automobile insurance earned premiums were 81.4% for the three months ended September 30, 2012, compared to 79.7% for the same period in 2011. Underlying loss and LAE for the three months ended September 30, 2012 included unfavorable development of $1.1 million from the first two quarters of 2012. Underlying loss and LAE for the three months ended September 30, 2011 included $2.1 million of favorable development from the first two quarters of 2011. Excluding the impact of such development, underlying losses and LAE as a percentage of personal automobile insurance earned premiums were 80.1% for the three months ended September 30, 2012, compared to 81.7% in 2011, and decreased due primarily to improved bodily injury results resulting from the rate of increase in average earned premiums outpacing the rate of increase in average claim cost, partially offset by an increase in the underlying loss ratio for collision driven by increased frequency.

Commercial automobile insurance incurred losses and LAE were $11.8 million for the nine months ended September 30, 2012, compared to $19.1 million for the same period in 2011. Commercial automobile insurance incurred losses and LAE decreased by $7.3 million for the nine months ended September 30, 2012, compared to the same period in 2011, due primarily to higher levels of favorable loss and LAE reserve development, partially offset by higher underlying losses and LAE as a percentage of commercial automobile insurance earned premiums. Favorable loss and LAE reserve development was $12.8 million for the nine months ended September 30, 2012, of which $6.7 million related to 2011 and 2010 accident years, with the balance of $6.1 million dispersed over several older accident years. Favorable loss and LAE reserve development was $3.0 million for the nine months ended September 30, 2011. Underlying losses and LAE as a percentage of commercial automobile insurance earned premiums were 77.3% for the nine months ended September 30, 2012, compared to 73.8% in 2011, and increased due primarily to higher frequency associated with most coverages.

Commercial automobile insurance incurred losses and LAE were $6.6 million for the three months ended September 30, 2012, compared to $5.7 million for the same period in 2011. Commercial automobile insurance incurred losses and LAE increased by $0.9 million for the three months ended September 30, 2012, compared to the same period in 2011, due primarily to higher underlying losses and LAE, partially offset by higher levels of favorable development. Underlying losses and LAE as a percentage of commercial automobile insurance earned premiums were 77.7% for the three months ended September 30, 2012, compared to 65.3% in 2011, and increased due primarily to higher frequency of bodily injury claims and higher frequency and severity of property damage and collision claims. Favorable loss and LAE reserve development was $2.0 million for the three months ended September 30, 2012, of which $1.1 million related to 2011 and 2010 accident years, with the balance of $0.9 million dispersed over several older accident years. Favorable loss and LAE reserve development was $0.8 million for the three months ended September 30, 2011.

Other insurance consists of certain reinsurance pools in run-off and other personal insurance in run-off. Unfavorable loss and LAE reserve development on certain reinsurance pools in run-off was $0.4 million for the nine months ended September 30, 2011. There was no loss and LAE reserve development on reinsurance pools in run-off for the nine and three months ended September 30, 2012.

Insurance expenses as a percentage of earned premiums was 21.3% for the nine months ended September 30, 2012, compared to 20.2% in 2011. Insurance expenses as a percentage of earned premiums was 22.2% for the three months ended September 30, 2012, compared to 21.2% in 2011. Insurance expenses as a percentage of earned premiums

increased for the nine and three months ended September 30, 2012, compared to the same periods in 2011, due primarily to higher expenses associated with information technology initiatives.
Kemper Specialty reported Segment Net Operating Income of $4.0 million and $2.7 million for the nine and three months ended September 30, 2012, respectively, compared to $15.4 million and $5.7 million for the nine and three months ended September 30, 2011, respectively. The Kemper Specialty segment’s effective income tax rate differs from the federal statutory income tax rate due primarily to tax-exempt investment income and dividends received deductions. Tax-exempt investment income and dividends received deductions were $6.8 million and $1.9 million for the nine and three months ended September 30, 2012, respectively, compared to $8.5 million and $2.7 million for the same periods in 2011.

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Kemper Direct

Selected financial information for the Kemper Direct segment follows:

| (Dollars in Millions) | Nine Months Ended Sep 30, 2012 | Nine Months Ended Sep 30, 2011 | Three Months Ended Sep 30, 2012 | Three Months Ended Sep 30, 2011 |
|---|---|---|---|---|
| Net Premiums Written | $115.5 | $163.5 | $35.9 | $52.0 |
| Earned Premiums: | | | | |
| Automobile | $123.9 | $164.8 | $37.9 | $52.0 |
| Homeowners | 7.2 | 6.8 | 2.4 | |