CITIZENS FINANCIAL CORP /KY/
Form 10-K
March 31, 2005

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended **DECEMBER 31, 2004**

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 0-20148

CITIZENS FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Kentucky	**61-1187135**
(State of Incorporation)	(I.R.S. Employer Identification No.)

12910 Shelbyville Road, Louisville, Kentucky 40243

(Address of principal executive offices)

(502) 244-2420

(Registrant s telephone number)

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

Securities registered pursuant to Section 12(g) of the Act: **Class A Stock, No Par Value**

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, and (2) has been subject to such filing requirements for the past 90 days. Yes _X_ No __

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

Indicate by check mark whether the registrant is an accelerated filer (as determined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes __ No _X_

State the aggregate market value of the common equity held by non-affiliates of the registrant: **$4,845,782** (based on an $7.51 per share average of bid and asked prices on March 30, 2005).

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date**1,671,628** shares of Class A Stock as of March 30, 2005.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the issuer s Board of Director s Proxy Statement for the Annual Meeting of Shareholders now scheduled for May 26, 2005 are incorporated into Part III of this Form 10-K. The date of this Report is March 31, 2005.

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This report contains projections and other forward-looking statements regarding future events or the future financial performance of the Company. Actual events and results may differ materially from those in the projections and other forward-looking statements set forth herein. Among the important factors that could cause actual events or results to differ materially from those in the projections and other forward-looking statements are: changes in the market value of the Company s investments, including stock market performance and interest rate changes; customer response to marketing efforts; mortality and morbidity trends; regulatory changes; actions of independent rating agencies; general economic conditions and increased competition; the Company s ability to achieve operating efficiencies; unanticipated adverse litigation; and changes in Federal tax law. Readers are referred to the Items 1, 7, 7a and 8 in this report and to the Company Report on Financial Statements in the Company s Annual Report to Shareholders for the year ended December 31, 2004 for a discussion of these and other important risk factors concerning the Company and its operations.

PART I

ITEM 1. BUSINESS

General

Citizens Financial Corporation (herein, the Company or the Registrant) was incorporated in Kentucky in 1990 at the direction of the Board of Directors of Citizens Security Life Insurance Company (Citizens Security) for the ultimate purpose of becoming an insurance holding company. Pursuant to a merger completed in 1991, Citizens Security became a wholly owned subsidiary of the Company. The Company is now a holding company that engages in the business of life insurance, annuities, and accident and health insurance through Citizens Security and United Liberty Life Insurance Company (United Liberty), a wholly owned subsidiary of Citizens Security (herein collectively, the Life Insurance Subsidiaries). Citizens Security also owns Citizens Insurance Company (Citizens Insurance), which is licensed as a property and casualty insurer but currently has no business inforce. The Life Insurance Subsidiaries and Citizens Insurance are herein collectively referred to as the Insurance Subsidiaries.

Insurance Operations

The Company, through its Life Insurance Subsidiaries, operates in five segments -- 1) home service life insurance, 2) broker-sold life insurance and annuities, 3) preneed life insurance, 4) dental insurance, and 5) other health and accident insurance. The home service and preneed life segments provide individual coverages; the dental segment provides group coverages; while the broker life and other health segments include individual and group insurance coverages. The following table presents each business segment s revenue; pretax profit (loss) excluding realized investment gains (losses) and interest expense; and ending assets for each of the last three fiscal years. Additional segment information is contained in Item 7 and in Note 8 of the Notes to Consolidated Financial Statements.

Segment Revenue, Profit (Loss) and Assets:

December 31	2004	2003	2002
Revenue:			
Home Service Life	$ 8,873,473	$ 9,147,813	$ 9,260,097
Broker Life	5,731,569	6,019,952	5,964,089
Preneed Life	9,422,793	14,780,938	19,706,136
Dental	9,358,935	8,417,118	8,209,257
Other Health	1,103,521	1,381,981	1,432,607
Segment Totals	34,490,291	39,747,802	44,572,186
Net realized investment gains (losses)	2,868,250	1,977,635	(2,469,768)
Total Revenue	$37,358,541	$41,725,437	$42,102,418

Year Ended December 31	2004	2003	2002
Segment Profit (Loss):			
Home Service Life	$ (616,755)	$ 75,520	$ 275,809
Broker Life	(961,414)	(121,851)	(265,488)
Preneed Life	(275,350)	(955,227)	(670,349)
Dental	(150,335)	230,289	297,740
Other Health	(303,463)	(201,385)	(191,289)
Segment Totals	(2,307,317)	(972,654)	(553,577)
Net realized investment gains (losses)	2,868,251	1,977,635	(2,469,768)
Interest expense	354,200	363,273	305,715
Income (Loss) before income tax	$ 206,734	$641,708	$ (3,329,060)

December 31	2004	2003	2002
Assets:			
Home Service Life	$ 41,465,725	$ 41,312,914	$ 45,219,971
Broker Life	54,414,225	54,585,019	53,874,949
Preneed Life	58,560,125	60,100,723	46,739,831
Dental	1,025,005	930,279	660,334
Other Health	1,805,479	1,951,397	1,946,447
Total Assets	$157,270,559	$158,880,332	$148,441,532

Home Service Life. The Home Service Life segment consists primarily of traditional whole life insurance, which provides policyholders with permanent life insurance and fixed, guaranteed rates of return on the cash value element of policy premiums. Agents for these products sell primarily small face value policies (typically from $1,000 to $10,000). These policies are subject to normal underwriting procedures with the extent of such procedures determined by the amount of insurance, age of applicant and other pertinent factors.

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Broker Life. The Broker Life segment offers traditional whole life insurance; universal life insurance, which provides policyholders with permanent life insurance and adjustable rates of return on the cash value element of policy premiums, based upon current interest rates; annuities; group life; accidental death and dismemberment; and dependent life insurance. The majority of Broker Life sales consist of whole life graded death benefit and simplified issue policies.

The graded death benefit policy returns premium plus interest compounded at an annual rate of 10% if the insured dies of natural causes during the first three years the policy is in force. If the insured dies of an accidental cause, the benefit payable is the face amount of the policy. The simplified issue product provides full face amount coverage from date of issue, is more extensively underwritten and carries lower premium rates than the graded death benefit product. These products are targeted towards the final expense market.

Generally, traditional whole life insurance products are more profitable than universal life policies, in part because investment margins are normally greater for traditional whole life products than for universal life policies. Overall profitability on universal life policies may decline as a result of downward interest crediting rate adjustments to the extent that policyholders withdraw funds to invest in higher-yielding financial products. The profitability of traditional whole life products and universal life policies is also dependent upon the ultimate underwriting experience and the realization of anticipated unit administrative costs. The Company believes that the historical claims experience for the traditional whole life and universal life products issued by the Life Insurance Subsidiaries has been within expected ranges, in relation to the mortality assumptions used to price the products.

Substantially all annuity considerations are attributable to sales of flexible premium deferred annuities, life policy annuity riders, and single premium deferred annuities. Generally, a flexible premium deferred annuity or a life policy annuity rider permits premium payments in such amounts as the policyholder deems appropriate, while a single premium deferred annuity requires a one-time lump sum payment.

Preneed Life. The Preneed Life segment products are traditional whole life policies sold to individuals in connection with prearrangement of their funeral and include single and multi-pay coverages, generally in amounts of $10,000 and less. These policies are generally sold to older individuals at increased premium rates.

Coverage in Force.

The following table provides information concerning the Life Insurance Subsidiaries' volume of life insurance coverage in force excluding participation in group underwriting pools for federal employees (FEGLI) and service personnel (SGLI) for each of the last three fiscal years.

Year Ended December 31 *(Dollars in Thousands)*	2004	2003	2002
Gross In-force at beginning of period1	$765,051	$792,722	$812,515
New business issued during period:			
Individual	$109,073	$103,239	$ 95,706
Group	12,668	10,377	13,063
New business total	$121,741	$113,616	$108,769
Terminations during period	$148,808	$141,287	$128,562
Termination rate2	19.50%	17.8%	15.8%

Gross In-force at end of period1:			
Individual	$639,360	$661,720	$663,394
Group	98,624	103,331	129,328
Gross In-force total at end of period	$737,984	$765,051	$792,722
Reinsurance ceded at end of period	84,456	91,480	96,202
Net In-force at end of period	$653,528	$673,571	$696,520

1 Before deduction of reinsurance ceded.

2 Represents the percentage of individual policies terminated during the indicated period by lapse, surrender, conversion,

maturity, or otherwise.

The downward trend in Net In-force amounts is primarily the result of the reduced new premium and continued benefit payments in the preneed segment.

Dental Insurance. Dental products are indemnity policies sold on a pure group and voluntary group basis. Voluntary dental groups must meet prescribed participation limits. All dental products have annual limits on all covered procedures and lifetime limits on orthodontia procedures. In addition, orthodontia and major restorative procedures are not covered for the first six months to one year, depending upon the plan, unless a no-loss-no-gain provision is attached to the policy.

Other Health Insurance. Other Health products include individual accident and health insurance policies, which provide coverage for monthly income during periods of hospitalization, scheduled reimbursement for specific hospital and surgical expenses and cancer treatments, and lump sum payments for accidental death or dismemberment. Group health plans are also offered, providing coverage for short-term disability, and income protection. The Company is not allocating significant marketing resources to this segment.

Marketing. The Life Insurance Subsidiaries are currently licensed to sell products in 29 states and the District of Columbia. Citizens Security and United Liberty are both licensed in the states designated below with a *b* while only Citizens Security is licensed in the states designated *c* and only United Liberty in the states designated *u*.

b	Alabama	*b*	Indiana	*u*	Nebraska	*u*	Oregon
u	Arizona	*u*	Kansas	*u*	Nevada	*c*	Pennsylvania
b	Arkansas	*b*	Kentucky	*c*	New Jersey	*b*	South Carolina
u	Colorado	*b*	Louisiana	*u*	New Mexico	*b*	Tennessee
c	Delaware	*b*	Maryland	*c*	North Carolina	*b*	Texas
c	District of Columbia	*c*	Mississippi	*u*	Oklahoma	*u*	Utah
b	Florida	*b*	Missouri	*c*	Ohio	*c*	Virginia
c	Georgia					*b*	West Virginia

The Life Insurance Subsidiaries market products through the personal producing general agent distribution system. Approximately 3,100 sales representatives are licensed as independent agents for the Life Insurance Subsidiaries. Nearly all of these agents also represent other insurers. Approximately 900 of these agents specialize in the home service market. That market consists primarily of middle and low-income families and individuals who desire whole life policies with policy limits typically below $10,000. Agents usually collect premiums directly at monthly intervals. The home service market has higher than average policy lapse rates. Approximately 800 agents specialize in the preneed market. Typically, these agents are funeral directors or operate from facilities owned by funeral directors.

The Life Insurance Subsidiaries furnish rate material, brochures, applications, and other pertinent sales material, at no expense to the agents. The agents are responsible for complying with state licensing laws and any related appointment fees. Agents are compensated by commissions. The Life Insurance Subsidiaries have agent commission arrangements that are generally intended to provide competitive incentives for agents to increase their production of new insurance and to promote continued renewals of in-force insurance. Historically, these incentives have frequently involved awards, overrides, and compensation scales that escalate according to achievement levels for newly-issued business and that provide additional payments for renewal business.

Underwriting. The Life Insurance Subsidiaries follow underwriting procedures designed to assess and quantify insurance risks before issuing life and health insurance policies to individuals and members of groups. Such procedures require medical examinations (including blood tests, where permitted) of applicants for certain policies of health insurance and for policies of life insurance in excess of certain policy limits. These requirements are graduated according to the applicant's age and vary by policy type. In addition, certain types of life insurance policies are offered with higher premium rates and less stringent underwriting requirements. The Life Insurance Subsidiaries also rely upon each applicant's written application for insurance, which is generally prepared under the supervision of a trained agent. In issuing health insurance, information from the application and, in some cases, inspection reports, physician statements, or medical examinations are used to determine whether a policy should be issued as applied for, issued with reduced coverage under a health rider, or rejected.

Acquired Immunodeficiency Syndrome ("AIDS") claims identified to date, as a percentage of total claims, have not been significant for the Life Insurance Subsidiaries. Evaluating the impact of future AIDS claims under health and life insurance policies issued is extremely difficult, in part due to the insufficiency and conflicting data regarding the number of persons now infected with the AIDS virus, uncertainty as to the speed at which the AIDS virus has and may spread through the general population, and advancements in medical treatment options. The Life Insurance Subsidiaries have implemented, where legally permitted, underwriting procedures designed to assist in the detection of the AIDS virus in applicants.

Investments. The Company derives a substantial portion of its revenue from investments. The Life Insurance Subsidiaries maintain diversified investment portfolios that are held primarily to fund future policyholder obligations. State insurance laws impose certain restrictions on the nature and extent of investments by insurance companies and, in some states, require divestiture of assets contravening these restrictions. Within the framework of such laws, the Life Insurance Subsidiaries follow a general strategy to maximize total return (current income plus appreciation) without subjecting themselves to undue risk. Where deemed appropriate, the Life Insurance Subsidiaries will hold selected non-investment grade bonds that provide higher yields or are convertible to common stock. The Company considers a bond non-investment grade if it is unrated or rated less than BBB by Standard & Poor's Rating Group ("S&P") or BAA by Moody's Investors Service ("Moody's"). The Company s non-investment grade bonds, based on reported fair values, represented 4.8% of the Company s cash and invested assets as of December 31, 2004. Citizens Security has maintained substantial investments in equity securities in an effort to achieve higher investment earnings than can usually be achieved through portfolio bonds but at a greater comparative risk. The Company also maintains an investment portfolio of equity securities separate from those of the Life Insurance Subsidiaries. Federally-insured mortgage-backed securities, collateralized mortgage obligations and real estate investments, apart from the investment in the office building described in Item 2., "Description of Property," represented approximately 1.0% of cash and invested assets as of December 31, 2004. Neither the Company nor its subsidiaries owned any collateralized mortgage-backed securities as of December 31, 2004 that would be included in the high-risk classification.

For additional information concerning investment results, see Item 7.

Reinsurance. In keeping with industry practice, the Life Insurance Subsidiaries reinsure, with unaffiliated insurance companies, portions of the life and health insurance risks which they underwrite. The Life Insurance Subsidiaries retain no more than $40,000 of individual life insurance risk and $15,000 of group life insurance risk for any single life. Graded death benefit and simplified issue coverages above $4,000 are generally 50% reinsured, with the Life Insurance Subsidiaries maintaining a maximum $10,000 risk on any one life. Individual and group accidental death coverage is 100% reinsured. At December 31, 2004, approximately $84,456,000 or 11% of life insurance in force was reinsured under arrangements described in Note 10 of Notes to the Consolidated Financial Statements. Under most reinsurance arrangements described above, new insurance is reinsured automatically rather than on a basis that would require the reinsurer's prior approval. Generally, the Life Insurance Subsidiaries enter into indemnity reinsurance arrangements to assist in diversifying their risks and to limit their maximum loss on large or unusually hazardous risks. Indemnity reinsurance does not discharge the ceding insurer's liability to meet policy claims on the reinsured business. Accordingly, the Life Insurance Subsidiaries remain responsible for policy claims on the reinsured business to the extent a reinsurer should fail to pay such claims.

Competition. The insurance industry is highly competitive, with approximately 1,500 life and health insurance companies in the United States. Many insurers and insurance holding company systems have substantially greater capital and surplus, larger and more diversified portfolios of life and health insurance policies, and larger agency sales operations than those of the Life Insurance Subsidiaries. Financial and claims-paying ratings assigned to insurers by A.M. Best Company ("Best") and by nationally-recognized statistical rating organizations have become more important to policyholders. Citizens Security's rating was last changed by Best in October 2001, when it was downgraded to B- (Fair) from B (Fair). The B- rating was affirmed in December 2004. United Liberty s rating has remained at B- (Fair) since its 1998 acquisition. According to Best, B- ratings are assigned to companies that have on balance, fair financial strength, operating performance and market profile when compared to the standards established by Best. Also according to Best, B- companies have an ability to meet their current obligations to policyholders, but their financial strength is vulnerable to adverse changes in underwriting or economic conditions. There are seven Best rating categories above the B- category from B to A++. The Life Insurance Subsidiaries will continue to pursue upward revisions in their Best ratings. Citizens Insurance has no insurance business inforce and is not rated by Best.

A rating is not a recommendation to buy, sell or hold securities and is subject to revision or withdrawal by the assigning rating organization. Each rating should be evaluated independently of any other rating.

The Life Insurance Subsidiaries compete primarily on the basis of the experience, size, accessibility and claims response of their customer service representatives, product design, service and pricing. The Company believes that the Life Insurance Subsidiaries are generally competitive in the markets in which they are engaged based upon premium rates and services, have good relationships with their agents, and have an adequate variety of insurance and annuity products approved for issuance.

State Insurance Regulation. The Insurance Subsidiaries are subject to comprehensive regulation in the states in which they are authorized to conduct business. The laws of such states establish supervisory agencies with broad administrative powers, among other things, to grant and revoke licenses for transacting business, regulate the form and content of policies, establish reserve requirements, prescribe the type and amount of allowable investments, and review premium rates for fairness and adequacy. The Insurance Subsidiaries file detailed annual statements with the NAIC and with many states in which they are licensed to transact business. The Kentucky Office of Insurance also periodically examines the business and accounts of the Insurance Subsidiaries.

The Life Insurance Subsidiaries also can be required, under the solvency or guaranty laws of most states in which they do business, to pay assessments (up to prescribed limits) to fund policyholder losses or liabilities of other insurance companies that become insolvent. These assessments may be deferred or foregone under most guaranty laws if they would threaten an insurer's financial strength and, in certain instances, may be offset against future premium or intangible property taxes. Gross assessments for the Life Insurance Subsidiaries, net of refunds but before offsets for future premium or intangible property taxes, were $5,178, $6,945, and $12,587 in 2004, 2003, and 2002, respectively.

Kentucky, in common with substantially all states, regulates transactions between or affecting insurance holding companies and their insurance company subsidiaries, including the Company and the Insurance Subsidiaries. Generally, under Kentucky insurance holding company statutes, the Kentucky Office of Insurance must approve in advance the direct or indirect acquisition of 15% or more of the voting securities of an insurance company organized under the laws of Kentucky. Such statutes also regulate certain transactions among affiliates, including the payment of dividends by an insurance company to its holding company parent. Under the Kentucky statutes, the Insurance Subsidiaries may not during any year pay dividends on their common and preferred stock to their parent company in excess of the lesser of the net gain from operations for the preceding year or 10% of their capital and surplus at the end of the preceding year, without the consent of the Executive Director of the Kentucky Office of Insurance. For 2005, the maximum amount of dividends that Citizens Insurance could pay, without the Executive Director's approval, is $56,500. Citizens Security can pay a maximum dividend of $264,300 without the Executive Director s approval. United Liberty is unable to pay such a dividend. The Company provides substantially all management, operating and employee services for the Insurance Subsidiaries and is reimbursed at actual cost plus 15%. This management fee totaled $5,460,000 for 2004. The Company currently has resources which management believes will be adequate to service debt obligations through 2005. In addition, the Company s Chairman has expressed potential willingness to lend up to $2,000,000 of additional funds to the Company if necessary. Accordingly, the Company is not relying upon affiliate dividends or preferred stock redemptions for near-term debt service.

During recent years, the NAIC has taken several steps to address public concerns regarding insurer solvency. These steps included implementing a state certification program designed to promote uniformity among the insurance laws of the various states and developing insurer reporting requirements that focus on asset quality, capital adequacy, profitability, asset/liability matching, and liquidity. These requirements include establishment of asset valuation reserves ("AVR") and interest maintenance reserves ("IMR"), risk-based capital ("RBC") rules to assess the capital adequacy of an insurer, and a revision to the Standard Valuation Law ("SVL") that specifies minimum reserve levels and requires cash flow testing in which projected cash inflows from assets are compared to projected cash outflows for liabilities to determine reserve adequacy.

The Life Insurance Subsidiaries AVR, as of December 31, 2004, 2003 and 2002, is shown in Item 7. Cash flow testing and the results of such testing as applied to the Life Insurance Subsidiaries are also described and discussed in Item 7.

RBC provides a means of establishing the capital standards for insurance companies to support their overall business operations in light of their size and risk profile. The four categories of major risk involved in the formula are [i] asset risk -- the risk with respect to the insurer's assets; [ii] insurance risk -- the risk of adverse insurance experience with respect to the insurer's liabilities and obligations; [iii] interest rate risk -- the interest risk with respect to the insurer's business; and [iv] business risk -- all other business risks. A company's RBC is calculated by applying factors to various asset, premium and reserve items, with higher factors for those items with greater

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underlying risk and lower for less risky items. RBC standards are used by regulators to set in motion appropriate regulatory actions relating to insurers that show signs of weak or deteriorating conditions. They also provide an additional standard for minimum capital, below which companies would be placed in conservatorship.

Based on RBC computations as of December 31, 2004, the Insurance Subsidiaries each have capital which is in excess of minimum regulatory requirements.

Action taken by the NAIC in these and other areas may have a significant impact on the regulation of insurance companies during the next several years. In addition, various proposals are being considered for permitting insurers to elect Federal regulation. Given their comparatively small size, it may be expected that the Life Insurance Subsidiaries would be affected by more stringent regulatory policy, both under existing laws and any new regulatory initiatives. Such effects could include curtailment or discontinuance of insurance underwriting in one or more states, mandated increases in capital and surplus, and/or other effects.

Income Taxation. The Life Insurance Subsidiaries are taxed under the life insurance company provisions of the Internal Revenue Code of 1986, as amended (the "Code"). Under the Code, a life insurance company's taxable income incorporates all income, including life and health premiums, investment income, and certain decreases in reserves. The Code currently establishes a maximum corporate tax rate of 35% and imposes a corporate alternative minimum tax rate of 20%. See Item 7 and Note 6 of the Notes to Consolidated Financial Statements.

The Code currently requires capitalization and amortization over a five to ten year period of certain policy acquisition costs incurred in connection with the sale of certain insurance products. Prior tax laws permitted these costs to be deducted as incurred. These provisions apply to life, health, and annuity business. Certain proposals to make additional changes in the federal income tax laws, including increasing marginal tax rates, and regulations affecting insurance companies or insurance products, continue to be considered at various times in the United States Congress and by the Internal Revenue Service. The Company currently cannot predict whether any additional changes will be adopted in the foreseeable future or, if adopted, whether such measures will have a material effect on its operations.

Reserves. In accordance with applicable insurance laws, the Life Insurance Subsidiaries have established and carry as liabilities actuarially determined reserves to meet their policy obligations. Life insurance reserves, when added to interest thereon at certain assumed rates and premiums to be received on outstanding policies, are required to be sufficient to meet policy obligations. The actuarial factors used in determining reserves in the statutory basis financial statements are based upon statutorily prescribed mortality and interest rates. Reserves maintained for health insurance include the unearned premiums under each policy, reserves for claims that have been reported but not yet paid, and reserves for claims that have been incurred but have not been reported. Furthermore, for all health policies under which renewability is guaranteed, additional reserves are maintained in recognition of the actuarially-calculated probability that the frequency and amount of claims will increase as policies persist. The Life Insurance Subsidiaries do not continue accumulating reserves on reinsured business after it is ceded. The Life Insurance Subsidiaries are required to maintain reserves on reinsured business assumed on a basis essentially comparable to direct insurance reserves. Reinsurance business assumed is presently insignificant in amount.

The reserves carried in the financial statements included in this Form 10-K are calculated on the basis of accounting principles generally accepted in the United States and differ from the reserves specified by laws of the various states, which govern preparation of financial statements on the statutory basis of accounting for the Life Insurance Subsidiaries. These differences arise from the use of different mortality and morbidity tables and interest assumptions, the introduction of lapse assumptions into the reserve calculation, and the use of the level premium reserve method on all insurance business. See Note 1 of the Notes to Consolidated Financial Statements, for certain additional information regarding reserve assumptions under accounting principles generally accepted in the United States.

Employees. As of March 1, 2005, the Company employed 63 people, excluding agents. As of that date, the Company had approximately 3,100 independent agents licensed to sell its products.

ITEM 2. PROPERTIES

The Company owns, through Citizens Security, a three-story, 63,000 square foot office building in suburban Louisville, Kentucky completed in 1988. The Company and its Subsidiaries occupy about 32% of the building for their headquarters and home offices. The Company leases the remaining space to tenants under leases of various durations. Market conditions for this property are generally favorable and, in management s opinion, the property is adequately covered by insurance. Currently, the Company s policy is not to invest in additional real estate or real estate mortgages, although a change in such policy would not require a vote of security holders. In addition, the Company s current bank lending agreement precludes investment in additional real estate and in mortgages with a loan-to-appraised-value ratio of more than 75%.

ITEM 3. LEGAL PROCEEDINGS

United Liberty, which the Company acquired in 1998, is defending an action in an Ohio state court brought by two policyholders in 2000. The Complaint referred to a class of life insurance policies, including related certificates of participation, that United Liberty issued over a period of years ending around 1971 (known as Five Star Policies). It alleged that United Liberty s dividend payments on these policies from 1993 through 1999 were less than the amounts required by the certificates of participation. It did not specify the amount of the alleged underpayment but implied a maximum of about $850,000. The plaintiffs also alleged that United Liberty is liable to pay punitive damages, also in an unspecified amount, for breach of an implied covenant of good faith and fair dealing to the plaintiffs in relation to the dividends. The action has been certified as a class action on behalf of all policyholders who were Ohio residents and whose policies were still in force in 1993. United Liberty denied the material allegations of the Complaint and has defended the action vigorously.

As a result of a provisional settlement agreement dated October 8, 2004 that would apply to all holders of the Five Star policies wherever they reside, the Company has recognized as of December 31, 2004 an obligation for future payments to the policyholders and their attorneys totaling $825,000. The terms of the settlement agreement are subject to the approval of the court in which the action is pending. The court will schedule a hearing on the issue of approval, following notice to members of the class, who will be afforded the opportunity to argue in support of or opposition to the settlement agreement. Accordingly, this description is subject to change depending upon the outcome of the hearing.

The $825,000 obligation for future payments consist of [i] up to $500,000 payable to all persons who owned Five Star Policies that were still in force in 1993, [ii] $315,000 in attorneys fees payable to counsel for the class and [iii] a $10,000 incentive award payable to the lead plaintiffs for the class.

The $500,000 portion is payable in respect of dividend obligations on the Five Star Policies from 1993 through 2000 and is to be paid in three annual installments beginning within 60 days after expiration of the time within which any appeal may be taken from the trial court s approval of the settlement agreement. The Company currently projects the first payment date to be after June 30, 2005 (the Initial Payment Date). The attorneys fees and incentive award are also payable by the Initial Payment Date.

The Company has reflected in the Consolidated Statements of Operations for the year ended December 31, 2004 the $500,000 portion of the amount payable for dividends in Policy Benefits and Expenses , and the $325,000 for attorneys fees and incentive award in General expenses . The total amount payable of $825,000 is reflected in the Consolidated Balance Sheets as of December 31, 2004 in Accrued expenses and other liabilities . The Settlement Agreement also provides that the Company will have no further obligation to pay dividends on the Five Star Policies of the kind that gave rise to the litigation. This change permitted the Company to reduce the reserves it will be required to maintain for the Five Star Policies to the extent they remain in force by the $500,000 settlement amount for dividends. This reduction in reserves is reflected in the Consolidated Statements of Operations for the year ended December 31, 2004 in Policyholder benefits , and in the Consolidated Balance Sheets as of December 31, 2004 in Future policy benefits .

In addition, the Company is party to other lawsuits in the normal course of business. Management believes that recorded claims liabilities are adequate to ensure that these other suits will be resolved without material financial impact to the Company.

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ITEM 4. SUBMISSION OF

MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted during the fourth quarter of the fiscal year covered by this Form 10-K to a vote of the Company's security holders, through the solicitation of proxies or otherwise.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY,

RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

As of March 24, 2005, there were approximately 2,500 holders of record of the Company's Class A Stock, its only class of common equity. The Class A Stock is currently eligible for quotation on the National Association of Securities Dealers, Inc.'s Small-Cap Market ("NASDAQ") under the trading symbol CNFL. Trading volume in 2004 was about 9.0% of the average shares outstanding during the year and trading volume by non-affiliates was about 25.7% of the average shares owned by non-affiliates during the year.

The following table summarizes quarterly high and low bid quotations for the Class A Stock in 2004 and 2003 as reported by NASDAQ. Such quotations reflect inter-dealer prices and do not include retail markup, markdown, or commission, and may not necessarily represent actual transactions.

	Bid Quotations for Class A Stock	
Quarter Ended	High Bid	Low Bid
December 31, 2004	$ 8.000	$ 6.500
September 30, 2004	$ 8.250	$ 6.380
June 30, 2004	$ 8.000	$ 6.760
March 31, 2004	$ 8.600	$ 6.800
December 31, 2003	$ 8.590	$ 6.500
September 30, 2003	$ 6.940	$ 6.030
June 30, 2003	$ 6.950	$ 4.250
March 31, 2003	$ 5.750	$ 3.950

The Company has not paid a dividend on the Class A Stock. The Board of Directors of the Company has not adopted a dividend payment policy; however, dividends must necessarily depend upon the Company's earnings and financial condition, applicable legal restrictions, and other factors relevant at the time the Board of Directors considers a dividend policy. The Company is subject to a loan agreement covenant that prevents it from paying dividends on the Class A Stock without the consent of the lender except to the extent it can meet certain requirements relating to the ratio of its outstanding borrowings compared to dividends and income before interest expense, amortization, depreciation and income tax expense for (5) consecutive quarters and provided that there is no default or potential default under the loan agreement. As of

January 2005, the bank loan covenant precludes the Company from paying any dividends. Cash available for dividends to shareholders of the Company must initially come from income and capital gains earned on its investment portfolio, management service fees and dividends paid by the Insurance Subsidiaries, and Citizens Security s repurchase of its preferred stock owned by the Company. Provisions of the Kentucky Insurance Code subject transactions between the Insurance Subsidiaries and their respective parents, including dividend payments, to certain standards generally intended to prevent such transactions from adversely affecting the adequacy of the Insurance Subsidiaries capital and surplus available to support policyholder obligations. See Item 1. "Description of Business -- State Insurance Regulation." In addition, under the Kentucky Business Corporation Act, the Company may not pay dividends if, after giving effect to a dividend, it would not be able to pay its debts as they become due in the usual course of business or if its total liabilities would exceed its total assets.

Equity Compensation Plan Information

	a	*b*	*c*

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Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders	0	Not applicable	110,000
Equity compensation plans not approved by security holders	0	Not applicable	0
Total	0	Not applicable	110,000

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (a)	Average Price Paid per Share (b)	Total Number of Shares Purchased as part of Publicly Announced Plans or Programs (c)	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs (c)
October 1, 2004 through October 31, 2004	6,000	$7.50	6,000	$147,109
November 1, 2004 through November 30, 2004	0	0	0	0
December 1, 2004 through December 31, 2004	0	0	0	0
Total	6,000	$7.50	6,000	$147,109

(a) The total number of shares purchased from October 1, 2004 through October 31, 2004 represents 6,000 shares repurchased through a privately negotiated transaction.

(b) The average price paid per share of stock repurchased under the stock repurchase program includes any commissions paid to the brokers.

(c) Repurchased pursuant to the stock repurchase program publicly announced on August 12, 1998 under which our Board of Directors authorized the repurchase of up to an aggregate of $1,200,000 of our common stock and amended November 12, 2002 to authorize the repurchase of an additional $250,000. Under the repurchase program, we may repurchase outstanding shares of our common stock from time to time in the open market and through privately negotiated transactions. Unless terminated earlier by resolution of our Board of

Directors, the repurchase program will expire when we have repurchased all shares authorized for repurchase under the repurchase program.

ITEM 6. SELECTED FINANCIAL DATA

Year Ended December 31	2004	2003	2002	2001	2000
RESULTS OF OPERATIONS					
Premiums and other considerations	$27,972,409	$33,586,478	$38,479,150	$28,744,376	$23,822,424
Investment and other income, net	6,517,882	6,161,324	6,093,036	6,530,372	6,291,309
Policy benefits and reserve change	23,525,544	27,574,154	31,878,748	22,989,732	19,400,397
Commissions, expense, amortization, net	13,272,064	13,146,302	13,247,015	11,824,589	10,676,953
Segment profit (loss)	(2,307,317)	(972,654)	(553,577)	460,427	36,383
Realized investment gains (losses), net	2,868,250	1,977,635	(2,469,768)	(7,911,829)	1,180,879
Interest expense	354,200	363,273	305,715	532,962	769,132
Cumulative effect accounting change	---	---	---	(311,211)	---
Income tax expense (benefit)	(48,880)	(70,114)	(757,000)	(2,090,000)	210,000
NET INCOME (LOSS)	$ 255,613	$ 711,822	$(2,572,060)	$(6,205,575)	$ 238,130
NET INCOME (LOSS) APPLICABLE TO COMMON STOCK	$ 255,613	$ 711,822	$(2,572,060)	$(6,205,575)	$ 238,130
NET INCOME (LOSS) PER SHARE:					
Before accounting change	$ 0.15	$ .42	$ (1.50)	$(3.39)	$0.14
Basic	$ 0.15	$ .42	$ (1.50)	$(3.57)	$0.14
FINANCIAL POSITION					
Total assets	$157,270,559	$158,880,332	$ 148,441,532	$136,597,083	$135,538,006
Notes payable	$ 5,791,669	$7,133,335	$7,779,168	$ 7,095,834	$ 8,000,000
Shareholders equity	$ 19,754,351	$20,833,409	$17,757,632	$ 20,002,483	$ 23,274,109
Shareholders equity per share	$11.76	$12.47	$10.53	$11.65	$13.24
INVESTMENTS					
Average cash and invested assets	$135,819,153	$131,440,555	$117,460,459	$112,982,243	$121,807,002
Average equity portfolio (cost basis)	$ 11,269,557	$ 10,030,727	$ 6,966,585	$ 9,736,625	$ 20,017,915
Investment income yield	4.67%	4.5%	4.8%	5.6%	4.9%
Change in unrealized investment gains (losses), net of tax	$ (1,232,672)	$ 2,371,714	$ 466,654	$ 3,019,188	$ (4,896,265)
LIFE INSURANCE DATA					
Premiums	$ 17,621,330	$ 23,943,062	$ 28,948,728	$ 19,362,994	$ 14,553,493
Insurance in force, net at end of period	$653,528,000	$673,571,000	$ 696,520,000	$703,288,000	$706,044,000
HEALTH INSURANCE DATA					
Premiums	$10,351,079	$ 9,643,416	$ 9,530,422	$ 9,381,382	$ 9,268,931
Benefit ratio	71.81%	69.6%	69.5%	67.9%	66.7%

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Note: See Item 7 for additional information relevant to the above data. The above amounts include results from the acquisition of National Affiliated Investors Life Insurance Company (reinsurance assumption) from the date of its acquisition in 2000.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATION

EXECUTIVE SUMMARY

The Company s management continuously monitors the performance of and outlook for the Company by analyzing several indicators that they judge to be critical. The Key indicators of particular interest to management are (a) the general economic environment relative to outlook, (b) trend of premium volume, (c) lapse rates, (d) mortality and morbidity rates (e) trend of general expense levels, (f) asset and capital and surplus growth, (g) general interest rate movements, (h) investment yields, (i) diversity (e.g. by industry) and mix (e.g. between fixed income securities and equity securities) of our investment portfolios and (j) segment performance and trends.

The Company s management has identified the following as major financial, operational and marketing accomplishments during 2004: