

DELPHI FINANCIAL GROUP INC/DE
Form 10-Q
August 08, 2008

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

(Mark One)

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

For the Quarterly Period Ended June 30, 2008

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

For the transition period from _____ to _____

Commission File Number 001-11462

DELPHI FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware

(302) 478-5142

13-3427277

(State or other jurisdiction of
incorporation or organization)

(Registrant's telephone number,
including area code)

(I.R.S. Employer Identification
Number)

1105 North Market Street, Suite 1230, P.O. Box 8985, Wilmington,
Delaware

19899

(Address of principal executive offices)

(Zip 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 filing requirements for the past 90 days:

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes No

As of July 31, 2008, the Registrant had 41,177,716 shares of Class A Common Stock and 5,706,967 shares of Class B Common Stock outstanding.

DELPHI FINANCIAL GROUP, INC.
FORM 10-Q
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AND OTHER INFORMATION

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in Thousands, Except Per Share Data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Revenue:				
Premium and fee income	\$ 340,774	\$ 324,337	\$ 683,064	\$ 646,584
Net investment income	60,750	69,107	93,087	140,410
Net realized investment (losses) gains	(19,499)	937	(25,935)	555
Loss on redemption of junior subordinated deferrable interest debentures underlying company-obligated mandatorily redeemable capital securities issued by unconsolidated subsidiaries				(2,192)
	382,025	394,381	750,216	785,357
Benefits and expenses:				
Benefits, claims and interest credited to policyholders	243,755	235,483	486,667	473,695
Commissions	20,853	20,883	42,120	40,594
Amortization of cost of business acquired	20,222	20,059	36,645	40,951
Other operating expenses	53,608	49,872	105,811	99,820
	338,438	326,297	671,243	655,060
Operating income	43,587	68,084	78,973	130,297
Interest expense:				
Corporate debt	4,289	4,591	8,513	9,645
Junior subordinated debentures	3,246	1,406	6,486	1,406
Junior subordinated deferrable interest debentures underlying company-obligated redeemable capital securities issued by unconsolidated subsidiaries	353	479	757	1,763
	7,888	6,476	15,756	12,814
Income before income tax expense	35,699	61,608	63,217	117,483
Income tax expense	8,824	18,694	15,198	35,375
Net income	\$ 26,875	\$ 42,914	\$ 48,019	\$ 82,108

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Basic results per share of common stock:

Net income	\$ 0.56	\$ 0.85	\$ 0.99	\$ 1.63
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Diluted results per share of common stock:

Net income	\$ 0.55	\$ 0.83	\$ 0.97	\$ 1.59
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Dividends paid per share of common stock	\$ 0.10	\$ 0.09	\$ 0.19	\$ 0.17
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See notes to consolidated financial statements.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands, Except Per Share Data)

	June 30, 2008	December 31, 2007
Assets:		
Investments:		
Fixed maturity securities, available for sale	\$ 3,811,763	\$ 3,691,694
Short-term investments	325,716	286,033
Other investments	631,902	1,010,141
	4,769,381	4,987,868
Cash	43,544	51,240
Cost of business acquired	209,877	174,430
Reinsurance receivables	381,259	402,785
Goodwill	93,929	93,929
Other assets	275,171	260,602
Assets held in separate account	118,592	123,956
Total assets	\$ 5,891,753	\$ 6,094,810
Liabilities and Shareholders' Equity:		
Future policy benefits:		
Life	\$ 295,884	\$ 290,775
Disability and accident	719,541	688,023
Unpaid claims and claim expenses:		
Life	68,622	69,161
Disability and accident	364,407	341,442
Casualty	1,010,692	963,974
Policyholder account balances	1,190,604	1,083,121
Corporate debt	272,750	217,750
Junior subordinated debentures	175,000	175,000
Junior subordinated deferrable interest debentures underlying company-obligated mandatorily redeemable capital securities issued by unconsolidated subsidiaries	20,619	20,619
Other liabilities and policyholder funds	622,447	979,599
Liabilities related to separate account	118,592	123,956
Total liabilities	4,859,158	4,953,420
Shareholders' equity:		
Preferred Stock, \$.01 par; 50,000,000 shares authorized, none issued		
Class A Common Stock, \$.01 par; 150,000,000 shares authorized; 48,847,365 and 48,717,899 shares issued and outstanding, respectively	489	487
Class B Common Stock, \$.01 par; 20,000,000 shares authorized; 5,934,183 shares issued and outstanding	59	59

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Additional paid-in capital	518,109	509,742
Accumulated other comprehensive loss	(155,929)	(42,497)
Retained earnings	867,113	828,116
Treasury stock, at cost; 7,761,216 and 6,227,416 shares of Class A Common Stock, respectively, and 227,216 shares of Class B Common Stock	(197,246)	(154,517)
Total shareholders' equity	1,032,595	1,141,390
Total liabilities and shareholders' equity	\$ 5,891,753	\$ 6,094,810

See notes to consolidated financial statements.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Dollars in Thousands)
(Unaudited)

	Class A Common Stock	Class B Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total
Balance, January 1, 2007	\$ 480	\$ 57	\$ 474,722	\$ 19,133	\$ 763,386	\$ (82,970)	\$ 1,174,808
Cumulative effect adjustment					(82,553)		(82,553)
Adjusted balance, January 1, 2007	480	57	474,722	19,133	680,833	(82,970)	1,092,255
Net income					82,108		82,108
Other comprehensive loss:							
Decrease in net unrealized appreciation on investments				(44,398)			(44,398)
Decrease in net loss on cash flow hedge				392			392
Change in net periodic pension cost				536			536
Comprehensive income							38,638
Issuance of stock, exercise of stock options and share conversions	6	(2)	16,532				16,536
Stock-based compensation			3,462				3,462
Cash dividends					(8,391)		(8,391)
Balance, June 30, 2007	\$ 486	\$ 55	\$ 494,716	\$ (24,337)	\$ 754,550	\$ (82,970)	\$ 1,142,500
Balance, January 1, 2008	\$ 487	\$ 59	\$ 509,742	\$ (42,497)	\$ 828,116	\$ (154,517)	\$ 1,141,390

Net income					48,019		48,019
Other comprehensive loss:							
Increase in net unrealized depreciation on investments				(113,848)			(113,848)
Decrease in net loss on cash flow hedge				392			392
Change in net periodic pension cost				24			24
Comprehensive loss							(65,413)
Issuance of stock, exercise of stock options and share conversions	2		5,145				5,147
Stock-based compensation			3,222				3,222
Acquisition of treasury stock						(42,729)	(42,729)
Cash dividends					(9,022)		(9,022)
Balance, June 30, 2008	\$ 489	\$ 59	\$ 518,109	\$ (155,929)	\$ 867,113	\$ (197,246)	\$ 1,032,595

See notes to consolidated financial statements.

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

	Six Months Ended June 30,	
	2008	2007
Operating activities:		
Net income	\$ 48,019	\$ 82,108
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in policy liabilities and policyholder accounts	108,256	153,073
Net change in reinsurance receivables and payables	16,881	(11,492)
Amortization, principally the cost of business acquired and investments	33,010	40,549
Deferred costs of business acquired	(60,481)	(53,659)
Net realized losses (gains) on investments	25,935	(555)
Net change in federal income tax liability	(24,913)	9,267
Other	15,866	(38,188)
Net cash provided by operating activities	162,573	181,103
Investing activities:		
Purchases of investments and loans made	(706,313)	(665,152)
Sales of investments and receipts from repayment of loans	148,589	249,879
Maturities of investments	317,518	73,720
Net change in short-term investments	(39,683)	173,647
Change in deposit in separate account	3,430	(330)
Net cash used by investing activities	(276,459)	(168,236)
Financing activities:		
Deposits to policyholder accounts	154,302	55,642
Withdrawals from policyholder accounts	(53,226)	(82,476)
Borrowings under revolving credit facility	58,000	38,000
Principal payments under revolving credit facility	(3,000)	(158,000)
Proceeds from the issuance of 2007 Junior Debentures		172,309
Redemption of junior subordinated deferrable interest debentures		(37,728)
Acquisition of treasury stock	(42,729)	
Other financing activities	(7,157)	4,566
Net cash provided (used) by financing activities	106,190	(7,687)
(Decrease) increase in cash	(7,696)	5,180
Cash at beginning of period	51,240	48,204
Cash at end of period	\$ 43,544	\$ 53,384

See notes to consolidated financial statements.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note A Significant Accounting Policies

The financial statements of Delphi Financial Group, Inc. (the Company, which term includes the Company and its consolidated subsidiaries unless the context indicates otherwise) included herein were prepared in conformity with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The information furnished includes all adjustments and accruals of a normal recurring nature, which are in the opinion of management, necessary for a fair presentation of results for the interim periods. Operating results for the three and six months ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ended December 31, 2008. For further information refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2007 (the 2007 Form 10-K). Capitalized terms used herein without definition have the meanings ascribed to them in the 2007 Form 10-K.

Accounting Changes

Fair Value Measurements. As of January 1, 2008, the Company adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, which addresses the manner in which the fair value of companies' assets and liabilities should be measured under GAAP. SFAS No. 157 provides a common definition of fair value and establishes a framework for conducting fair value measures under GAAP, but this statement does not supersede existing guidance on when fair value measures should be used. This standard also requires companies to disclose the extent to which they measure assets and liabilities at fair value, the methods and assumptions they use to measure fair value, and the effect of fair value measures on their earnings. SFAS No.157 establishes a fair value hierarchy of three levels based upon the transparency and availability of information used in measuring the fair value of assets or liabilities as of the measurement date. The levels are categorized as follows:

Level 1 Valuation is based upon quoted prices for identical assets or liabilities in active markets. Level 1 fair value is not subject to valuation adjustments or block discounts.

Level 2 Valuation is based upon quoted prices for similar assets or liabilities in active markets or quoted prices for identical or similar instruments in markets that are not active. In addition, a company may use various valuation techniques or pricing models that use observable inputs to measure fair value.

Level 3 Valuation is generated from techniques in which one or more of the significant inputs are not observable. These inputs may reflect the Company's estimates of the assumptions that market participants would use in valuing the financial assets and financial liabilities.

In February 2008, the FASB issued Staff Position (FSP) FAS 157-2, Effective Date of FASB Statement No. 157 , which delayed the effective date of SFAS No. 157 until January 1, 2009 for certain nonfinancial assets and nonfinancial liabilities. This deferral is not applicable to financial assets and financial liabilities. The adoption of SFAS No. 157 did not have a material effect on the Company's financial condition or results of operations. The Company's fair value measurements are described further in Note C.

Fair Value Option. As of January 1, 2008, the Company adopted SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS No. 159 allows companies to choose, at specified election dates, to measure many financial assets and financial liabilities (as well as certain nonfinancial instruments that are similar to financial instruments) at fair value (the fair value option). The election is made on an instrument-by-instrument basis and is irrevocable. Upon initial adoption, SFAS No. 159 provides entities with a one-time chance to elect the fair value option for existing eligible items, and any differences between the carrying amount of the selected item and its fair value as of the effective date are included in the cumulative-effect adjustment to beginning retained earnings. All subsequent changes in fair value for the instrument elected are reported in earnings. The adoption of SFAS No. 159 did not have an effect on the Company's financial condition or results of operations as the Company elected not to apply the provisions of SFAS No. 159 to any of its existing eligible financial assets or liabilities on the date of

adoption.

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note A Significant Accounting Policies (Continued)

Stock-Based Compensation. As of January 1, 2008, the Company adopted Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 110. SAB No. 110 allows companies to continue using the simplified method as prescribed under SAB No. 107 under certain circumstances to estimate the expected term of options granted in accordance with SFAS No. 123 (Revised), Share-Based Payment. SAB No. 110 permits use of the simplified method when sufficient historical data is not available to provide a reasonable basis upon which to estimate the expected term of the options granted. The assumptions made by the Company with regard to its stock-based compensation are described in Note F.

Recently Issued Accounting Standards

In December 2007, the FASB issued SFAS No. 141 (Revised) (141R), Business Combinations. SFAS No. 141R establishes principles and requirements for how the acquirer in a business combination: (a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, (b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase and (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited specified exceptions. SFAS No. 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier application is prohibited. Assets and liabilities arising from a business combination having an earlier acquisition date are not to be adjusted upon the effectiveness of this statement.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51, which prescribes the accounting for and the financial reporting of a noncontrolling interest in a company's subsidiary, which is the portion of the equity (residual interest) in the subsidiary attributable to owners thereof other than the parent and the parent's affiliates. SFAS No. 160 requires that a noncontrolling interest in a consolidated subsidiary be presented in a consolidated statement of financial position as a separate component of equity and that changes in ownership interests in a consolidated subsidiary that does not result in a loss of control be recorded as an equity transaction with no gain or loss recognized. For a change in the ownership interests in a consolidated subsidiary that results in a loss of control or a deconsolidation, a gain or loss is recognized in the amount of the difference between the proceeds of that sale and the carrying amount of the interest sold. In the case of a deconsolidation, SFAS No. 160 requires the establishment of a new fair value basis for the remaining noncontrolling ownership interest, with a gain or loss recognized for the difference between that new basis and the historical cost basis of the remaining ownership interest. Upon adoption, the amounts of consolidated net income and consolidated comprehensive income attributable to the parent and the noncontrolling interest must be presented separately on the face of the consolidated financial statements. A detailed reconciliation of the changes in the equity of a noncontrolling interest during the period is also required. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Prospective adoption is required with some exceptions. Earlier application of SFAS No. 160 is prohibited. The adoption of SFAS No. 160 is not expected to have a material effect on the Company's consolidated financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of SFAS No. 133. SFAS No. 161 requires entities to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations and (c) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and credit-risk-related contingent features in derivative instruments. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early

application encouraged. In years after initial adoption, SFAS No. 161 requires comparative disclosures only for periods subsequent to initial adoption. SFAS No. 161 is a disclosure standard and as such will not impact the Company's consolidated financial position or results of operations.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP. SFAS No. 162 is effective sixty

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note A Significant Accounting Policies (Continued)

days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." SFAS No. 162 identifies the sources of accounting principles that are generally accepted and categorizes them in descending order of authority and as such will not impact the Company's consolidated financial position or results of operations. In June 2008, the FASB issued FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities." FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings under SFAS No. 128, "Earnings per Share." FSP EITF 03-6-1 provides guidance of calculation of earnings per share for share-based payment awards with rights to dividends or dividend equivalents. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. The adoption of FSP EITF 03-6-1 is not expected to have a material effect on the Company's consolidated financial position or results of operations.

Note B Investments

At June 30, 2008, the Company had fixed maturity securities available for sale with a carrying value and a fair value of \$3,811.8 million and an amortized cost of \$4,030.0 million. At December 31, 2007, the Company had fixed maturity securities available for sale with a carrying value and a fair value of \$3,691.7 million and an amortized cost of \$3,747.0 million.

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

	Amortized Cost	June 30, 2008		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
		(dollars in thousands)		
Mortgage-backed securities	\$ 1,222,779	\$ 19,795	\$ (120,186)	\$ 1,122,388
Corporate securities	1,664,549	13,882	(124,647)	1,553,784
U.S. Treasury and other U.S. Government guaranteed securities	47,711	2,529	(168)	50,072
U.S. Government-sponsored enterprises	22,044	268	(55)	22,257
Obligations of U.S. states, municipalities and political subdivisions	1,072,928	10,660	(20,326)	1,063,262
Total fixed maturity securities	\$ 4,030,011	\$ 47,134	\$ (265,382)	\$ 3,811,763

	Amortized Cost	December 31, 2007		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
		(dollars in thousands)		
Mortgage-backed securities	\$ 1,105,518	\$ 16,306	\$ (55,342)	\$ 1,066,482
Corporate securities	1,533,671	22,985	(52,519)	1,504,137
U.S. Treasury and other U.S. Government guaranteed securities	49,454	2,704		52,158
U.S. Government-sponsored enterprises	153,138	1,112		154,250

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Obligations of U.S. states, municipalities and political subdivisions	905,176	16,370	(6,879)	914,667
Total fixed maturity securities	\$ 3,746,957	\$ 59,477	\$ (114,740)	\$ 3,691,694

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note B Investments (Continued)

The gross unrealized losses and fair value of fixed maturity securities available for sale, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	Less Than 12 Months		June 30, 2008 12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(dollars in thousands)					
Mortgage-backed securities	\$ 525,649	\$ (51,888)	\$ 169,575	\$ (68,298)	\$ 695,224	\$ (120,186)
Corporate securities	588,407	(57,985)	272,982	(66,662)	861,389	(124,647)
U.S. Treasury and other U.S. Government guaranteed securities	5,151	(168)			5,151	(168)
U.S. Government-sponsored enterprises	6,689	(55)			6,689	(55)
Obligations of U.S. states, municipalities & political subdivisions	566,766	(17,056)	44,075	(3,270)	610,841	(20,326)
Total fixed maturity securities	\$ 1,692,662	\$ (127,152)	\$ 486,632	\$ (138,230)	\$ 2,179,294	\$ (265,382)

	Less Than 12 Months		December 31, 2007 12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(dollars in thousands)					
Mortgage-backed securities	\$ 285,684	\$ (26,938)	\$ 240,650	\$ (28,404)	\$ 526,334	\$ (55,342)
Corporate securities	449,456	(33,191)	229,845	(19,328)	679,301	(52,519)
U.S. Treasury and other U.S. Government guaranteed securities						
U.S. Government-sponsored enterprises						
Obligations of U.S. states, municipalities & political subdivisions	264,460	(6,711)	2,586	(168)	267,046	(6,879)
Total fixed maturity securities	\$ 999,600	\$ (66,840)	\$ 473,081	\$ (47,900)	\$ 1,472,681	\$ (114,740)

The Company regularly evaluates its investment portfolio utilizing its established methodology to determine whether declines in the fair values of its investments are other than temporary. The gross unrealized losses at June 30, 2008 are attributable to over thirteen hundred fifty fixed maturity security positions, with no unrealized loss associated with any one security exceeding \$6.4 million. At June 30, 2008 approximately 22% of the aggregate gross unrealized losses were attributable to fixed maturity security positions as to which the unrealized loss represents 10% or less of the amortized cost for such security. Unrealized losses attributable to fixed maturity securities having investment grade ratings by nationally recognized statistical rating organizations at June 30, 2008 comprised 80% of the aggregate gross unrealized losses, with the remainder of such losses being attributable to non-investment grade fixed maturity securities. For fixed maturity securities, management evaluated, among other things, the financial position and prospects of the issuers, conditions in the issuers' industries and geographic areas, liquidity of the investments, changes in the amount or timing of expected cash flows from the investment, recent changes in credit ratings by nationally recognized rating agencies and the length of time and extent to which the fair value of the investment is lower than amortized cost. Based on these evaluations, and taking into account the Company's ability and intent to retain the investments to allow for the anticipated recovery in their fair values, management concluded that the unrealized losses reflected in the table above were temporary.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note B Investments (Continued)

Net investment income was attributable to the following:

	Three Months Ended		Six Months Ended June 30,	
	June 30, 2008	2007	2008	2007
	(dollars in thousands)			
Gross investment income:				
Fixed maturity securities, available for sale	\$ 62,743	\$ 57,074	\$ 107,087	\$ 111,690
Mortgage loans	3,229	5,650	7,202	11,731
Short-term investments	1,981	2,875	5,124	6,824
Other	62	11,336	(10,835)	29,841
	68,015	76,935	108,578	160,086
Less: Investment expenses	(7,265)	(7,828)	(15,491)	(19,676)
	\$ 60,750	\$ 69,107	\$ 93,087	\$ 140,410

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note C Fair Value Measurements

As of January 1, 2008, the Company adopted SFAS No. 157, which addresses the manner in which the fair value of companies' assets and liabilities should be measured under GAAP. For a discussion of the SFAS No. 157 framework, see Note A.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	Total	June 30, 2008		Level 3
		Level 1	Level 2	
(dollars in thousands)				
Assets:				
Fixed maturity securities, available for sale:				
Mortgage-backed securities	\$ 1,122,388	\$	\$ 1,084,251	\$ 38,137
Corporate securities	1,553,784		1,021,264	532,520
U.S. Treasury and other U.S. Government guaranteed securities	50,072	23,575	24,753	1,744
U.S. Government-sponsored enterprise securities	22,257		22,257	
Obligations of U.S. states, municipalities and political subdivisions	1,063,262		1,063,262	
Other investments	153,870	125,937		27,933
Assets held in separate account	118,592			118,592
Total	\$ 4,084,225	\$ 149,512	\$ 3,215,787	\$ 718,926
Liabilities:				
Other liabilities	\$ 69,093	\$ 69,093	\$	\$

The following table provides a reconciliation of the beginning and ending balance of Level 3 assets measured at fair value on a recurring basis:

	Six Months Ended June 30, 2008						
	Total	Mortgage- backed Securities	Corporate Securities	U.S. Treasury and Other U.S. Government Guaranteed Securities	U.S. Government- sponsored Enterprise Securities	Other Investments	Assets held in Separate Account
(dollars in thousands)							
Balance at beginning of year	\$ 1,060,154	\$ 302,852	\$ 476,299	\$	\$ 129,993	\$ 27,054	\$ 123,956
Total (losses) gains Included in earnings	(19,767)	(11,012)	(3,507)		42	74	(5,364)
Included in other comprehensive loss	(58,177)	(24,764)	(34,513)		(93)	1,193	

Purchases, issuances and settlements	(16,133)	9,033	100,222		(125,000)	(388)
Net transfer (out) in of Level 3	(247,151)	(237,972)	(5,981)	1,744	(4,942)	
Balance at end of the period	\$ 718,926	\$ 38,137	\$ 532,520	\$ 1,744	\$	\$ 27,933 \$ 118,592
Net (losses) gains included in earnings attributable to the net change in unrealized gains or losses or assets measured at fair value using unobservable inputs and held at June 30, 2008	\$ (3,746)	\$	\$ (3,344)	\$	\$	\$ (402) \$

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note D Segment Information

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(dollars in thousands)			
Revenues:				
Group employee benefit products	\$ 366,949	\$ 355,656	\$ 715,030	\$ 711,733
Asset accumulation products	23,384	26,886	39,900	54,579
Other ⁽¹⁾	11,191	10,902	21,221	20,682
	401,524	393,444	776,151	786,994
Net realized investment (losses) gains	(19,499)	937	(25,935)	555
Loss on redemption of junior subordinated deferrable interest debentures underlying the Company-obligated mandatorily redeemable capital securities issued by unconsolidated subsidiaries				(2,192)
	\$ 382,025	\$ 394,381	\$ 750,216	\$ 785,357
Operating income:				
Group employee benefit products	\$ 63,342	\$ 64,315	\$ 107,792	\$ 128,074
Asset accumulation products	6,699	8,855	10,750	17,166
Other ⁽¹⁾	(6,955)	(6,023)	(13,634)	(13,306)
	63,086	67,147	104,908	131,934
Net realized investment (losses) gains	(19,499)	937	(25,935)	555
Loss on redemption of junior subordinated deferrable interest debentures underlying the Company-obligated mandatorily redeemable capital securities issued by unconsolidated subsidiaries				(2,192)
	\$ 43,587	\$ 68,084	\$ 78,973	\$ 130,297

(1) Primarily consists of operations from integrated disability and absence management services and

certain
corporate
activities.

Note E Comprehensive (Loss) Income

Total comprehensive (loss) income is comprised of net income and other comprehensive (loss) income, which includes the change in unrealized gains and losses on securities available for sale, change in net periodic pension cost and the change in the loss on the cash flow hedge described in the 2007 Form 10-K. Total comprehensive (loss) income was \$(65.4) million and \$38.6 million for the first six months of 2008 and 2007, respectively, and \$(18.2) million and \$(1.4) million for the second quarters of 2008 and 2007, respectively. The changes in such amounts, as between the current and prior year periods, are primarily attributable to increased in unrealized losses in the Company's fixed maturity securities.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note F Stock-Based Compensation

The Company recognized stock-based compensation expenses of \$5.3 million and \$4.5 million in the first six months of 2008 and 2007, respectively, of which \$2.7 million and \$2.3 million was recognized in the second quarter of 2008 and 2007, respectively. The remaining unrecognized compensation expense related to unvested awards at June 30, 2008 was \$25.0 million and the weighted average period of time over which this expense will be recognized is 3.7 years.

The fair values of options were estimated at the grant date using the Black-Scholes option pricing model with the following weighted average assumptions for the first half of 2008: expected volatility 19.2%, expected dividends 1.3%, expected lives of the options 6.9 years and the risk free rate 3.2%. The following weighted average assumptions were used for the first half of 2007: expected volatility 19.6%, expected dividends 0.8%, expected lives of the options 6.5 years and the risk free rate 4.7%.

The expected volatility reflects the Company's past monthly stock price volatility. The Company used the historical average period from the Company's issuance of an option to its exercise or cancellation and the average remaining years until expiration for the Company's outstanding options to estimate the expected life of options granted in the first half of 2008 for which the Company had sufficient historical exercise data. The Company used the simplified method in accordance with SAB No. 110 for options granted in the first half of 2008 for which sufficient historical data was not available due to significant differences in the vesting periods of these grants compared to previously issued grants. The expected lives of options granted in the first half of 2007 were calculated using the simplified method in accordance with SAB No. 107. The dividend yield is based on the Company's historical dividend payments. The risk-free rate is derived from public data sources at the time of each option grant. Compensation cost for service-based options is recognized over the requisite service period of the option using the straight-line method.

Option activity with respect to the Company's plans, excluding the performance-contingent incentive options referenced further below, was as follows:

Options	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In Years)	Aggregate Intrinsic Value (\$000)
Outstanding at January 1, 2008	3,260,251	\$27.15		
Granted	990,231	28.81		
Exercised	(63,770)	19.05		
Forfeited	(20,295)	35.11		
Expired	(13,575)	25.05		
Outstanding at June 30, 2008	4,152,842	27.64	6.2	\$8,215
Exercisable at June 30, 2008	2,024,559	\$21.76	3.3	\$8,214

The weighted average grant date fair value of options granted during the first half of 2008 and 2007 was \$6.75 and \$11.91, respectively, and during the second quarter of 2008 and 2007 was \$5.49 and \$12.12, respectively. The cash proceeds from stock options exercised were \$0.4 million and \$7.1 million for the first half of 2008 and 2007, respectively. The total intrinsic value of options exercised during the first half of 2008 and 2007 was \$3.8 million and \$9.1 million, respectively.

At June 30, 2008, 4,438,250 performance contingent incentive options were outstanding with a weighted average exercise price of \$25.95, a weighted average contractual term of 6.8 years and an intrinsic value of \$5.2 million. 2,053,250 options with a weighted average exercise price of \$22.24, a weighted average contractual term of 5.2 years and an intrinsic value of \$5.2 million were exercisable at June 30, 2008.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note G Computation of Results per Share

The following table sets forth the calculation of basic and diluted results per share:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(amounts in thousands, except per share data)			
Numerator:				
Net income	\$ 26,875	\$ 42,914	\$ 48,019	\$ 82,108
Denominator:				
Weighted average common shares outstanding	48,146	50,441	48,600	50,309
Effect of dilutive securities	854	1,293	976	1,292
Weighted average common shares outstanding, assuming dilution	49,000	51,734	49,576	51,601
Basic results per share of common stock:				
Net income	\$ 0.56	\$ 0.85	\$ 0.99	\$ 1.63
Diluted results per share of common stock:				
Net income	\$ 0.55	\$ 0.83	\$ 0.97	\$ 1.59

DELPHI FINANCIAL GROUP, INC.
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

The Company, through its subsidiaries, underwrites a diverse portfolio of group employee benefit products, primarily disability, group life and excess workers' compensation insurance. Revenues from this group of products are primarily comprised of earned premiums and investment income. The profitability of group employee benefit products is affected by, among other things, differences between actual and projected claims experience, the retention of existing customers, product mix and the Company's ability to attract new customers, change premium rates and contract terms for existing customers and control administrative expenses. The Company transfers its exposure to a portion of its group employee benefit risks through reinsurance ceded arrangements with other insurance and reinsurance companies. Accordingly, the profitability of the Company's group employee benefit products is affected by the amount, cost and terms of reinsurance it obtains. The profitability of those group employee benefit products for which reserves are discounted; in particular, the Company's disability and primary and excess workers' compensation products, is also significantly affected by the difference between the yield achieved on invested assets and the discount rate used to calculate the related reserves. The Company continues to benefit from the favorable market conditions which have in recent years prevailed for its excess workers' compensation products as to pricing and other contract terms for these products; however, due primarily to improvements in the primary workers' compensation market resulting in lower premium rates in that market, conditions relating to new business production and growth in premiums for these products are less favorable at present. In addition, the Company is presently experiencing more competitive market conditions, particularly as to pricing, for its other group employee benefit products. These conditions may impact the Company's ability to achieve levels of new business production and growth in premiums for these products commensurate with those achieved in recent years. For these products, the Company is continuing to enhance its focus on the small case niche (insured groups of 10 to 500 individuals), including employers which are first-time providers of these employee benefits, which the Company believes to offer opportunities for superior profitability. The Company is also emphasizing its suite of voluntary group insurance products, which includes, among others, its group limited benefit health insurance product. The Company markets its other group employee benefit products on an unbundled basis and as part of an integrated employee benefit program that combines employee benefit insurance coverages and absence management services. The integrated employee benefit program, which the Company believes helps to differentiate itself from competitors by offering clients improved productivity from reduced employee absence, has enhanced the Company's ability to market its other group employee benefit products to large employers.

The Company also operates an asset accumulation business that focuses primarily on offering fixed annuities to individuals. In addition, during the first quarter of 2006, the Company issued \$100 million in aggregate principal amount of fixed and floating rate funding agreements with maturities of three to five years in connection with the issuance by an unconsolidated special purpose vehicle of funding agreement-backed notes in a corresponding principal amount. The Company believes that the funding agreement program enhances the Company's asset accumulation business by providing an alternative source of distribution for this business. The Company's liabilities for the funding agreements are recorded in policyholder account balances. Deposits from the Company's asset accumulation business are recorded as liabilities rather than as premiums. Revenues from the Company's asset accumulation business are primarily comprised of investment income earned on the funds under management. The profitability of asset accumulation products is primarily dependent on the spread achieved between the return on investments and the interest credited to holders of these products. The Company sets the crediting rates offered on its asset accumulation products in an effort to achieve its targeted interest rate spreads on these products, and is willing to accept lower levels of sales on these products when market conditions make these targeted spreads more difficult to achieve.

The management of the Company's investment portfolio is an important component of its profitability. Over the second half of 2007 and continuing in the first half of 2008, due to the extraordinary decline in housing prices and the consequences in the credit markets, particularly the structured mortgage securities market, the investment markets

have been the subject of substantially increased volatility and dramatically widened spreads in certain sectors. At the same time the overall level of risk-free interest rates has declined substantially. These market conditions have resulted in a high degree of variability in the carrying values of certain portions of its investment portfolio. Such conditions may persist or worsen in the future, and, in the cases of those investments whose changes in value, positive or negative, are included in the Company's net investment income, such as investment funds organized as limited partnerships and limited liability companies, trading account securities and hybrid financial instruments, this variability may continue to result in significant fluctuations in net investment income, and as a result, in the Company's results of operations. In addition, the Company may determine that declines in market value relative to cost of certain securities are other than temporary; in which event the declines will be reported as realized investment losses in the Company's results of operations.

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The following discussion and analysis of the results of operations and financial condition of the Company should be read in conjunction with the Consolidated Financial Statements and related notes included in this document, as well as the Company's annual report on Form 10-K for the year ended December 31, 2007 (the 2007 Form 10-K). Capitalized terms used herein without definition have the meanings ascribed to them in the 2007 Form 10-K. The preparation of financial statements in conformity with GAAP requires management, in some instances, to make judgments about the application of these principles. The amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period could differ materially from the amounts reported if different conditions existed or different judgments were utilized. A discussion of how management applies certain critical accounting policies and makes certain estimates is contained in the 2007 Form 10-K in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates" and should be read in conjunction with the following discussion and analysis of results of operations and financial condition of the Company. In addition, a discussion of uncertainties and contingencies which can affect actual results and could cause future results to differ materially from those expressed in certain forward-looking statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations can be found below under the caption "Forward-Looking Statements And Cautionary Statements Regarding Certain Factors That May Affect Future Results," in Part I, Item 1A of the 2007 Form 10-K, "Risk Factors."

Results of Operations

Six Months Ended June 30, 2008 Compared to

Six Months Ended June 30, 2007

Summary of Results. Net income was \$48.0 million, or \$0.97 per diluted share, in the first half of 2008 as compared to \$82.1 million, or \$1.59 per diluted share, in the first half of 2007. Net income in the first half of 2008 and 2007 included realized investment (losses) gains (net of the related income tax (benefit) expense) of \$(16.9) million, or \$(0.34) per diluted share, and \$0.4 million, or \$0.01 per diluted share, respectively. Net income in the first half of 2008 benefited from growth in income from the Company's core group employee benefit products and was adversely impacted by realized investment losses and a significant decrease in net investment income. Core group employee benefit products include disability, group life, excess workers' compensation, travel accident and dental insurance. Premiums from these core group employee benefit products increased 6% in the first half of 2008. The combined ratio (loss ratio plus expense ratio) for group employee benefit products decreased to 91.6% in the first half of 2008 from 92.8% in the first half of 2007. In the first half of 2008 and 2007, realized investment losses included losses of \$(24.3) million and \$(1.9) million, respectively, due to the other than temporary declines in the market values of certain fixed maturity and other securities. Net investment income decreased in the first half of 2008 from the first half of 2007 due to a lower tax equivalent weighted average annualized yield on invested assets of 4.2% in the 2008 period as compared to 6.5% for the prior period.

Premium and Fee Income. Premium and fee income in the first half of 2008 was \$683.1 million as compared to \$646.6 million in the first half of 2007, an increase of 6%. Premiums from core group employee benefit products increased 6% to \$648.3 million in the first half of 2008 from \$609.7 million in the first half of 2007. This increase reflects normal growth in employment and salary levels for the Company's existing customer base, price increases, and new business production. Premiums from excess workers' compensation insurance for self-insured employers were \$130.7 million in the first half of 2008 as compared to \$141.1 million in the first half of 2007. Excess workers' compensation premiums in the first half of 2007 included \$3.5 million of 2006 policy year premiums from Canadian policies assumed by SNCC in the first quarter of 2007 under the renewal rights agreement into which SNCC entered in 2005 (the Renewal Rights Agreement), pursuant to Canadian regulatory approval received in the first quarter of 2007. Excess workers' compensation new business production, which represents the amount of new annualized premium sold, was \$8.0 million in the first half of 2008 compared to \$19.5 million in the first half of 2007, which included new business production of \$3.4 million from the Renewal Rights Agreement. The retention of existing customers in the first half of 2008 remained strong. In its July 2008 renewal season, which is not reflected in the Company's results for the first half of 2008, SNCC's rates declined modestly and SIRs were on average up modestly on new and renewal policies, excluding Canadian policies written under the Renewal Rights Agreement.

Premiums from the Company's other core group employee benefit products increased 10% to \$517.6 million in the first half of 2008 from \$468.6 million in the first half of 2007, primarily reflecting a 12% increase in premiums from the Company's group life products, a 9% increase in premiums from the Company's disability products and new business production. During the first half of 2008, premiums from the Company's group life products increased to \$201.0 million from \$179.7 million in the first half of 2007, primarily reflecting new business production and a decrease in premiums ceded by the Company to reinsurers. During the first half of 2008, premiums from the Company's group disability products increased to \$282.8 million from \$259.1 million in the first half of 2007, primarily reflecting new business production. Premiums from the Company's turnkey disability business were \$24.1 million and \$25.5 million in the first half of 2008 and 2007, respectively. New business production for the Company's other core group employee benefit products was \$111.7 million and \$128.2 million in the first half of 2008 and

2007, respectively. New business production includes only directly written business, and does not include premiums from the Company's turnkey disability business. The level of production achieved from these other core group employee benefit products also reflects the Company's focus on the small case niche (insured groups of 10 to 500 individuals). The Company continues to implement price increases for certain existing group disability and group life insurance customers.

Non-core group employee benefit products include LPTs, primary workers' compensation, bail bond insurance, workers' compensation reinsurance and reinsurance facilities. Premiums from non-core group employee benefit products were \$14.8 million in the first half of 2008 as compared to \$19.4 million in the first half of 2007, primarily due to a lower level of premium from LPTs, which are episodic in nature.

Deposits from the Company's asset accumulation products were \$151.8 million in the first half of 2008 as compared to \$51.2 million in the first half of 2007. This increase in deposits is primarily due to increased sales of the Company's multi-year rate guarantee products. Deposits from the Company's asset accumulation products, consisting of new annuity sales and issuances of funding agreements, are recorded as liabilities rather than as premiums.

Net Investment Income. Net investment income in the first half of 2008 was \$93.1 million as compared to \$140.4 million in the first half of 2007. This decrease reflects a decrease in the tax equivalent weighted average annualized yield on invested assets to 4.2% for the