

FOCUSED THINKING
MEASURED STEPS
STEADY GROWTH

~

annual report

Universal American Financial Corp.

2002

FINANCIAL HIGHLIGHTS

(In thousands, except per share data)

AS OF OR FOR THE YEARS ENDED DECEMBER 31,

	2002	2001	2000
INCOME STATEMENT AND OTHER DATA			
Premium In Force	\$ 619,170	\$ 555,939	\$ 485,617
Total Revenues	331,523	300,943	284,091
Pretax Income	44,030	43,363	33,066
Net Income	30,127	28,925	22,885
PER SHARE DATA (Diluted)			
Net Operating Income ⁽¹⁾	\$ 0.62	\$ 0.53	\$ 0.48
Net Income	0.56	0.57	0.49
Book Value ⁽²⁾	4.77	4.21	3.58
BALANCE SHEET DATA			
Total Assets	\$1,401,668	\$1,270,216	\$1,189,864
Stockholders' Equity	286,769	230,770	173,949

⁽¹⁾ Net operating income represents net income excluding realized gains and losses, net of tax. Management believes that realized gains and losses are not indicative of overall operating trends.

⁽²⁾ Diluted book value per share represents total stockholders' equity, excluding accumulated other comprehensive income, plus assumed proceeds from the exercise of vested options, divided by the total shares outstanding plus the shares assumed issued from the exercise of vested options. Accumulated other comprehensive income includes the after tax net unrealized gain (loss) on available for sale securities and unrealized foreign exchange gain (loss).

UNIVERSAL AMERICAN FINANCIAL CORP.

CORPORATE OVERVIEW

Universal American Financial Corp. has 900 employees, \$1.4 billion in assets and a history of profitable growth.

We offer a portfolio of supplemental life and health insurance products to the growing senior and self-employed markets, and administrative services for insured and non-insured programs in the senior market. Our company operates in the United States and Canada, where we are better known by the names of our insurance companies and services.

1.

Senior Market Brokerage

American Pioneer Life Insurance Company
Constitution Life Insurance Company
American Progressive Life
and Health Insurance Company of New York

2.

Career Agency

Pennsylvania Life Insurance Company
Penncorp Life Insurance Company (Canada)
Pyramid Life Insurance Company

3.

Administrative Services

CHCS Services, Inc.

FOCUSED THINKING*

2.1

TO OUR SHAREHOLDERS:

*

Amidst one of the most turbulent periods in recent memory, *Universal American Financial Corp.* has continued to execute its *focused business plan and maintain its steady growth.*

While we are not completely insulated from external events, we have chosen to concentrate on businesses that are less likely to be affected by economic variances and are more influenced by predictable demographic trends.

“One of the most exciting aspects about our company is that we are always exploring new ideas and innovative approaches that make the best use of the core competencies of our company.”

We have remained faithful to the business plan and strategy that we have outlined in past years, and, with few exceptions, we have consistently been able to deliver on the goals that we set out for our company.

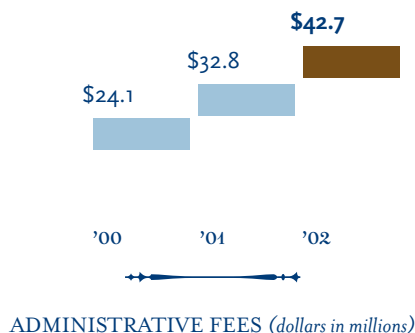
In the past year, all of our key corporate skills were displayed. Each one of our operating segments achieved record revenues and profitability, through a combination of strong sales and improved risk management. After a couple of years of patiently searching for deals that fit our increasingly narrow criteria, we closed an important company acquisition, Pyramid Life, and a smaller reinsurance transaction, each of which should add profitability and further our strategic vision. Finally, we were able to access the capital markets to fund our growth and acquisitions in a manner that befits the improvement in our operating and financial condition over the past several years.

The past year was notable for more than just our financial results. As we build our company, we think more about our primary market – the aging American

population – and how we can expand and improve upon our current offerings. One of the most exciting aspects about our company is that we are always exploring new ideas and innovative approaches that make the best use of the core competencies of our company.

CORPORATE GOVERNANCE

The highly publicized accounting scandals and the resulting enactment of the Sarbanes-Oxley Act of 2002 brought the issues of corporate governance to the forefront in the past year. Even when Universal American was a much smaller company, we always practiced the principles of responsible corporate governance, and as such we have not had to make many structural changes in response to the newly enacted laws and regulations. Nevertheless, we embrace the new rules as an impetus to institute new procedures and processes that are designed to further improve our internal controls and the quality of our financial reporting. We have renewed our efforts to state our financial results and other



disclosures in manners that are clear and easy to understand. We have paid particular attention to conforming to the rules that require us to explain how the metrics we use to measure our success conform to reported GAAP results.

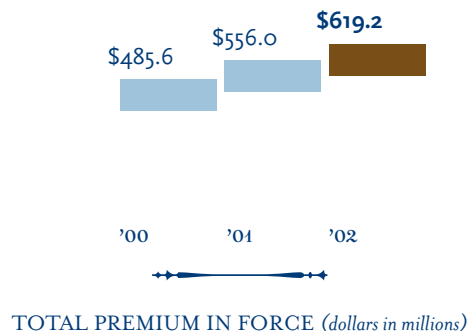
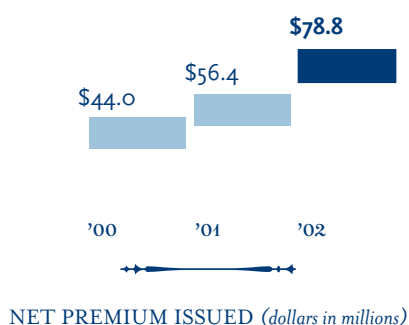
MARKETING OUR INSURANCE PRODUCTS

Universal American has identified two markets – seniors in the United States and self-employed throughout Canada and certain regions of this country – and concentrates its efforts on providing basic protection and asset accumulation products to these groups that are growing faster than the rest of the population.

We sell our insurance products through two types of marketing channels: brokerage and career sales. We have been able to expand our sales reach through the growth of our senior market brokerage division and we continue to open new states and create new relationships with independent producers throughout the country.

Through 2001, the large number of disenrollments from HMO's accelerated our new sales of Medicare products. As this trend diminished in 2002, we experienced an expected modest decrease in new issued premium. In anticipation of this development, we took proactive steps to continue to build our net revenues. First, we decreased the amount of premium that we ceded to our reinsurers. As our capital base has strengthened, we are able to absorb more net premium. In addition, we have begun to emphasize the sale of senior life insurance and simple asset accumulation products.

We are particularly excited about the growth potential in our career sales operations, especially with the addition of Pyramid Life. It is tougher to build a loyal sales force that sells only our products, but the benefits of controlled distribution, particularly better loss experience and higher persistency, more than justify the effort.



“Management of insurance risk is the most important determinant of the success of our company.”

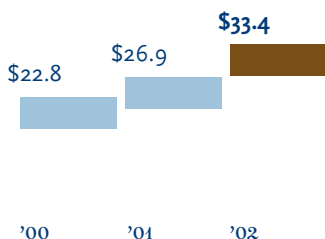
Again, our Canadian operation was an important contributor to our growth and profitability. As a result of increased recruiting and productivity, our Canadian sales increased by 17 percent in 2002.

MANAGING RISK – PRODUCTS

Management of insurance risk is the most important determinant of the success of our company. With one notable exception, our pricing and underwriting discipline resulted in meaningful loss ratio improvements in our major lines of business, which drove our increased profitability. Unfortunately, we began last year to experience adverse development in one block of discontinued home health care insurance, which impacted an otherwise strong performance in our senior market brokerage segment. We have implemented steps to mitigate the adverse effects of this block.

MANAGING RISK – INVESTMENT PORTFOLIO

The goal for our investment portfolio is to provide a source of safe and predictable cash flow to support the benefits promised in our products. Following our 1999 acquisitions, we made a concerted effort to improve the quality of our investment portfolio and by 2002, we had reduced our holdings in non-investment-grade securities significantly. As we learned the hard way in the WorldCom debacle, an investment-grade designation is not a guarantee of performance. As a result, we adopted an even more conservative posture as we not only continued to improve quality but also reduced certain sector and single issue exposures. The result is a portfolio with an aggregate rating of AA-, containing less than 1 percent invested in less-than-investment-grade securities (as defined by S&P) and having a market value of \$50 million in excess of its carrying value.



NET OPERATING INCOME (dollars in millions)

Net operating income represents net income excluding realized gains and losses, net of tax. Management believes that realized gains and losses are not indicative of overall operating trends.

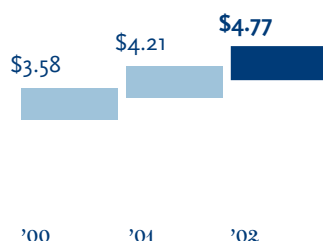
ACQUISITION OF PYRAMID LIFE

Universal American has always viewed selective acquisitions as a core part of its long-term growth strategy. We have, however, become increasingly discriminating about what we consider to be an appropriate acquisition for our company. Not only must a potential acquisition fit our rigorous financial criteria, it must also be a strategic fit as well. We believe that the acquisition of Pyramid Life, which closed in March 2003, hits both of these marks.

Pyramid Life has built a highly skilled career agency operation that has specialized in selling senior market health insurance products. As we did successfully after we acquired Pennsylvania Life and Penncorp Life, we will expand the Pyramid Life product offerings and we expect to see the Pyramid Life agents sell more life insurance and asset accumulation products.

This acquisition will also increase scale in our senior market operations and should result in meaningful synergies when we integrate Pyramid Life's \$110 million of annualized premium in force into our operating centers by the end of 2003.

The acquisition of Pyramid Life also gave us the opportunity to improve the capital structure of Universal American. We were able to refinance our debt on better terms, and we have issued a significant amount of Trust Preferred securities which gives us permanent financing without diluting equity ownership. One of the marks of how far we have come as a company is the fact that we were able to raise the capital necessary for the acquisition on favorable terms in a difficult environment.



BOOK VALUE PER DILUTED SHARE

Diluted book value per share represents total stockholders' equity, excluding accumulated other comprehensive income, plus assumed proceeds from the exercise of vested options, divided by the total shares outstanding plus the shares assumed issued from the exercise of vested options. Accumulated other comprehensive income includes the after tax net unrealized gain (loss) on available for sale securities and unrealized foreign exchange gain (loss).

“Financially, 2002 was a terrific year for Universal American as we achieved record revenues and profits in all of our operating segments.”

**ADMINISTRATIVE SERVICES –
CHCS SERVICES, INC.**

CHCS Services, Inc., our administrative services company, contributes financially and strategically to the success of our company. Not only does CHCS Services add profits and cash flow, it also gives us insight into the issues that face seniors and the companies that create insurance products for them. This perspective is gained from working with leading insurance and health care companies, and servicing policyholders. In any given month CHCS Services manages the care of 5,200 seniors and the company has managed over 100,000 long term care clients to date. Nurse Navigator, our noninsurance program offering long term care discounts and advice, is one example of the innovative thinking that has come out of this segment.

THE RESULTS

Financially, 2002 was a terrific year for Universal American as we achieved record revenues and profits in all of our operating segments. With the momentum that we have established, boosted by the addition of Pyramid Life, we look forward to continued good results.

As always, I would like to thank our loyal producers and dedicated employees who continue to contribute so much to the success of Universal American. To our policyholders, we will continue to work hard to justify your faith in our company. Finally, to our investors we renew our dedication to building shareholder value and to running our company in accordance with the spirit and letter of good corporate governance.



A handwritten signature in blue ink that reads "R. A. Barasch".

RICHARD A. BARASCH
Chairman and
Chief Executive Officer

MEASURED STEPS*

p. 7

* Universal American has built a successful business by making *smart moves at the right time*. Through acquisitions and new product and process introductions, we've expanded our three operations – Senior Market Brokerage, Career Agency and Administrative Services – and grown premiums, sales and profits year after year. In 2002, we added new products, brought in additional agents, entered more markets and made another key acquisition. With measured steps, we continue to move forward.

Universal American Financial Corp. is organized into three business segments each with its own set of respected brand names, products and services. The hallmark of all these businesses is a commitment to high quality and sound solutions.

- * Senior Market Brokerage focuses on the sale of senior market insurance products through independent marketing organizations.
- * Career Agency comprises a field force that distributes insurance products exclusively on our behalf, to the senior and self-employed markets in the United States and Canada.
- * Administrative Services is a third-party administrator and service provider for senior health insurance products and services offered by both affiliated and unaffiliated insurance companies.

All three of our businesses are dedicated to meeting market needs. We deliver on our promises to the seniors and self-employed workers who purchase our products, the agents who represent our company in the field, and the insurers and health care companies who count on us to administer their senior market and long term care programs.

Our understanding of the customers and markets we serve has enabled us to become one of the leading senior market life and health insurers and one of the foremost administrators of senior market insurance and non-insured programs.

UNIVERSAL AMERICAN FINANCIAL CORP.

1.
Senior Market
Brokerage



2.
Career
Agency



3.
Administrative
Services



Senior Market Brokerage

p. 9

The addition of new products, agents and markets – coupled with undeniable demographics – continues to drive strong growth in our senior market brokerage business.

For the second year in a row, we added more than 3,000 licensed agents to our distribution network. We also continued our geographic expansion, entering seven new states. As a result, revenues rose nearly 30 percent and gross premiums climbed 20 percent in 2002.

We have built our distribution on the strength of our Medicare products. Our strategy now is to build on the marketing relationships that we have developed to sell our other senior-oriented products, including life insurance and annuities. In 2002, our sales of life insurance increased by 19 percent and our sales of annuities more than doubled. One of our core strategies for 2003 is to refresh our product lines and increase our sale of these products.

We are particularly excited about expanding Medicare select offerings, which provide the same benefits as

Medicare supplement but at a lower cost due to hospital PPO discounts. We are expanding our networks and now sell this product in 14 states.

We have – and are enhancing – the right protection and asset accumulation products to meet the needs of our aging population. We continue to look for new and innovative products. In 2003, we will introduce two new dental insurance products for seniors, and a new series of senior life insurance products with long term care riders and customer-friendly payment plans.

Our distribution channel for these products continues to widen. Since 2001, our agent network has grown 40 percent and we have expanded our geographic penetration from 19 states to 33 states – with plans to add approximately one state per quarter going forward.

Our senior market brokerage business is staying true to its formula for success, combining strong senior products, excellent service and an agent-friendly environment to drive growth now – and in the years to come.

Universal American provides a full line of senior market products through American Pioneer, American Progressive and Constitution Life.



GARY BRYANT
Executive Vice President
and Chief Operating Officer

Career Agency

2002 was a milestone year for our career agency business, marked by a strong move into the senior market and a strategic acquisition. Since we joined forces with the career agents in 1999, we have made constant progress in building this part of our business. At the outset, we focused on cost controls and risk management to generate profitability. Starting in 2001 and accelerating into 2002, we began to realize the marketing potential that we had anticipated. Now, with the addition of Pyramid Life, we have more than 2,200 career agents in 38 states in the United States and all provinces of Canada.

The agents of Pennsylvania Life and Penncorp Life (Canada) have historically sold income protection products for self-employed customers. Working from more than 100 offices strategically located in small cities and rural areas through the United States and Canada, our career agents are positioned to meet the needs of contractors, farmers and small business owners. That formula has continued to work particularly well in Canada, as Penncorp Life has built a valuable and profitable franchise in this niche market. Our strong sales management leadership increased new business in Canada by 12 percent in 2002.

In the United States, our strategy has been to augment the traditional income protection business with a growing senior market emphasis. Pennsylvania Life has a strong portfolio of senior market products, which we can cross-sell to existing customers. In 2002, new sales increased by

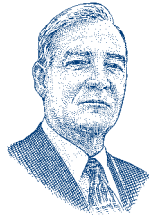
9 percent, and 49 percent of new life and accident & health sales were in senior market products. Annuity sales, which jumped 400 percent in 2002 to \$32 million, is another attractive offering to our policyholders – and another important revenue stream for our career agency business.

The acquisition of Pyramid Life is in keeping with our strategy to build our career agency with an emphasis on the senior market.

With this acquisition, we will be adding more than \$110 million of in-force premium, and an additional 1,000 career agents who sold more than \$25 million of senior market products in 2002.

Our unique career agency model works extremely well for our products and core markets. With the addition of Pyramid Life to our vibrant base, our career sales division is well positioned for increased sales and profitability.

Universal American's career agents sell accident and sickness disability and senior market health and life coverage exclusively on our behalf through Pennsylvania Life Insurance Company, Penncorp Life Insurance Company, and most recently, Pyramid Life Insurance Company.



BILL WEHNER
President
Pennsylvania Life



PAUL EDMONDSON
President
Penncorp Life (Canada)

Administrative Services

11

A steady pipeline of new business and improvements to our delivery systems resulted in a solid year in 2002 for CHCS Services, Inc.

Leading insurance companies and health care clients have long turned to CHCS Services for the administration of Medicare supplement and long term care insurance programs. In 2002 we continued to attract high profile clients seeking to outsource all or a portion of their administrative functions. Late in the year, we were awarded a five-year contract with Blue Cross and Blue Shield of Florida for the full policy administration of its long term care products. Another highlight of the year was CHCS Services' involvement with the largest long term care offering in history. When the federal government embarked on its first-ever long term care offering to its employees, we were one of the third-party administrators (TPA) chosen to provide underwriting services.

CHCS Services continued to open new channels in 2002 for its noninsurance program, known as Nurse Navigator.

Nurse Navigator offers eldercare services and discounts to retirees and families caring for an aging parent or loved one through a combination of our senior care call center, an eldercare Web site, and our national network of long term care providers and geriatric care managers. In 2002 we diversified the client base for these services, which now includes associations, insurance companies, work life organizations, and corporations. In addition, we were awarded a contract by the United States government's Defense Contract Management Agency to provide eldercare training and counseling services for its 12,000 employees domestically and overseas.

Throughout the year we sought to create greater efficiency by accelerating the flow of information, improving service levels to our customers and their policyholders, and providing turn-key TPA services. These improvements, together with the addition of new clients, led to a very strong financial performance in 2002, including a 30 percent increase in revenues, a 15 percent increase in operating profits and a 20 percent increase in premium under management to over \$500 million from the year before.

CHCS Services, Inc., Universal American's administrative services company, offers outsourcing to insurers in the senior health market, care coordination to long term care companies, and eldercare programs and services through the workplace, affinity groups and insurers.



GARY JACOBS
President
CHCS Services, Inc.



JASON ISRAEL
Chief Operating Officer
CHCS Services, Inc.

STEADY GROWTH*

* Universal American *is well positioned for continued success.* A strong and conservative balance sheet provides a solid platform upon which we can execute our business plan. And our financial results provide a clear picture of our company's growth, momentum and stability.



ROBERT A. WAEGELEIN, CPA
Executive Vice President
and Chief Financial Officer

14.	Selected Consolidated Financial Data
16.	Management's Discussion and Analysis of Financial Condition and Results of Operations
35.	Consolidated Balance Sheets
36.	Consolidated Statements of Operations
37.	Consolidated Statements of Stockholders' Equity and Comprehensive Income
38.	Consolidated Statements of Cash Flows
39.	Notes to Consolidated Financial Statements
63.	Independent Auditors' Report
64.	Market for Universal American's Common Equity and Related Stockholder Matters
64.	Corporate Information

SELECTED CONSOLIDATED FINANCIAL DATA

UNIVERSAL AMERICAN FINANCIAL CORP. AND SUBSIDIARIES

(In thousands, except per share data)

AS OF OR FOR THE YEAR ENDED DECEMBER 31,	2002	2001	2000 ⁽²⁾	1999 ⁽²⁾	1998
INCOME STATEMENT DATA:					
Direct premium and policyholder fees	\$ 586,686	\$ 513,575	\$ 451,323	\$ 252,553	\$ 131,044
Reinsurance premium assumed	5,075	2,549	3,055	1,751	998
Reinsurance premium ceded	(325,184)	(286,918)	(234,625)	(138,827)	(89,546)
Net premium and other policyholder fees	266,577	229,206	219,753	115,477	42,496
Net investment income	57,716	57,812	56,945	29,313	10,721
Realized gains (losses)	(5,083)	3,078	146	(241)	256
Fee and other income	12,313	10,847	7,247	3,587	2,616
Total revenues	331,523	300,943	284,091	148,136	56,089
Total benefits, claims and other deductions	287,493	257,580	251,025	132,080	52,157
Income before taxes	44,030	43,363	33,066	16,056	3,932
Net income after taxes	30,127	28,925	22,885	9,813	2,608
Net income applicable to common shareholders ⁽¹⁾	30,127	28,925	22,885	9,633	2,174
PER SHARE DATA:					
Net income applicable to common shareholders: ⁽¹⁾					
Basic	\$ 0.57	\$ 0.58	\$ 0.49	\$ 0.42	\$ 0.29
Diluted	0.56	0.57	0.49	0.34	0.20
Book value per share	5.42	4.38	3.72	2.92	3.18
NON-GAAP FINANCIAL DATA:					
Net income applicable to common shareholders ⁽¹⁾	\$ 30,127	\$ 28,925	\$ 22,885	\$ 9,633	\$ 2,174
Adjustments to net operating income: ⁽⁵⁾					
Realized (gains) losses, net of tax ⁽⁴⁾	3,304	(2,001)	(95)	157	(166)
Net operating income ⁽⁵⁾	33,431	26,924	22,790	9,790	2,008
PER SHARE DATA:					
Net operating income ⁽⁵⁾					
Basic	\$ 0.63	\$ 0.54	\$ 0.49	\$ 0.42	\$ 0.27
Diluted	0.62	0.53	0.48	0.35	0.19
Diluted book value per share ⁽⁶⁾	4.77	4.21	3.58	3.06	2.52
Tangible book value per share ⁽⁷⁾	4.57	4.00	3.33	2.94	2.11
RATIOS:					
Operating return on average equity ⁽⁸⁾	13.9%	13.7%	14.7%	11.6%	8.0%
Ratio of acquired intangibles to equity ⁽⁹⁾	3.8%	5.2%	7.2%	4.1%	20.9%
Ratio of deferred policy acquisition costs to equity ⁽¹⁰⁾	32.1%	28.6%	28.0%	26.1%	85.8%
Debt to total capital ratio ⁽¹¹⁾	19.5%	21.4%	28.6%	33.2%	14.7%

AS OF DECEMBER 31,	2002	2001	2000 ⁽³⁾	1999 ⁽²⁾	1998
BALANCE SHEET DATA:					
Total cash and investments	\$ 999,902	\$ 879,223	\$ 824,930	\$ 812,297	\$ 164,674
Total assets	1,401,668	1,270,216	1,189,864	1,153,421	283,302
Policyholder related liabilities	993,686	914,073	884,011	877,347	228,958
Outstanding bank debt	50,775	61,475	69,650	70,000	4,750
Trust preferred securities	15,000	—	—	—	—
Series B Preferred Stock	—	—	—	—	4,000
Series C Preferred Stock	—	—	—	—	5,168
Series D Preferred Stock	—	—	—	—	2,250
Total stockholders' equity	286,769	230,770	173,949	133,965	28,318
NON-GAAP FINANCIAL DATA:					
Total stockholders' equity excluding accumulated other comprehensive income ⁽¹²⁾	\$ 256,881	\$ 225,167	\$ 169,074	\$ 140,852	\$ 27,460
DATA REPORTED TO REGULATORS:⁽¹³⁾					
Statutory capital and surplus	\$ 129,679	\$ 123,285	\$ 101,367	\$ 105,281	\$ 21,076
Asset valuation reserve	858	3,985	5,384	5,585	1,205
Adjusted capital and surplus	130,537	127,270	106,751	110,866	22,281

⁽¹⁾ After provision for Series C Preferred Stock dividends of \$180 and \$434 for the years ended December 31, 1999 and 1998, respectively.

⁽²⁾ Includes the results of the companies acquired in the 1999 Acquisition, since their acquisition on July 30, 1999.

⁽³⁾ Includes the results of AIAG since its acquisition on January 6, 2000, and CHCS since its acquisition on August 10, 2000.

⁽⁴⁾ Tax on realized gains and losses is computed based on a 35% effective rate for all periods.

⁽⁵⁾ Represents net income applicable to common shareholders, excluding realized gains and losses, net of tax. Management believes that realized gains and losses are not indicative of overall operating trends.

⁽⁶⁾ Diluted book value per share represents total stockholders' equity, excluding accumulated other comprehensive income, plus assumed proceeds from the exercise of vested options, divided by the total shares outstanding plus the shares assumed issued from the exercise of vested options.

⁽⁷⁾ Tangible book value per share represents total stockholders' equity, excluding accumulated other comprehensive income, goodwill and present value of future profits, plus assumed proceeds from the exercise of vested options, divided by the total shares outstanding plus the shares assumed issued from the exercise of vested options.

⁽⁸⁾ Operating return on average equity represents net operating income divided by the average of the beginning and the end of year total stockholders' equity, excluding accumulated other comprehensive income.

⁽⁹⁾ The ratio of acquired intangible assets to equity represents the sum of goodwill and present value of future profits divided by shareholders' equity.

⁽¹⁰⁾ The ratio of deferred policy acquisition costs to equity represents deferred policy acquisition costs divided by shareholders' equity.

⁽¹¹⁾ The debt to total capital ratio is calculated as the ratio of the total outstanding bank debt plus trust preferred securities to the sum of total shareholders' equity, excluding accumulated other comprehensive income, plus total outstanding bank debt plus trust preferred securities.

⁽¹²⁾ Accumulated other comprehensive income includes the after tax net unrealized gain (loss) on available for sale securities and unrealized foreign exchange gain (loss).

⁽¹³⁾ Includes capital and surplus of Penncorp Life (Canada) of C\$59,724 as of December 31, 2002, C\$32,314 as of December 31, 2001, C\$30,421 as of December 31, 2000 and C\$31,531 as of December 31, 1999, as reported to the Office of the Superintendent of Financial Institutions Canada, converted at the related exchange rates of C\$0.6377 per U.S. \$1.00 as of December 31, 2002, C\$0.6261 per U.S. \$1.00 as of December 31, 2001, C\$0.6671 per U.S. \$1.00 as of December 31, 2000, and C\$0.6900 per U.S. \$1.00 as of December 31, 1999.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The purpose of this section is to discuss and analyze our consolidated results of operations, financial condition, and liquidity and capital resources. This analysis should be read in conjunction with our consolidated financial statements and related notes, which appear elsewhere in this report and are also contained in our Form 10-K for the year ended December 31, 2002, which is filed with the Securities and Exchange Commission.

Forward-Looking Statements

Certain statements in this report or incorporated by reference into this report and oral statements made from time to time by our representatives constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements not based on historical information. They relate to future operations, strategies, financial results or other developments. In particular, statements using verbs such as "expect," "anticipate," "believe" or similar words generally involve forward-looking statements. Forward-looking statements include statements about development and distribution of our products, investment spreads or yields, the impact of proposed or completed acquisitions, the adequacy of reserves or the earnings or profitability of our activities. Forward-looking statements are based upon estimates and assumptions that are subject to significant business, economic and competitive uncertainties, many of which are beyond our control and are subject to change. These uncertainties can affect actual results and could cause actual results to differ materially from those expressed in any forward-looking statements. Whether or not actual results differ materially from forward-looking statements may depend on numerous foreseeable and unforeseeable risks and uncertainties, some of which relate particularly to our business, such as our ability to set adequate premium rates and maintain adequate reserves, our ability to compete effectively and our ability to grow our business through internal growth as well as through acquisitions. Other risks and uncertainties may be related to the insurance industry generally or the overall economy, such as regulatory developments, industry consolidation and general economic conditions and interest rates. We disclaim any obligation to update forward-looking statements.

Introduction

We own nine insurance companies (collectively, the "Insurance Subsidiaries"): American Progressive Life & Health Insurance Company of New York ("American Progressive"), American Pioneer Life Insurance Company ("American Pioneer"), American Exchange Life Insurance Company ("American Exchange"), Constitution Life Insurance Company ("Constitution"), Marquette National Life Insurance Company ("Marquette"), Peninsular Life Insurance Company ("Peninsular"), Pennsylvania Life Insurance Company ("Pennsylvania Life"), Penncorp Life Insurance Company ("Penncorp Life (Canada)") and Union Bankers Insurance Company ("Union Bankers"). The insurance company subsidiaries are licensed to sell life and accident and health insurance in all fifty states, the District of Columbia and all the provinces of Canada. In addition to the Insurance Subsidiaries, we own a third party administrator, CHCS Services, Inc., that administers senior market business for more than 40 unaffiliated insurance companies, as well as our own companies.

Overview

Our principal business segments are: Career Agency, Senior Market Brokerage and Administrative Services. We also report the corporate activities of our holding company in a separate segment. During 2002 we modified the way we report segment information by combining our previously defined Senior Market Brokerage and Special Markets segments into one segment, Senior Market Brokerage. Our decision to combine the two segments was based on the significant reduction in the insurance in force in the Special Markets segment as a result of our exit from the major medical line of business. Reclassifications have been made to conform prior year amounts to the current year presentation. A description of these segments follows:

CAREER AGENCY – The Career Agency segment is comprised of the operations of Pennsylvania Life and Penncorp Life (Canada), both of which we acquired in 1999. Penncorp Life (Canada) operates exclusively in Canada, while Pennsylvania Life operates in the United States. The Career Agency segment includes the operations of a career agency field force, which distributes fixed benefit accident and sickness disability insurance, life insurance, supplemental senior health insurance and annuities in the United States and Canada. The career agents

are under exclusive contract with either Pennsylvania Life or Penncorp Life (Canada).

SENIOR MARKET BROKERAGE – This segment includes the operations of our other insurance subsidiaries, primarily American Pioneer, American Progressive and Constitution, that distribute senior market products through general agency and brokerage distribution systems. The products include Medicare supplement/select, long term care, senior life insurance and annuities. In 2002, we combined our Special Markets segment with our Senior Market Brokerage segment.

ADMINISTRATIVE SERVICES – CHCS Services, Inc. acts as a third party administrator and service provider for both affiliated and unaffiliated insurance companies, primarily with respect to senior market insurance products and non-insurance products. The services that we perform include policy underwriting and issuance, telephone and face-to-face verification, policyholder services, claims adjudication, case management, care assessment and referral to health care facilities.

CORPORATE – This segment reflects the activities of our holding company, including the payment of interest on our debt, certain senior executive compensation, and the expense of being a public company.

Intersegment revenues and expenses are reported on a gross basis in each of the operating segments. These intersegment revenue and expenses affect the amounts reported on the individual financial statement line items, but are eliminated in consolidation and do not change operating income before taxes. The significant items eliminated include intersegment revenue and expense relating to services performed by the Administrative Services segment for the Career Agency and Senior Market Brokerage segments and interest on notes issued by the Corporate segment to the other operating segments.

Critical Accounting Policies

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). The preparation of our financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the amounts of assets and liabilities and disclosures of assets and liabilities reported by us at the date of the financial statements and the revenues and expenses reported during the reporting period. As additional information becomes available or actual amounts become determinable, the recorded estimates may be revised and reflected in operating results. Actual results could differ from

those estimates. Accounts that, in our judgment, are most critical to the preparation of our financial statements include policy liabilities and accruals, deferred policy acquisition costs, valuation of certain investments and deferred taxes.

Policy liabilities and accruals

We calculate and maintain reserves for the estimated future payment of claims to our policyholders using the same actuarial assumptions that we use in the pricing of our products. For our accident and health insurance business, we establish an active life reserve plus a liability for due and unpaid claims, claims in the course of settlement and incurred but not reported claims, as well as a reserve for the present value of amounts not yet due on claims. Many factors can affect these reserves and liabilities, such as economic and social conditions, inflation, hospital and pharmaceutical costs, changes in doctrines of legal liability and extracontractual damage awards. Therefore, the reserves and liabilities we establish are based on extensive estimates, assumptions and prior years’ statistics. When we acquire other insurance companies or blocks of insurance, our assessment of the adequacy of transferred policy liabilities is subject to similar estimates and assumptions. Establishing reserves is an uncertain process, and it is possible that actual claims will materially exceed our reserves and have a material adverse effect on our results of operations and financial condition. Our net income depends significantly upon the extent to which our actual claims experience is consistent with the assumptions we used in setting our reserves and pricing our policies. If our assumptions with respect to future claims are incorrect, and our reserves are insufficient to cover our actual losses and expenses, we would be required to increase our liabilities resulting in reduced net income and shareholders’ equity.

Deferred policy acquisition costs

The cost of acquiring new business, principally commissions and certain expenses of the agency, policy issuance, underwriting and related departments, all of which vary with, and are primarily related to the production of new and renewal business, have been deferred. These costs are being amortized in relation to the present value of expected gross profits on the policies arising principally from investment, mortality and expense margins in accordance with SFAS No. 97, “Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments,” for interest sensitive life and annuity products and in proportion to premium revenue using the same assumptions used in estimating the liabilities for future

policy benefits in accordance with SFAS No. 60, "Accounting and Reporting by Insurance Enterprises," for non-interest sensitive life and all accident & health products.

The determination of gross profits is an inherently uncertain process, and relies on assumptions including the persistency of the policies issued as well as anticipated benefits, commissions and expenses. It is possible that the actual profits from the business will vary materially from the assumptions used in the determination and amortization of deferred acquisition costs. Deferred policy acquisition costs are written off to the extent that it is determined that future policy premiums and investment income or gross profits would not be adequate to cover related losses and expenses.

Investment valuation

Fair value of investments is based upon quoted market prices, where available, or on values obtained from independent pricing services. For certain mortgage and asset-backed securities, the determination of fair value is based primarily upon the amount and timing of expected future cash flows of the security. Estimates of these cash flows are based upon current economic conditions, past credit loss experience and other circumstances.

We regularly evaluate the amortized cost of our investments compared to the fair value of those investments. Impairments of securities generally are recognized when a decline in fair value below the amortized cost basis is considered to be other-than-temporary. Generally, we consider a decline in fair value to be other-than-temporary when the fair value of an individual security is below amortized cost for an extended period and we do not believe that recovery in fair value is probable. Impairment losses for certain mortgage and asset-backed securities are recognized when an adverse change in the amount or timing of estimated cash flows occurs, unless the adverse change is solely a result of changes in estimated market interest rates. The cost basis for securities determined to be impaired are reduced to their fair value, with the excess of the cost basis over the fair value recognized as a realized investment loss.

Deferred taxes

We use the asset and liability method to account for deferred income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are

expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date of a change in tax rates.

We establish valuation allowances on our deferred tax assets for amounts that we determine will not be recoverable based upon our analysis of projected taxable income and our ability to implement prudent and feasible tax planning strategies. Increases in these valuation allowances are recognized as deferred tax expense. Subsequent determinations that portions of the valuation allowances are no longer necessary are reflected as deferred tax benefits. To the extent that valuation allowances were established in conjunction with acquisitions, changes in those allowances are first applied to increasing or decreasing the goodwill (but not below zero) or other intangibles related to the acquisition and then applied as an increase or decrease in income tax expense.

Acquisitions, Divestitures and Financing Activity

Pending Acquisition

In December 2002, Pennsylvania Life entered into a definitive contract to acquire Pyramid Life Insurance Company ("Pyramid Life") from Ceres Group, Inc. for \$56 million in cash. This transaction is subject to regulatory approvals and other customary conditions and is scheduled to close by the end of the first quarter of 2003.

Pyramid Life specializes in providing health and life insurance products to the senior market. These products include Medicare supplement, long term care, life insurance, and annuities. Pyramid Life markets its products in 26 states through a career agency sales force of over 1,100 career agents operating out of 29 Senior Solutions Sales Centers. As of the end of 2002, Pyramid Life had approximately \$110 million of premium in force and in excess of \$114 million of assets.

During 2002, Pyramid Life agents produced more than \$25 million of annualized new sales. We believe this acquisition will add further scale and efficiencies to our operations in the rapidly expanding senior market. Following a transition period, we plan to take advantage of our cost-effective and efficient service center to administer the business; however, we will preserve the marketing identity and quality service that has defined Pyramid Life.

Trust Preferred Transaction

In December 2002, the Company issued \$15.0 million of floating rate trust preferred securities through a subsidiary trust.

These securities are due in 2032 and are not callable for the first five years. The floating rate is equal to the three-month LIBOR plus 4.0%, currently 5.4%. Approximately \$6.0 million of the proceeds were used to augment the capital of our insurance subsidiaries and the balance of approximately \$9.0 million was retained at the parent company in anticipation of funding the acquisition of Pyramid Life. In March 2003, a second subsidiary trust of the Company issued \$10.0 million of floating rate trust preferred securities under terms similar to the above securities at a rate of 5.29%. The proceeds will be used to pay down a portion of the term loan and for general corporate purposes.

Acquisition of Block of Business

In November 2002 we entered into an agreement with Nationwide Life Insurance Company (“Nationwide”) to acquire, through a 100% quota share reinsurance agreement, Nationwide’s individual Medicare supplement policies representing approximately \$20.0 million of annualized premium in force. In connection with this transaction, administration of the business was transferred to CHCS Services, Inc.

Equity Offering

In the third quarter of 2001, we completed a secondary equity offering in which we sold 5.7 million shares of our common stock with proceeds to the Company of \$26.0 million, net of expenses. In addition, 2.2 million shares were sold by some of our shareholders as part of the offering. The primary reason for the offering was to enhance the capital of our insurance subsidiaries to support our growth and to improve our risk based capital ratios. Out of the proceeds of the offering, \$9.3 million was contributed to the capital and surplus of our insurance subsidiaries, \$5.5 million was used to reduce inter-company obligations and the balance was held for general corporate purposes.

Acquisition of Administrative Service Companies

In November 2001, we acquired the assets of Living Strategies, Inc., a privately held company based in Bala Cynwyd, Pennsylvania, including certain contracts, trademarks and proprietary web-based technology. Living Strategies is a recognized provider of employer-sponsored elder care programs, providing assistance and support to those dealing with the aging of their parents and family members. As a result of the acquisition of the Living Strategies assets, we have enhanced our technology infrastructure and expanded the audience for our elder care management services.

In August 2000, we acquired CHCS a privately held administrator of long term care products located in Weston, Florida. CHCS administers long term care and home health care insurance and non-insurance products. This acquisition enhanced our expertise in the long term care business.

In January 2000, we acquired CHCS Services, Inc., formerly American Insurance Administration Group, Inc., a privately-held third party administrator located in Clearwater, Florida. American Insurance Administration Group is a third party administrator of senior health insurance. This acquisition strengthened our expertise and capacity to administer senior market products.

1999 Acquisition

In July 1999, we acquired six insurance companies, including the subsidiaries that comprise our career agency segment, and other assets from Penncorp Financial Group. This acquisition enhanced our prospects for future growth by expanding our geographic reach and through the addition of a career agency marketing channel to supplement our senior market brokerage agency marketing channel.

Cancellation of Major Medical Insurance

In the fourth quarter of 2000, we decided to exit our underperforming individual major medical business to the extent possible. Of the \$31.3 million of individual major medical premium that was in force on December 31, 2000, approximately \$1.6 million remained in force on December 31, 2002, which we are not able to cancel.

Health Maintenance Organization (“HMO’s”) Dis-enrollment

Beginning in 1998, many HMO’s realized that their Medicare programs were unprofitable and, therefore, decided to terminate these programs. As a result, millions of seniors were involuntarily dis-enrolled from these programs. This development contributed to our increased new sales of Medicare supplement products in 2001 and 2000. Under applicable legislation, such dis-enrollees had the right to acquire Medicare supplement insurance without medical underwriting or pre-existing condition limitations. As we expected, during 2002 new sales of our Medicare products have slowed since the HMO’s are not dis-enrolling members as much as they were in prior years. To offset this impact, we have continued to expand geographically, and we have stepped up recruiting effort to augment our production. Additionally, we have increased our retention on new Medicare supplement business. As a result, we believe that we will continue to grow our net premiums.

Results of Operations – Consolidated Overview

The following table reflects each of our segment's operating income contribution and contains a reconciliation to net income for these items.

FOR THE YEAR ENDED DECEMBER 31,
(In thousands)

	2002	2001	2000
Operating Income:			
Career Agency	\$ 33,470	\$ 28,427	\$ 28,814
Senior Market Brokerage	14,904	13,716	10,281
Administrative Services	7,632	6,625	3,844
Segment operating income	56,006	48,768	42,939
Corporate & Eliminations	(6,893)	(8,483)	(10,019)
Operating income before realized gains and income taxes ⁽¹⁾	49,113	40,285	32,920
Income taxes ⁽²⁾	(17,286)	(14,098)	(11,473)
Benefit of release of tax valuation allowance	1,604	737	1,343
Total income taxes on operating items	(15,682)	(13,361)	(10,130)
Net operating income ⁽¹⁾	33,431	26,924	22,790
Realized gains (losses), net of tax ⁽³⁾	(3,304)	2,001	95
Net income	\$ 30,127	\$ 28,925	\$ 22,885
Per share data (diluted):			
Net operating income ⁽¹⁾	\$ 0.62	\$ 0.53	\$ 0.48
Realized gains (losses), net of tax	(0.06)	0.04	0.01
Net income	\$ 0.56	\$ 0.57	\$ 0.49

⁽¹⁾ We evaluate the results of operations of our segments based on operating income by segment. Operating income excludes realized gains and losses. Management believes that realized gains and losses are not indicative of overall operating trends. This differs from generally accepted accounting principles, which includes the effect of realized gains in the determination of net income. The schedule above reconciles our operating income to net income in accordance with generally accepted accounting principles.

⁽²⁾ The effective tax rates were 35.2% for the year ended December 31, 2002, 35.0% for 2001 and 34.8% for 2000.

⁽³⁾ Tax on realized capital gains (losses) is based on a 35.0% effective tax rate for all periods.

Years Ended December 31, 2002 and 2001

Net income increased by \$1.2 million to \$30.1 million (\$0.56 per share) in 2002, compared to \$28.9 million (\$0.57 per share) in 2001. The decrease in the per share amounts results from the 7.5% increase in the weighted shares outstanding in 2002 as a result of the equity offering in July 2001.

Our overall effective tax rate was 31.6% for 2002 as compared to 33.2% in 2001. As a result of the increased profitability of our Career Agency and Senior Market Brokerage segments, valuation allowances on certain of the tax loss carryforwards were no longer considered necessary during both 2002 and

2001. The amount of the valuation allowance released through deferred income tax expense during 2002 was \$1.6 million, or \$0.03 per share, compared to \$0.7 million, or \$0.01 per share during 2001. Excluding the release of the tax valuation allowance, the effective tax rate on operating income was 35.2% in 2002, compared to 35.0% in 2001.

We incurred realized losses, net of tax, of \$3.3 million, or \$0.06 per share, in 2002, largely as the result of the loss on our WorldCom bonds. This compares to the net realized gain of \$2.0 million, or \$0.04 per diluted share, in 2001.

Net operating income for 2002, excluding realized gains (losses) and excluding the benefit of the release of a portion of the reserve held against the Company's deferred tax asset, was \$31.8 million, or \$0.59 per share. This is comparable to \$26.2 million, or \$0.52 per share, in 2001, representing increases of 21.4% and 13.5%, respectively.

Pre-tax operating income from our Career Agency segment increased by \$5.0 million, or 18%, compared to 2001. This reflects an increase in new sales and improved loss ratios for our disability business.

Our senior market brokerage segment improved results by more than 9%, increasing pre-tax operating income by \$1.2 million. This improvement is primarily the result of improved loss ratios for our Medicare supplement/select business. However, this was partially offset by an increase in claims relating to a block of home health care policies that we stopped selling in 2000.

Pre-tax operating income from our administrative services segment improved by \$1.0 million, or 15%, in 2002 compared to 2001. The increase is due primarily to the growth in the Medicare supplement business being serviced by our administrative services company.

The decrease in the pre-tax operating loss from our corporate segment is due primarily to the reduction in interest cost. This reduction was due to a combination of a declining balance of debt outstanding as a result of principal repayments and reductions in the weighted average interest rates for the year, compared to 2001.

Years Ended December 31, 2001 and 2000

Net income increased by \$6.0 million to \$28.9 million (\$0.57 per share) in 2001, compared to \$22.9 million (\$0.49 per share) in 2000.

Our overall effective tax rate was 33.2% in 2001 as compared to 30.8% in 2000. As a result of the increased profitability of our operating segments, valuation allowances on certain of the tax loss carryforwards were no longer considered necessary during both 2001 and 2000. The amount of the valuation allowance released through deferred income tax expense during 2001 was \$0.7 million, or \$0.01 per share, compared to \$1.3 million, or \$0.03 per share, during 2000. Excluding the release of the tax valuation allowance, the effective tax rate on operating income was 35.0% in 2001, compared to 34.8% in 2000.

Net operating income for 2001, excluding realized gains (losses) and excluding the benefit of the release of a portion of the reserve held against the Company's deferred tax asset, was \$26.2 million, or \$0.52 per share. This is comparable to \$21.5 million, or \$0.46 per share, in 2000.

Pre-tax operating income from our Career Agency segment decreased by \$0.4 million, or 1%, compared to 2000. This decrease was due primarily to a reduction in the underwriting profit of the U.S. operations, offset by a reduction in general expenses.

Our Senior Market Brokerage segment improved results by more than 33%, increasing pre-tax operating income by \$3.4 million. In the fourth quarter of 2000, we wrote off \$1.4 million of deferred acquisition costs as a result of our decision to exit the major medical line of business. Adjusted for this item, pre-tax operating income for the segment increased by \$2.0 million. This improvement is the result of continued internally generated growth of business in this segment, primarily in the Medicare supplement line.

Pre-tax operating income from our Administrative Services segment improved by \$2.8 million, or 72%, in 2001 compared to 2000. The increase is due primarily to the growth in the Medicare supplement business being serviced by our administrative services company.

The decrease in the pre-tax operating loss from our corporate segment is due primarily to the reduction in interest cost. This reduction was due to a combination of a declining balance of debt outstanding as a result of principal repayments and reductions in the weighted average interest rates for the year, compared to 2000.

SEGMENT RESULTS — CAREER AGENCY

FOR THE YEAR ENDED DECEMBER 31,

(In thousands)

	2002	2001	2000
Net premiums and policyholder fees:			
Life and annuity	\$ 14,900	\$ 14,116	\$ 17,258
Accident & health	110,450	112,028	112,100
Net premiums	125,350	126,144	129,358
Net investment income	33,537	32,768	31,714
Other income	328	1,383	647
Total revenue	159,215	160,295	161,719
Policyholder benefits	75,519	83,947	81,432
Interest credited to policyholders	2,910	1,981	1,657
Change in deferred acquisition costs	(15,308)	(12,178)	(12,476)
Amortization of present value of future profits and goodwill	—	7	28
Commissions and general expenses, net of allowances	62,624	58,111	62,264
Total benefits, claims and other deductions	125,745	131,868	132,905
Segment operating income	\$ 33,470	\$ 28,427	\$ 28,814

Years ended December 31, 2002 and 2001

Pre-tax operating income from our Career Agency segment increased by \$5.0 million, or 18%, compared to 2001. This reflects an increase in new sales and improved loss ratios for our disability business.

REVENUES. Net premiums for 2002 fell by approximately 0.6% compared to 2001. Canadian operations accounted for approximately 39% of the net premiums for the segment in 2002, compared to 37% in 2001. New sales during 2002 increased by 10% over 2001. This increase was driven by a 9% increase in sales in the U.S. and a 12% increase in sales in Canada. The increase in production in the U.S. came from sales of our senior market products, such as Medicare supplement, long term care and senior life, which accounted for 49% of the new sales in the U.S. The Career agents also sold \$33.0 million of fixed annuities during 2002, compared to \$8.4 million in 2001, that are not reported as premiums for GAAP.

Net investment income increased by approximately 2% over 2001. The increase is due to an increase in the segment's invested assets, offset by a decrease in the overall yield. Other income decreased by \$1.1 million, due primarily to a decrease in the sale of non-insurance products.

BENEFITS, CLAIMS AND OTHER DEDUCTIONS. Policyholder benefits, including the change in reserves, decreased by approximately 10% compared to 2001. Overall loss ratios for the segment improved from 67% in 2001 to 60% in 2002, primarily in our disability line as a result of active rate and claims management. Interest credited increased by \$1.0 million, consistent with the increase in fixed annuities.

The increase in deferred acquisition costs was approximately \$3.1 million more in 2002 than the increase in 2001. This is directly related to the increase in the new business, including annuities, generated by the segment during 2002.

Commissions and general expenses increased by approximately \$4.5 million, or 8%, in 2002 compared to 2001. This relates primarily to the increase in new business, including annuities.

Years ended December 31, 2001 and 2000

Pre-tax operating income from our Career Agency segment decreased by \$0.4 million, or 1%, compared to 2000. This decrease was due primarily to a reduction in the underwriting profit of the U.S. operations, offset by a reduction in general expenses.

REVENUES. Net premiums for 2001 fell by approximately 2.5% compared to 2000. In the U.S. the decrease is due to a greater amount of annuities, which are not reported as premiums for GAAP purposes. The decrease in Canadian net premium is due to the run-off of the older block of Canadian business. Canadian operations accounted for approximately 37% of the net premiums for the segment in both 2001 and 2000.

Net investment income increased by approximately 3% over 2000. The increase is due to an increase in the segment's invested assets, offset by a decrease in the overall yield.

Other income increased by approximately \$0.7 million in 2001 compared to 2000. This increase is due primarily to fees associated with the sale by Career Agents of a recently introduced non-insurance product designed to provide access to nursing home and home healthcare services. This increase in other income is largely offset by an increase in commissions related to this non-insurance product.

BENEFITS, CLAIMS AND OTHER DEDUCTIONS. Policyholder benefits, including the change in reserves, increased by approximately 3% compared to 2000. This was due to higher overall loss ratios, primarily in the accident & health lines of business, for the segment in 2001 compared to 2000 on lower premium, as noted above.

The increase in deferred acquisition costs was approximately \$0.3 million less in 2001, compared to the increase in 2000. This reflects a decrease in the underwriting and issue costs and a higher level of amortization as the post acquisition block of business increases.

Commissions and general expenses decreased by approximately \$4.2 million, or 7%, in 2001 compared to 2000. This decrease is primarily due to the consolidation of the operations from the Raleigh location into the existing operations in Toronto, Canada and Pensacola, Florida.

SEGMENT RESULTS — SENIOR MARKET BROKERAGE FOR THE YEAR ENDED DECEMBER 31, (In thousands)

	2002	2001	2000
Net premiums and policyholder fees:			
Life and annuity	\$ 16,169	\$ 16,491	\$ 16,442
Accident & health	125,058	86,571	73,953
Net premiums	141,227	103,062	90,395
Net investment income	23,946	25,174	26,095
Other income	325	205	335
Total revenue	165,498	128,441	116,825
Policyholder benefits	105,887	81,072	72,487
Interest credited to policyholders	8,053	8,288	8,473
Change in deferred acquisition costs	(12,575)	(7,038)	(3,449)
Amortization of present value of future profits and goodwill	128	424	413
Commissions and general expenses, net of allowances	49,101	31,979	28,620
Total benefits, claims and other deductions	150,594	114,725	106,544
Segment operating income	\$ 14,904	\$ 13,716	\$ 10,281

The following table details the gross premiums and policyholder fees collected for the major product lines in the Senior Market Brokerage segment and the corresponding average amount of net premium retained after reinsurance. Our insurance subsidiaries reinsure our senior market products to unaffiliated third party reinsurers under various quota share agreements. Medicare supplement/select written premium in force as of December 31, 2002, is reinsured under quota share reinsurance agreements ranging between 50% and 90% based upon the geographic distribution. During the first quarter of 2002, we increased our retention on certain new business written from 25% to 50%. We are considering a further increase in our retention on new business further by the end 2003. We have also acquired various blocks of Medicare supplement premium, which are reinsured under quota share reinsurance agreements ranging from 75% to 100%.

FOR THE YEAR ENDED DECEMBER 31,
(In thousands)

	2002		2001		2000	
	GROSS	NET	GROSS	NET	GROSS	NET
	PREMIUMS	RETAINED	PREMIUMS	RETAINED	PREMIUMS	RETAINED
Medicare supplement acquired	\$151,073	11%	\$149,287	7%	\$145,972	8%
Medicare supplement/select written	248,618	35%	161,121	31%	82,013	31%
Other senior supplemental health	24,949	60%	22,553	61%	20,701	56%
Other health	13,111	45%	29,526	47%	46,917	54%
Senior life insurance	8,227	58%	8,328	69%	6,625	50%
Other life	14,716	79%	14,700	73%	17,677	72%
Total gross premiums	\$460,694	31%	\$385,515	27%	\$319,905	29%

Year ended December 31, 2002 and 2001

Our Senior Market Brokerage segment improved results by more than 9%, increasing pre-tax operating income by \$1.2 million. This improvement is primarily the result of improved loss ratios for our Medicare supplement/select business. However, this was partially offset by an increase in claims relating to a block of home health care policies that we stopped selling in 2000.

REVENUES. New production of our senior market products amounted to \$98.2 million in 2002. This represents a 10% decrease compared to \$109.5 million in 2001. As we anticipated, new sales of our Medicare products have slowed since Health Maintenance Organizations (“HMOs”) are not disenrolling members as much as in prior years. We have continued to expand geographically and have increased our recruiting efforts to further augment our production. Additionally, \$17.6 million of fixed annuities were sold during 2002, compared to \$7.1 million in 2001, that are not reported as premiums for GAAP.

Gross premium increased \$75.2 million, or 20%, over 2001 despite the slow down in new production. The increase in gross premium includes a \$87.5 million, or 54%, increase on Medicare supplement/select business written as a result of continued new sales. In addition, premiums increased due to normal rate increases implemented by the Company and better than assumed persistency. Other senior supplemental health premium, which includes long term care, nursing home and home health care increased 11%, or \$2.4 million. These increases were partially offset by a decrease of \$16.4 million, or 56%, in other health premium, primarily as a result of our decision to exit the major medical line of business.

In November 2002, we entered into an agreement with Nationwide Life Insurance Company to reinsure a block of its Medicare supplement business with annualized premium in force of approximately \$20.0 million. This added approximately \$3.5 million of premium to the Medicare supplement acquired line.

Net premiums for 2002 increased to \$141.2 million, an increase of 37% compared to 2001. Net premiums grew more than gross premium as a result of our decision to reinsure less premium and retain more risk. The net amount of premium retained increased from 27% in 2001 to 31% in 2002 due to the increase in retention on new Medicare supplement/select premiums written from 25% to 50%, effective January 2002.

Net investment income decreased by 5% compared to 2002, primarily as a result of a decline in investment yields.

BENEFITS, CLAIMS AND OTHER DEDUCTIONS. Policyholder benefits, including the change in reserves, increased by approximately \$24.8 million, or 31%, compared to 2001.

The increase is due primarily to higher annualized premium in force in our Medicare supplement lines, even though our loss ratio for this line improved. Additionally, we experienced an increase in claims in a block of home health care business that we stopped selling in 2000. We believe that we are taking the necessary steps, particularly as to rate management, so that we can eliminate the negative drag of this block as soon as possible. We implemented a 30% rate increase on this block during 2002 and we will file for additional rate increases in 2003 so that we can continue to mitigate the effect of this block on the earnings of the segment. We have not experienced a similar increase in claims in any of the long term care blocks that we are currently marketing.

The increase in deferred acquisition costs was approximately \$5.5 million more in 2002, than in 2001. The increase in deferred acquisition costs relates primarily to our higher retention on new business.

Commissions and other operating expenses increased by approximately \$17.1 million, or 54%, in 2002 compared to 2001. The following table details the components of commission and other operating expenses:

(In thousands)

	2002	2001
Commissions	\$ 80,816	\$ 66,956
Other operating costs	60,455	50,354
Reinsurance allowances	(92,170)	(85,331)
Commissions and general expenses, net of allowances	\$ 49,101	\$ 31,979

The ratio of commissions to gross premiums increased to 17.5% in 2002 from 17.4% in 2001. Other operating costs as a percentage of gross premiums was 13.1% in 2002, consistent with 2001. Commission and expense allowances received from reinsurers as a percentage of the premiums ceded decreased to 28.9% in 2002 from 30.2% in 2001, primarily due to the reduction in new business ceded as a result of our decision to increase our retention on new business.

Year ended December 31, 2001 and 2000

Our Senior Market Brokerage segment improved results by more than 33%, increasing pre-tax operating income by \$3.4 million. In the fourth quarter of 2000, we wrote off \$1.4 million of deferred acquisition costs related to our decision to exit the major medical line of business. Adjusted for this item, pre-tax operating income for the segment increased by \$2.0 million. This improvement is the result of continued internally generated growth of business in this segment, primarily in the Medicare supplement line.

REVENUES. New production of our senior market products amounted to \$109.5 million in 2001. This represents a 29% increase over the \$84.9 million in 2000 and reflects a benefit from new sales of our Medicare products as a result of the dis-enrollment of members from HMO's. We have continued to expand geographically and have increased our recruiting efforts to further augment our production. Additionally, \$7.1 million of fixed annuities were sold during 2001, compared to \$5.2 million in 2000.

Gross premium increased \$65.6 million, or 21%, over 2000. The increase in gross premium includes a \$79.1 million, or

96%, increase on Medicare supplement/select business written by the Insurance Subsidiaries as a result of continued new sales. In addition, premiums increased due to normal rate increases implemented by the Company and better than assumed persistency. Medicare supplement acquired increased by \$3.3 million, or 2%. Other senior supplemental health premium, which includes long term care, nursing home and home health care increased 9%, or \$1.9 million. These increases were partially offset by a decrease of \$17.4 million, or 37%, in other health premium, primarily as a result of our decision to exit the major medical line of business.

Net premiums for 2001 increased by \$12.7 million, or 14%, compared to 2000. On a percentage basis, net premiums grew less than gross premium as a result of our decision to exit the major medical business, which is 100% retained. The decrease in the retained percentage from 29% to 27% was due primarily to the reduction in major medical premium.

Net investment income decreased by 4% compared to 2002, primarily as a result of a decline in invested assets and decreasing investment yields.

BENEFITS, CLAIMS AND OTHER DEDUCTIONS. Policyholder benefits, including the change in reserves, increased by approximately \$8.6 million, or 12%, compared to 2000. The increase is due primarily to higher annualized premium in force in our Medicare supplement lines, even though our loss ratio for this line improved.

The increase in deferred acquisition costs was approximately \$3.6 million more in 2001, than in 2000. This is net of the amortization of approximately \$1.4 million of deferred acquisition costs relating to our decision to exit the major medical line of business. The increase in deferred acquisition costs relates primarily to the increase in new sales.

Commissions and other operating expenses increased by approximately \$3.4 million, or 12%, in 2001 compared to 2000. The following table details the components of commission and other operating expenses:

(In thousands)

	2001	2000
Commissions	\$ 66,956	\$ 51,524
Other operating costs	50,354	44,986
Reinsurance allowances	(85,331)	(67,890)
Commissions and general expenses, net of allowances	\$ 31,979	\$ 28,620

The ratio of commissions to gross premiums increased to 17.4% in 2001 from 16.1% in 2000 as a result of the increase in new business sold. Other operating costs as a percentage of gross premiums decreased to 13.1% in 2001 from 14.1% in 2000. Commission and expense allowances received from reinsurers as a percentage of the premiums ceded were relatively flat at 30.2% in 2001 compared to 29.6% in 2000.

SEGMENT RESULTS — ADMINISTRATIVE SERVICES

FOR THE YEAR ENDED DECEMBER 31,

(In thousands)

	2002	2001	2000
Service fee and other income	\$42,748	\$32,831	\$24,130
Net investment income	470	322	77
Total revenue	43,218	33,153	24,207
Amortization of present value of future profits and goodwill	1,514	2,206	2,920
General expenses	34,072	24,322	17,443
Total expenses	35,586	26,528	20,363
Segment operating income	7,632	6,625	3,844
Depreciation, amortization and interest	2,846	3,108	3,379
Earnings before interest, taxes, depreciation and amortization ⁽¹⁾	\$10,478	\$ 9,733	\$ 7,223

⁽¹⁾ In addition to segment operating income, we also evaluate the results of our Administrative Services segment based on earnings before interest, taxes, depreciation and amortization ("EBITDA"), which is not in accordance with generally accepted accounting principles.

The following table details the service fee revenue earned by our Administrative Services segment:

(In thousands)

	2002	2001	2000
Affiliated revenue			
Medicare supplement	\$19,322	\$13,268	\$ 8,467
Long term care	2,637	1,607	981
Non-insurance products	1,089	272	—
Other health insurance	125	358	930
Life insurance	376	388	135
Total affiliated revenue	23,549	15,893	10,513
Unaffiliated revenue			
Medicare supplement	8,809	9,564	9,410
Long term care	8,544	5,577	2,725
Other health insurance	631	554	758
Non-insurance assistance	1,215	1,242	724
Total unaffiliated revenue	19,199	16,937	13,617
Total Administrative Services Revenue	\$42,748	\$32,830	\$24,130

Included in unaffiliated revenue are fees received from a reinsurer of 100% of certain business of our insurance subsidiaries, which amounted to \$6.9 million and \$7.8 million in 2002 and 2001. These fees, together with the affiliated revenue, were eliminated in consolidation.

Years ended December 31, 2002 and 2001

Operating income for the Administrative Services segment for 2002 improved by more than 15% over 2001, primarily as the result of the increase in Medicare premiums being serviced by our administrative services company and the scheduled reduction in the amortization of the present value of future profits ("PVFP"). Earnings before interest, taxes, depreciation and amortization ("EBITDA") increased by approximately 8% to \$10.5 million in 2002.

Service fee revenue increased by \$9.9 million, or 30%, in 2002 as compared to 2001. In 2002, approximately 44% of the total fees earned were from non-affiliated companies compared to 52% in 2001. The relative decrease in the non-affiliated fees is the result of continued growth of business from our Senior Market Brokerage segment. Affiliated fee revenue increased \$7.7 million compared to 2001 primarily as the result of the increase in Medicare supplement business in force at our insurance subsidiaries. Unaffiliated fee revenues increased by approximately \$2.3 million. This is primarily due to an increase in fees for underwriting of long term care policies for our third party clients, including the underwriting support work we performed for the consortium that is offering long term care to employees of the Federal Government and their families.

General expenses for the segment increased by \$9.8 million, or 40%, compared to 2001. The increase is due primarily to the increase in business and costs incurred to bring new clients on line. Additionally, during the second quarter of 2002, we completed the closing of our Clearwater office and consolidated those functions into our Pensacola operations. The total cost of the transition was approximately \$0.3 million, however most of this was offset by efficiencies and cost savings as a result of the transition.

The amortization of PVFP relates primarily to the acquisition of CHCS Services, Inc., formerly American Insurance Administration Group, Inc. ("AIAG"), in 2000. Approximately \$7.7 million of PVFP was established when AIAG was acquired

in January 2000. It is being amortized in proportion to the expected profits from the contracts in force on the date of acquisition. During 2002, approximately \$1.5 million was amortized compared to \$2.1 million in 2001. As of December 31, 2002, \$1.3 million, or 17%, of the original amount remains unamortized. It is anticipated that \$0.4 million will be amortized in 2003. During 2001 amortization of goodwill was approximately \$0.1 million. There was no amortization of goodwill during 2002 as a result of the adoption of SFAS 142.

Years ended December 31, 2001 and 2000

Operating income for the Administrative Services segment for 2001 improved by more than 72% over the amount in 2000, primarily as the result of the increase in Medicare premiums being serviced by our administrative services company. EBITDA increased by approximately 35% to \$9.7 million in 2001.

Service fee income increased by \$8.7 million, or 36%, in 2001 as compared to 2000. Fees for our administration of Medicare supplemental business increased by \$4.6 million, or 46%, in 2001 compared to 2000, primarily as a result of the increase in Medicare business issued by our Senior Market Brokerage segment. Fees for our administration of long term care business increased \$4.3 million in 2001 compared to 2000. This increase is due primarily to the inclusion of a full year of operations of CHCS in 2001 compared to only five months in 2000. During 2001 our Administrative Services segment generated 48% of its revenues from the administration of business on behalf of affiliates and 52% from unaffiliated third party clients. During 2000, our Administrative Services segment generated \$24.1 million in service fee income with 42% of its revenues from the administration of business on behalf of affiliates and 58% from unaffiliated third party clients.

Approximately \$2.1 million of the PVFP was amortized during 2001 and \$2.8 million of the PVFP was amortized during 2000. The remaining amortization related to the goodwill established in connection with the acquisition of CHCS.

General expenses for the segment increased by \$6.9 million in 2001 compared to 2000. Expenses relating to the administration of long term care business increased by approximately \$4.3 million. This increase is due primarily to the inclusion of a full year of operations of CHCS operations in 2001 compared to only five months in 2000. The remaining increase related to the costs associated with the increase in Medicare business administered, primarily for our affiliated insurance subsidiaries.

SEGMENT RESULTS — CORPORATE

The following table presents the primary components comprising the Corporate segment's operating loss:

FOR THE YEAR ENDED DECEMBER 31,
(In thousands)

	2002	2001	2000
Interest cost of acquisition financing	\$3,095	\$5,152	\$7,097
Amortization of capitalized loan origination fees	539	530	528
Stock-based compensation expense	641	730	757
Other parent company expenses, net	2,618	2,071	1,987
Insurance settlement	—	—	(350)
Segment operating loss	\$6,893	\$8,483	\$10,019

Years ended December 31, 2002 and 2001

The decrease in the operating loss from our Corporate segment for 2002 was due primarily to the reduction in interest cost. This reduction was due to a combination of the declining balance of debt outstanding as a result of principal repayments and reductions in the weighted average interest rates for the year, compared to 2001. During 2002, we repaid \$10.7 million of our term loan, resulting in a weighted average balance outstanding of \$55.7 million compared to \$65.5 million for 2001. Additionally, the weighted average interest rate on our debt decreased to 5.4% in 2002 from 7.8% in 2001. (See "Liquidity and Capital Resources" for additional information regarding our credit facility.) The increase in other parent company expenses was due to an increase in legal fees relating to litigation and an increase in the allocation of salaries and related costs for corporate activity relating to merger and acquisition efforts.

Years ended December 31, 2001 and 2000

The decrease in the operating loss from our Corporate segment in 2001 was due primarily to the reduction in interest cost. This reduction was due to a combination of the declining balance of debt outstanding as a result of principal repayments and reductions in the weighted average interest rates for the year, compared to 2000. During 2001, the weighted average balance outstanding decreased by \$4.6 million from \$70.1 million for 2000. The weighted average interest rate on our debt decreased to 7.8% in 2001 from 10.1% in 2000.

Eliminations

The Corporate segment reflects the elimination of revenues and expenses associated with services performed by our Administrative Services segment for our insurance company subsidiaries. These eliminations amounted to \$31.2 million for 2002, \$23.6 million for 2001 and \$18.1 million for 2000. The Corporate segment also reflects the elimination of interest income and expense on debentures issued by our parent holding company to our subsidiaries subsidiary of \$1.6 million for 2002, \$0.5 million for 2001, and \$0.7 million for 2000. (See "Affiliated Obligations of the Parent Company" below).

Liquidity and Capital Resources

Our capital is used primarily to support the retained risks and growth of our insurance company and administrative service subsidiaries and to support our parent company as an insurance holding company. In addition, we use capital to fund our anticipated growth through acquisitions of other companies or blocks of insurance or administrative service business.

We require cash at our parent company to meet our obligations under our credit facility and our outstanding debentures held by our subsidiaries, American Progressive and Pennsylvania Life. In January 2002, our parent company issued a debenture to Pennsylvania Life in conjunction with the transfer of the business of Pennsylvania Life's Canadian Branch to Penncorp Life (Canada). Repayment of the debenture is anticipated to be funded from dividends from Penncorp Life (Canada). We also require cash to pay the operating expenses necessary to function as a holding company (applicable insurance department regulations require us to bear our own expenses), and to meet the costs of being a public company.

We believe that our current cash position, the availability of the revolving credit facility, the expected cash flows of our administrative service company and the surplus note interest payments from American Exchange (as explained below) can support our parent company obligations for the foreseeable future. However, there can be no assurance as to our actual future cash flows or to the continued availability of dividends from our insurance company subsidiaries.

Contractual Obligations and Commercial Commitments

Our current credit facility consists of a term loan and a \$10 million revolving loan facility. The loans call for interest at LIBOR for one, two, three or six months plus 350 basis points (4.84% beginning January 31, 2003). Principal payments are due on a quarterly basis over a seven-year period that commenced

on July 31, 2000. The final maturity date of the facility is July 31, 2006. We pay a commitment fee of 50 basis points on the unutilized portion of the revolving facility, which is currently \$7.0 million. The term loan is secured by a first priority security interest in 100% of the outstanding common stock of American Exchange, American Progressive, and WorldNet Services and 65% of the outstanding common stock of UAFC (Canada) Inc. (the parent of Penncorp Life (Canada)) and a subordinate interest in 100% of the outstanding common stock of American Pioneer. As of December 31, 2002, \$47.8 million was outstanding under the term loan and \$3.0 million was outstanding under the revolving loan facility. We incurred the revolving indebtedness in connection with our acquisition of CHCS in August 2000. During January 2003, we made a regularly scheduled principal repayment that further reduced the outstanding balance of the term loan to \$45.0 million. During 2002, we paid \$2.6 million in interest and repaid \$10.7 million in principal on the term loan. For 2001, we paid \$5.2 million in interest and repaid \$8.2 million in principal on the term loan. For 2000, we paid \$7.1 million in interest and repaid \$3.4 million in principal on the term loan.

The following table shows the schedule of remaining principal payments (in thousands) on the Company's outstanding term loan, with the final payment in July 2006:

2003	\$ 8,700
2004	12,400
2005	13,275
2006	10,575
Total	\$44,950

In connection with the pending acquisition of Pyramid Life, we intend to refinance the above term loan. We anticipate that our new credit facility will total \$85 million, consisting of a \$70 million five year term loan with a \$15 million revolver. We intend to use the proceeds from the term loan along with existing cash to repay the existing term loan and finance the acquisition of Pyramid Life. The refinancing, if consummated, would trigger the immediate amortization of the capitalized loan origination fees from the existing term loan resulting in a pre-tax expense of approximately \$1.9 million.

We are obligated under certain lease arrangements for its executive and administrative offices in New York, Florida, Texas, and Ontario, Canada. Rent expense for the three years ended December 2002, 2001 and 2000 was \$1.7 million, \$1.8 million, and \$2.9 million, respectively. The minimum rental commitments, subject to escalation clauses, at

December 31, 2002 under non-cancelable operating leases (in thousands) are as follows:

2003	\$ 2,005
2004	1,807
2005	1,279
2006	1,145
2007 and thereafter	3,764
Totals	\$10,000

In addition to the above, Pennsylvania Life is the named lessee on approximately 40 properties occupied by Career Agents for uses as field offices. Rent for these field offices is reimbursed by the agents. The total annual rent obligation for these field offices is approximately \$633,000.

Trust Preferred Offering

In December 2002, the Company formed Universal American Statutory Trust I, a Connecticut statutory business trust (the "Trust"), which issued, through a private placement, \$15.0 million, thirty year floating rate trust preferred securities (the "Capital Securities"). The Trust will have the right to call the Capital Securities at par after five years from the date of issuance. The proceeds from the sale of the Capital Securities, together with proceeds from the sale by the Trust of its common securities to the Company, were invested in floating rate junior subordinated deferrable interest debentures of the Company due 2032 (the "Junior Subordinated Debt"). The proceeds were used to support the growth of the Company's insurance subsidiaries and a portion retained at the parent company in anticipation of funding the acquisition of Pyramid Life.

The Capital Securities represent an undivided beneficial interest in the Trust's assets, which consist solely of the Junior Subordinated Debt. Holders of Capital Securities generally have no voting rights. The Company owns all of the common securities of the Trust. Holders of both the Capital Securities and the Junior Subordinated Debt are entitled to receive cumulative cash distributions accruing from December 4, 2002, the date of issuance, and payable quarterly in arrears commencing March 4, 2003 at a floating rate equal to the three-month LIBOR plus 4.0% (currently 5.4%) of the stated liquidation amount of \$1,000 per Capital Security. The floating rate resets quarterly and is limited to a maximum of 12.5% through December 4, 2007. The Capital Securities are subject to mandatory redemption upon repayment of the Junior Subordinated Debt at maturity or upon earlier redemption. The Junior Subordinated Debt is unsecured and ranks junior and subordinate in right of payment to all present and future senior debt

of the Company and are effectively subordinated to all existing and future obligations of the Company's subsidiaries. The Company has the right to redeem the Junior Subordinated Debt on or after December 4, 2007.

The Company has the right at any time, and from time to time, to defer payments of interest on the Junior Subordinated Debt for a period not exceeding 20 consecutive quarters up to the debentures' maturity date. During any such period, interest will continue to accrue and the Company may not declare or pay any cash dividends or distributions on, or purchase, the Company's capital stock nor make any principal, interest or premium payments on or repurchase any debt securities that rank equally with or junior to the Junior Subordinated Debt. The Company will have the right at any time to dissolve the Trust and cause the Junior Subordinated Debt to be distributed to the holders of the Capital Securities. The Company has guaranteed, on a subordinated basis, all of the Trust's obligations under the Capital Securities including payment of the redemption price and any accumulated and unpaid distributions to the extent of available funds and upon dissolution, winding up or liquidation but only to the extent the Trust has funds available to make such payments.

The Capital Securities have not been and will not be registered under the Securities Act of 1933, as amended (the "Securities Act"), and will only be offered and sold under an applicable exemption from registration requirements under the Securities Act.

In March 2003, a second subsidiary trust of the Company issued \$10.0 million of floating rate trust preferred securities under terms similar to the above securities at a rate of 5.29%. The proceeds will be used to pay down a portion of the term loan and for general corporate purposes.

Equity Offering

On July 12, 2001, the Company entered into an Underwriting Agreement with Banc of America Securities LLC and Raymond James & Associates, Inc., as representatives of the underwriters named therein, and certain shareholders of the Company, with respect to the sale of up to 7,950,000 shares of the Company's common stock (including 750,000 shares of Common Stock subject to an over-allotment option granted to the Underwriters by the Company and some of the selling shareholders). As a result, on July 12, 2001, the Company issued five million shares of common stock at a price of \$5.00 per share, generating proceeds of \$25 million. Expenses for this transaction, including the underwriters'

discounts and commissions, amounted to \$2.4 million, resulting in net proceeds of \$22.6 million to the Company. The proceeds from this offering were used to enhance the capital and surplus of certain of our insurance subsidiaries through capital contribution totaling \$9.3 million (\$5.0 million to American Pioneer and \$4.3 million to American Exchange), to reduce intercompany obligations by \$5.5 million and to hold the balance at the parent company for general corporate purposes. In connection with this offering, certain shareholders of the company, none of whom were management, sold 2.2 million shares at \$5.00 per share, less the underwriters' discounts and commissions of \$0.3187 per share.

On August 13, 2001, the over-allotment option provided in the underwriting agreement was exercised and, as a result, the Company issued an additional 720,000 shares of common stock at a price of \$5.00 per share, less the underwriters' discounts and commissions of \$0.3187 per share, generating additional net proceeds of \$3.4 million. In connection with the over-allotment option, certain shareholders sold an additional 30,000 shares at \$5.00 per share, less the underwriters' discounts and commissions of \$0.3187 per share.

The net proceeds to the Company of the total offering, including the over-allotment, was \$26.0 million, net of total expenses of \$2.6 million.

Affiliated Obligations of the Parent Company

In connection with an agreement entered into in 1996 under which American Pioneer became a direct subsidiary of our holding company rather than an indirect subsidiary owned through American Progressive, our holding company issued \$7.9 million in debentures to American Progressive. A portion of the proceeds from our equity offering in July 2001 was used to pay down \$5.5 million of the debentures. A scheduled redemption of \$0.4 million was made in December 2002, leaving a balance at December 31, 2002 of \$2.0 million, which is due in May 2003. Our holding company pays interest on the outstanding debentures quarterly at a rate of 8.50%. During 2002 our parent holding company paid \$0.1 million in interest on these debentures to American Progressive, \$0.5 million in 2001 and \$0.7 million in 2000. The interest on these debentures is eliminated in consolidation.

In January 2002, our parent company issued a debenture in the amount of \$18.5 million to Pennsylvania Life in connection with the transfer of the business of Pennsylvania Life's Canadian Branch to Penncorp Life (Canada). Our parent company paid \$4.4 million in principal during 2002, reducing the outstanding

balance to \$14.1 million at December 31, 2002. Principal and interest payments are made quarterly. The debenture is scheduled to be repaid in full by the third quarter of 2005. During 2002, our parent holding company paid \$1.5 million in interest on these debentures. The interest on these debentures is eliminated in consolidation. Dividends from Penncorp Life (Canada) funded the interest and principal paid on the debenture in 2002 and it is anticipated that they will fund all future payments made on this debenture.

Administrative Service Company

Liquidity for our administrative service company is measured by its ability to pay operating expenses. The primary source of liquidity is fees collected from clients. We believe that the sources of cash for our administrative service company exceed scheduled uses of cash and results in amounts available to dividend to our parent holding company. We measure the ability of the administrative service company to pay dividends based on its earnings before interest, taxes, depreciation and amortization ("EBITDA"). EBITDA for our administrative services segment was \$10.5 million for the year ended December 31, 2002, \$9.7 million for the year ended December 31, 2001, and \$7.2 million for the year ended December 31, 2000.

Insurance Subsidiary – Surplus Note

Cash generated by our insurance company subsidiaries will be made available to our holding company, principally through periodic payments of principal and interest on surplus notes. As of December 31, 2002, the principal amount of surplus notes owed to our holding company from our American Exchange subsidiary was \$60.0 million. The notes pay interest to our parent holding company at LIBOR plus 375 basis points. We anticipate that the surplus notes will be primarily serviced by dividends from Pennsylvania Life, a wholly owned subsidiary of American Exchange, and by tax-sharing payments among the insurance companies that are wholly owned by American Exchange and file a consolidated Federal income tax return. During 2002, the surplus note was reduced by \$10.0 million in the form of a capital contribution to American Exchange by our holding company. No principal payments were made during 2001 or 2000. During 2002, American Exchange paid \$3.8 million in interest on the surplus notes to our parent holding company, \$5.7 million in 2001 and \$7.2 million in 2000.

During 2002, Pennsylvania Life paid cash dividends amounting to \$3.0 million to American Exchange. Universal American contributed 100% of the common stock of American Pioneer and American Progressive to American Exchange during 2002.

American Exchange also received capital contributions from its parent totaling \$4.2 million during the year. American Exchange made capital contributions of \$3.0 million to American Pioneer and \$1.2 million to American Progressive during 2002.

During 2001, Union Bankers paid cash dividends amounting to \$1.7 million to American Exchange. In addition, the insurance companies included in the tax allocation agreement with American Exchange paid \$6.5 million in tax sharing payments to American Exchange. In connection with the equity offering discussed above, American Exchange received \$4.3 million in capital contributions from its parent. During 2001, American Exchange made cash capital contributions of \$7.0 million to Pennsylvania Life.

During 2000, Pennsylvania Life paid \$2.9 million and Union Bankers paid \$2.0 million in dividends to American Exchange. In addition, the insurance companies included in the tax allocation agreement with American Exchange paid \$4.8 million in tax sharing payments to American Exchange.

Insurance Subsidiaries

Our insurance subsidiaries are required to maintain minimum amounts of capital and surplus as determined by statutory accounting practices. As of December 31, 2002, each insurance company subsidiary's statutory capital and surplus exceeded its respective minimum requirement. However, substantially more than these minimum amounts are needed to meet statutory and administrative requirements of adequate capital and surplus to support the current level of our insurance subsidiaries' operations. As of December 31, 2002 the statutory capital and surplus, including asset valuation reserves, of our U.S. domiciled insurance subsidiaries totaled \$106.5 million.

The National Association of Insurance Commissioners has developed, and state insurance regulators have adopted, risk-based capital requirements on life insurance enterprises. As of December 31, 2002 all of our insurance company subsidiaries maintained ratios of total adjusted capital to risk-based capital in excess of the minimum trigger point for regulatory action.

Penncorp Life (Canada) is subject to Canadian capital requirements and reports results to Canadian regulatory authorities based upon Canadian statutory accounting principles that vary in some respects from U.S. statutory accounting principles. Canadian net assets based upon Canadian statutory accounting principles were \$38.1 million as of December 31, 2002.

Penncorp Life (Canada) maintained a minimum continuing

capital and surplus requirement ratio in excess of the minimum requirement as of December 31, 2002.

Dividend payments by our insurance companies to our parent holding company or to intermediate subsidiaries are limited by, or subject to the approval of the insurance regulatory authorities of each insurance company's state of domicile. Such dividend requirements and approval processes vary significantly from state to state. The maximum amount of dividends which can be paid to American Exchange from Pennsylvania Life (to assist in servicing the surplus note held by American Exchange) without the prior approval of the Pennsylvania Department of Insurance is restricted to the greater of 10% of the Pennsylvania Life's surplus as regards policyholders as of the preceding December 31, or the net gain from operations during the preceding year, but such dividends can be paid only out of unassigned surplus. Thus, future earnings of Pennsylvania Life would be available for dividends without prior approval, subject to the restrictions noted above. Based upon the current dividend regulations of Pennsylvania, Pennsylvania Life would be able to pay ordinary dividends of up to \$10.6 million to American Exchange (its direct parent) without the prior approval from Pennsylvania Department of Insurance in 2003. Additionally, it is anticipated that Penncorp Life (Canada) would be able to pay ordinary dividends of up to \$6.6 million to Universal American in 2003. We do not expect that our remaining regulated insurance subsidiaries will be able to pay ordinary dividends in 2003.

Liquidity for our insurance company subsidiaries is measured by their ability to pay scheduled contractual benefits, pay operating expenses, and fund investment commitments. Sources of liquidity include scheduled and unscheduled principal and interest payments on investments, premium payments and deposits and the sale of liquid investments. We believe that these sources of cash for our insurance company subsidiaries exceed scheduled uses of cash.

Liquidity is also affected by unscheduled benefit payments including death benefits, benefits under accident and health insurance policies and interest-sensitive policy surrenders and withdrawals. The amount of surrenders and withdrawals is affected by a variety of factors such as credited interest rates for similar products, general economic conditions and events in the industry that affect policyholders' confidence. Although the contractual terms of substantially all of our in force life insurance policies and annuities give the holders the right to surrender the policies and annuities, we impose penalties for early surrenders. As of December 31, 2002 we held reserves

that exceeded the underlying cash surrender values of our in force life insurance and annuities by \$18.3 million. Our insurance subsidiaries, in our view, have not experienced any material changes in surrender and withdrawal activity in recent years.

Changes in interest rates may affect the incidence of policy surrenders and withdrawals. In addition to the potential impact on liquidity, unanticipated surrenders and withdrawals in a changed interest rate environment could adversely affect earnings if we were required to sell investments at reduced values in order to meet liquidity demands. We manage our asset and liability portfolios in order to minimize the adverse earnings impact of changing market rates. We seek to invest in assets that have duration and interest rate characteristics similar to the liabilities that they support.

The net yields on our cash and invested assets decreased from 6.78% in 2001 to 6.12% in 2002. A significant portion of these securities are held to support the liabilities for policyholder account balances, which liabilities are subject to periodic adjustments to their credited interest rates. The credited interest rates of the interest-sensitive policyholder account balances are determined by us based upon factors such as portfolio rates of return and prevailing market rates and typically follow the pattern of yields on the assets supporting these liabilities.

As of December 31, 2002, our insurance company subsidiaries held cash and cash equivalents totaling \$23.5 million, as well as fixed maturity securities that could readily be converted to cash with carrying values (and fair values) of \$954.5 million. The fair values of these holdings totaled more than \$978.0 million as of December 31, 2002.

Investments

Our investment policy is to balance the portfolio duration to achieve investment returns consistent with the preservation of capital and maintenance of liquidity adequate to meet payment of policy benefits and claims. We invest in assets permitted under the insurance laws of the various states in which we operate. Such laws generally prescribe the nature, quality of and limitations on various types of investments that may be made. However, we do not invest in partnerships, special purpose entities, real estate, commodity contracts, or other derivative securities. We currently engage the services of independent professional insurance investment advisors under the direction of the management of our insurance company subsidiaries and in accordance with guidelines adopted by the Investment Committees of their respective boards of directors. Conning Asset Management Company manages our fixed

maturity portfolio in the United States and MFC Global Investment Management manages our Canadian fixed maturity portfolio. Our policy is not to invest in derivative programs or other hybrid securities, except for GNMA's, FNMA's and investment grade corporate collateralized mortgage obligations. We invest primarily in fixed maturity securities of the U.S. Government and its agencies and in corporate fixed maturity securities with investment grade ratings of "Baa3" (Moody's Investor Service), "BBB-" (Standard & Poor's Corporation) or higher. As of December 31, 2002, 99.4% of our fixed maturity investments had investment grade ratings from Moody's Investors Service or Standard & Poor's Corporation. However, we do own some investments that are rated "BB+" or below by Standard & Poor's (together 0.6% of total fixed maturities as of December 31, 2002). There were no non-income producing fixed maturities for the year ended December 31, 2002. During the year ended December 31, 2002, we recognized other-than-temporary declines in the value of certain fixed maturity securities of \$10.6 million, primarily as a result of the impairment of our WorldCom bonds, which were disposed of in the third quarter of 2002 at a price approximating their carrying value after recognition of the other-than-temporary decline. We recognized other-than-temporary declines in the value of fixed maturity securities of \$4.2 million during 2001 and \$0.5 million during 2000. In each case these represent our estimate of the other-than-temporary declines in value and were included in net realized gains (losses) on investments in our consolidated statements of operations.

Federal Income Taxation of the Company

We file a consolidated return for Federal income tax purposes, in which American Exchange and the companies acquired in 1999 are not currently permitted to be included. As of December 31, 2002 we (exclusive of American Exchange and the companies acquired in 1999) had net operating tax loss carryforwards of approximately \$2.7 million that expire in the years 2015 to 2016. As of December 31, 2002, we also had an Alternative Minimum Tax ("AMT") credit carryforward for Federal income tax purposes of approximately \$0.1 million that can be carried forward indefinitely. As a result of the change in our ownership in July 1999, use of most of our loss carryforwards is subject to annual limitations.

American Exchange and the other U. S. companies acquired in 1999 file a separate consolidated Federal income tax return. As of December 31, 2002, these companies had net operating loss carryforwards, most of which were incurred prior to their

acquisition by us, of approximately \$27.4 million that expire in the years 2008 to 2017. As a result of the change in the ownership of the companies acquired in 1999, use of most of these loss carryforwards is subject to annual limitations.

As of December 31, 2002 and 2001, we carried valuation allowances of \$5.1 million and \$6.8 million, respectively, with respect to our tax loss carryforwards (deferred tax assets). We determine a valuation allowance based upon an analysis of projected taxable income and our ability to implement prudent and feasible tax planning strategies. The tax planning strategies include the expense reductions anticipated from our recent reorganization and from the income generated by our administrative services companies. As a result of the increased profitability of the insurance subsidiaries acquired in 1999, valuation allowances on certain of the life tax loss carryforwards were considered not necessary at December 31, 2002. The amount of the valuation allowance released during 2002 was \$2.1 million and was recorded as a benefit in the deferred income tax expense. As a result of the increased profitability of the Administrative Services segment, valuation allowances on certain of the non-life tax loss carryforwards were considered not necessary as of December 31, 2002. The amount of the valuation allowance released during 2002 was \$0.1 million and was recorded as a benefit in the deferred income tax expense. These decreases were partially offset by the establishment of a valuation allowance of \$0.5 million for certain capital losses incurred in 2002 by the Company that are subject to limitation on their use. We believe it is more likely than not that we will realize the recorded net deferred tax assets.

Our U.S. insurance company subsidiaries, other than Peninsular Life Insurance Company, are taxed as life insurance companies as provided in the Internal Revenue Code. The Omnibus Budget Reconciliation Act of 1990 amended the Internal Revenue Code to require a portion of the expenses incurred in selling insurance products to be capitalized and amortized over a period of years, as opposed to an immediate deduction in the year incurred. Instead of measuring actual selling expenses, the amount capitalized for tax purposes is based on a percentage of premiums. In general, the capitalized amounts are subject to amortization over a ten-year period. Since this change only affects the timing of the deductions, it does not, assuming stability of rates, affect the provisions for taxes reflected in our financial statements prepared in accordance with GAAP. However, by deferring deductions, the change does have the effect of increasing the current tax expense, thereby reducing statutory surplus. Because of our

insurance company subsidiaries' net operating loss carryforwards, there was no material increase in our current income tax provision for any of the three years in the period ended December 31, 2002 due to this provision.

Effects of Recently Issued Accounting Pronouncements

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 establishes an accounting model for long-lived assets to be disposed of by sale that applies to all long-lived assets, including discontinued operations. SFAS 144 requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. The provisions of SFAS 144 are effective for financial statements issued for fiscal years beginning after December 15, 2001. Adoption of SFAS 144 did not have a material impact on the Company's consolidated financial condition or results of operations.

In June 2001, the FASB issued SFAS No. 141, "Business Combinations" ("SFAS 141"). SFAS 141 eliminates the pooling-of-interests method of accounting for business combinations, requiring all business combinations to be accounted for under the purchase method. Accordingly, net assets acquired are recorded at fair value with any excess of cost over net assets assigned to goodwill. SFAS 141 also requires that certain intangible assets acquired in a business combination be recognized apart from goodwill. The provisions of SFAS 141 apply to all business combinations initiated after June 30, 2001. Adoption of SFAS 141 did not have a material impact on the Company's consolidated financial condition or results of operations.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). Under SFAS 142, effective January 1, 2002 amortization of goodwill is precluded; however, its recoverability must be periodically (at least annually) reviewed and tested for impairment. Goodwill must be tested at the reporting unit level for impairment in the year of adoption, including an initial test performed within six months of adoption. If the initial test indicates a potential impairment, then a more detailed analysis to determine the extent of impairment must be completed within twelve months of adoption. During the first quarter of 2002, the Company completed the review and analysis of its goodwill asset in accordance with the provisions of SFAS 142. The result of these analyses indicated that each reporting unit's fair value exceeded its carrying amount, including goodwill. As a result, goodwill for each reporting unit was not considered impaired. SFAS 142 also

requires that useful lives for intangibles other than goodwill be reassessed and remaining amortization periods be adjusted accordingly. Adoption of SFAS 142 did not have a material impact on the Company's consolidated financial condition or results of operations. The Company updated its review of its goodwill assets during the fourth quarter of 2002 and determined that the goodwill asset remained unimpaired.

Effective April 1, 2001, the Company adopted Emerging Issues Task Force ("EITF") Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets" ("EITF 99-20"). Under the consensus, investors in certain securities with contractual cash flows, primarily asset-backed securities, are required to periodically update their best estimate of cash flows over the life of the security. If the fair value of the securitized financial asset is less than its carrying amount and there has been a decrease in the present value of the estimated cash flows since the last revised estimate, considering both timing and amount, an other than temporary impairment charge is recognized. The estimated cash flows are also used to evaluate whether there have been any changes in the securitized asset's estimated yield. All yield adjustments are accounted for on a prospective basis. Adoption of EITF 99-20 did not have a material impact on the Company's consolidated financial condition or results of operations.

Effective January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), as amended by SFAS Nos. 137 and 138. The standard requires, among other things, that all derivatives be carried on the balance sheet at fair value. The standard also specifies hedge accounting criteria under which a derivative can qualify for special accounting. In order to receive special accounting, the derivative instrument must qualify as a hedge of either the fair value or the variability of the cash flow of a qualified asset or liability, or forecasted transaction. Special accounting for qualifying hedges provides for matching the timing of gain or loss recognition on the hedging instrument with the recognition of the corresponding changes in value of the hedged item. The Company does not currently have any derivative instruments and therefore adoption of SFAS 133 did not have a material impact on the Company's consolidated financial condition or results of operations.

Pending Accounting Pronouncements

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB

Statement No. 13, and Technical Corrections" ("SFAS 145"). SFAS 145 requires any gain or loss on extinguishments of debt to be presented as a component of continuing operations (unless specific criteria are met) whereas SFAS No. 4 required that such gains and losses be classified as an extraordinary item in determining net income. The Company will adopt these provisions on January 1, 2003, as required. The other provisions of SFAS No. 145 were not relevant to the Company.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"). SFAS 146 requires costs associated with exit or disposal activities (including restructurings) to be recognized when the costs are incurred, rather than at a date of commitment to an exit or disposal plan. This standard nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." Under SFAS 146, a liability related to an exit or disposal activity is not recognized until such liability has actually been incurred whereas under EITF Issue No. 94-3 a liability was recognized at the time of a commitment to an exit or disposal plan. The provisions of this standard are effective for exit or disposal activities initiated after December 31, 2002. The Company will adopt this standard on January 1, 2003, as required.

On December 31, 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure" ("SFAS 148"). This standard amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. This standard also requires prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. As permitted by SFAS 123, the Company measured its stock-based compensation using the intrinsic value approach under Accounting Principles Board ("APB") Opinion No. 25. Accordingly, the Company did not recognize compensation expense upon the issuance of its stock options because the option terms were fixed and the exercise price equaled the market price of the underlying common stock on the grant date. The Company complied with the disclosure provisions of SFAS 148 by providing pro forma disclosures of net income and related per share data giving consideration to the fair value method provisions of SFAS 123.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In general, market risk relates to changes in the value of financial instruments that arise from adverse movements in interest rates, equity prices and foreign exchange rates. We are exposed principally to changes in interest rates that affect the market prices of our fixed income securities.

Interest Rate Sensitivity

Our profitability could be affected if we were required to liquidate fixed income securities during periods of rising and/or volatile interest rates. However, we attempt to mitigate our exposure to adverse interest rate movements through a combination of active portfolio management and by staggering the maturities of our fixed income investments to assure sufficient liquidity to meet our obligations and to address reinvestment risk considerations. Our insurance liabilities generally arise over relatively long periods of time, which typically permits ample time to prepare for their settlement. To date, we have not used various financial risk management tools on our investment securities, such as interest rate swaps, forwards, futures and options to modify our exposure to changes in interest rates. However, we may consider using risk management tools in the future.

Certain classes of mortgage-backed securities are subject to significant prepayment risk due to the fact that in periods of declining interest rates, individuals may refinance higher rate mortgages to take advantage of the lower rates then available. We monitor and adjust our investment portfolio mix to mitigate this risk.

We regularly conduct various analyses to gauge the financial impact of changes in interest rate on our financial condition. The ranges selected in these analyses reflect our assessment as being reasonably possible over the succeeding twelve-month period. The magnitude of changes modeled in the accompanying analyses should not be construed as a prediction of future economic events, but rather, be treated as a simple illustration of the potential impact of such events on our financial results.

The sensitivity analysis of interest rate risk assumes an instantaneous shift in a parallel fashion across the yield curve, with scenarios of interest rates increasing and decreasing 100 and 200 basis points from their levels as of December 31, 2002, and with all other variables held constant. A 100 basis point increase in market interest rates would result in a pre-tax decrease in the market value of our fixed income investments

of \$54.1 million and a 200 basis point increase in market interest rates would result in \$104.6 million decrease. Similarly, a 100 basis point decrease in market interest rates would result in a pre-tax increase in the market value of our fixed income investments of \$54.7 million and a 200 basis point decrease in market interest rates would result in a \$114.7 million increase.

Currency Exchange Rate Sensitivity

Portions of our operations are transacted using the Canadian dollar as the functional currency. As of and for the year ended December 31, 2002, approximately 12.5% of our assets, 16.6% of our revenues, excluding realized gains, and 22.3% of our operating income before taxes were derived from our Canadian operations. As of and for the year ended December 31, 2001, approximately 13.7% of our assets, 19.1% of our revenues, excluding realized gains, and 36.0% of our operating income before taxes were derived from our Canadian operations. Accordingly, our earnings and shareholder's equity are affected by fluctuations in the value of the U.S. dollar as compared to the Canadian dollar. Although this risk is somewhat mitigated by the fact that both the assets and liabilities for our foreign operations are denominated in Canadian dollars, we are still subject to translation losses.

We periodically conduct various analyses to gauge the financial impact of changes in the foreign currency exchange rate on our financial condition. The ranges selected in these analyses reflect our assessment of what is reasonably possible over the succeeding twelve-month period.

As of December 31, 2002, a 10% strengthening of the U.S. dollar relative to the Canadian dollar would result in a decrease in our operating income before taxes of approximately \$1.0 million and a decrease in shareholders' equity of approximately \$3.3 million. A 10% weakening of the U.S. dollar relative to the Canadian dollar would result in an increase in our operating income before taxes of approximately \$1.2 million and an increase in shareholders' equity of approximately \$4.0 million. Our sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor in any potential change in sales levels, local prices or any other variables.

The magnitude of changes reflected in the above analysis regarding interest rates and foreign currency exchange rates should, in no manner, be construed as a prediction of future economic events, but rather as a simple illustration of the potential impact of such events on our financial results.

CONSOLIDATED BALANCE SHEETS
UNIVERSAL AMERICAN FINANCIAL CORP. AND SUBSIDIARIES
(In thousands)

AS OF DECEMBER 31,	2002	2001
ASSETS		
Investments (Notes 2 and 5):		
Fixed maturities available for sale, at fair value (amortized cost: 2002, \$884,054; 2001, \$786,844)	\$ 934,950	\$ 799,218
Equity securities, at fair value (cost: 2002, \$1,661; 2001, \$4,339)	1,645	4,199
Policy loans	23,745	24,043
Other invested assets	2,808	3,773
Total investments	963,148	831,233
Cash and cash equivalents	36,754	47,990
Accrued investment income	11,885	12,663
Deferred policy acquisition costs (Notes 2 and 10)	92,093	66,025
Amounts due from reinsurers (Note 12)	220,100	212,532
Due and unpaid premiums	6,066	3,385
Deferred income tax asset (Note 6)	35,842	59,952
Present value of future profits and goodwill (Notes 2 and 3)	10,960	11,921
Other assets	24,820	24,515
Total assets	1,401,668	1,270,216
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Policyholder account balances (Note 2)	271,578	236,742
Reserves for future policy benefits	627,174	591,453
Policy and contract claims – life	6,718	6,282
Policy and contract claims – health (Note 11)	88,216	79,596
Loan payable (Note 13)	50,775	61,475
Company obligated mandatorily redeemable preferred securities of subsidiary trust holding solely junior subordinated debentures (Note 14)	15,000	–
Amounts due to reinsurers	7,285	6,680
Other liabilities	48,153	57,218
Total liabilities	1,114,899	1,039,446
Commitments and contingencies (Note 15)		
STOCKHOLDERS' EQUITY (Notes 7 and 8)		
Common stock		
(Authorized: 80 million shares, issued and outstanding: 2002, 53.2 million shares; 2001, 52.8 million shares)	532	528
Additional paid-in capital	158,264	155,746
Accumulated other comprehensive income (Notes 7 and 19)	29,887	5,603
Retained earnings	99,406	69,279
Less: Treasury stock (2002, 0.2 million shares; 2001, 0.1 million shares)	(1,320)	(386)
Total stockholders' equity	286,769	230,770
Total liabilities and stockholders' equity	\$1,401,668	\$1,270,216

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

UNIVERSAL AMERICAN FINANCIAL CORP. AND SUBSIDIARIES

(In thousands, per share amounts in dollars)

FOR THE YEARS ENDED DECEMBER 31,	2002	2001	2000
REVENUES:			
Direct premiums and policyholder fees earned	\$ 586,686	\$ 513,575	\$ 451,323
Reinsurance premiums assumed	5,075	2,549	3,055
Reinsurance premiums ceded	(325,184)	(286,918)	(234,625)
Net premiums and policyholder fees earned (Note 12)	266,577	229,206	219,753
Net investment income (Note 5)	57,716	57,812	56,945
Realized gains (losses) on investments (Note 5)	(5,083)	3,078	146
Fee and other income	12,313	10,847	7,247
Total revenues	331,523	300,943	284,091
BENEFITS, CLAIMS AND EXPENSES:			
Net increase in future policy benefits	12,880	10,450	6,968
Net claims and other benefits	168,526	154,570	146,951
Interest credited to policyholders	10,963	10,271	10,130
Net increase in deferred acquisition costs (Note 10)	(27,850)	(19,186)	(15,925)
Amortization of present value of future profits and goodwill (Note 3)	1,642	2,637	2,749
Commissions	115,074	99,026	82,903
Commission and expense allowances on reinsurance ceded	(94,689)	(87,122)	(69,757)
Interest expense	3,095	5,152	7,097
Other operating costs and expenses	97,852	81,782	79,909
Total benefits, claims and expenses	287,493	257,580	251,025
Income before taxes	44,030	43,363	33,066
Income tax expense (Note 6)	13,903	14,438	10,181
Net income applicable to common shareholders	\$ 30,127	\$ 28,925	\$ 22,885
Earnings per common share (Notes 2 and 18):			
Basic	\$ 0.57	\$ 0.58	\$ 0.49
Diluted	\$ 0.56	\$ 0.57	\$ 0.49

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

UNIVERSAL AMERICAN FINANCIAL CORP. AND SUBSIDIARIES

(In thousands)

FOR THE THREE YEARS ENDED DECEMBER 31, 2002	ACCUMULATED					TREASURY STOCK	TOTAL
	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	OTHER COMPREHENSIVE INCOME/(LOSS)	RETAINED EARNINGS			
Balance, January 1, 2000	\$459	\$122,924	\$ (6,887)	\$17,469	\$ —	\$133,965	
Net income	—	—	—	22,885	—	22,885	
Other comprehensive income (Note 19)	—	—	11,762	—	—	11,762	
Comprehensive income						<u>34,647</u>	
Issuance of common stock (Note 7)	9	3,289	—	—	—	3,298	
Stock-based compensation (Note 8)	—	2,388	—	—	—	2,388	
Loans to officers (Note 7)	—	13	—	—	—	13	
Treasury shares purchased, at cost (Note 7)	—	—	—	—	(711)	(711)	
Treasury shares reissued (Note 7)	—	11	—	—	338	349	
Balance, December 31, 2000	468	128,625	4,875	40,354	(373)	173,949	
Net income	—	—	—	28,925	—	28,925	
Other comprehensive income (Note 19)	—	—	728	—	—	728	
Comprehensive income						<u>29,653</u>	
Issuance of common stock (Note 7)	60	26,168	—	—	—	26,228	
Stock-based compensation (Note 8)	—	863	—	—	—	863	
Loans to officers (Note 7)	—	68	—	—	—	68	
Treasury shares purchased, at cost (Note 7)	—	—	—	—	(764)	(764)	
Treasury shares reissued (Note 7)	—	22	—	—	751	773	
Balance, December 31, 2001	528	155,746	5,603	69,279	(386)	230,770	
Net income	—	—	—	30,127	—	30,127	
Other comprehensive income (Note 19)	—	—	24,284	—	—	24,284	
Comprehensive income						<u>54,411</u>	
Issuance of common stock (Note 7)	4	1,016	—	—	—	1,020	
Stock-based compensation (Note 8)	—	1,412	—	—	—	1,412	
Loans to officers (Note 7)	—	10	—	—	—	10	
Treasury shares purchased, at cost (Note 7)	—	—	—	—	(1,520)	(1,520)	
Treasury shares reissued (Note 7)	—	80	—	—	586	666	
Balance, December 31, 2002	\$532	\$158,264	\$29,887	\$99,406	\$(1,320)	\$286,769	

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

UNIVERSAL AMERICAN FINANCIAL CORP. AND SUBSIDIARIES

(In thousands)

FOR THE YEARS ENDED DECEMBER 31,	2002	2001	2000
Cash flows from operating activities:			
Net income	\$ 30,127	\$ 28,925	\$ 22,885
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income taxes	9,404	8,695	7,011
Change in reserves for future policy benefits	33,780	22,885	3,142
Change in policy and contract claims	9,055	788	7,185
Change in deferred policy acquisition costs	(27,850)	(19,186)	(15,925)
Amortization of present value of future profits and goodwill	1,642	2,637	2,749
Amortization of bond premium, net	(3,716)	(3,770)	(2,748)
Change in policy loans	298	1,035	563
Change in accrued investment income	778	(1,203)	(410)
Change in reinsurance balances	(7,983)	(4,844)	1,155
Realized loss (gain) on investments	5,083	(3,078)	(146)
Change in restructuring liability	-	(2,776)	(7,025)
Change in income taxes payable	(1,143)	1,452	1,711
Other, net	(810)	116	(564)
Net cash provided by operating activities	48,665	31,676	19,583
Cash flows from investing activities:			
Proceeds from sale or redemption of fixed maturities	266,541	323,608	113,177
Cost of fixed maturities purchased	(362,141)	(364,699)	(127,255)
Proceeds from sale of equity securities	2,842	612	1,896
Cost of equity securities purchased	(640)	(1,480)	(534)
Change in other invested assets	965	160	1,158
Change in due from/to broker	(4,362)	-	-
Other investing activities	(2,539)	(1,687)	(3,105)
Purchase of business, net of cash acquired	-	(1,544)	(6,365)
Net cash used by investing activities	(99,334)	(45,030)	(21,028)
Cash flows from financing activities:			
Net proceeds from issuance of common stock	1,020	26,242	213
Cost of treasury stock purchases	(1,520)	(764)	(711)
Change in policyholder account balances	34,835	3,791	(16,210)
Change in reinsurance balances on policyholder account balances	798	-	-
Increase in loan payable	-	-	3,000
Principal repayment on loan payable	(10,700)	(8,175)	(3,350)
Issuance of trust preferred securities	15,000	-	-
Net cash provided from financing activities	39,433	21,094	(17,058)
Net increase (decrease) in cash and cash equivalents	(11,236)	7,740	(18,503)
Cash and cash equivalents at beginning of year	47,990	40,250	58,753
Cash and cash equivalents at end of year	\$ 36,754	\$ 47,990	\$ 40,250
Supplemental disclosure of cash flow information:			
Cash paid (received) during the year for:			
Interest	\$ 2,574	\$ 5,195	\$ 7,097
Income taxes	\$ 3,707	\$ 1,818	\$ (3,375)

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

I. Organization and Company Background:

Universal American Financial Corp. (“the Company” or “Universal American”) was incorporated in the State of New York in 1981 as a life and accident & health insurance holding company. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) and consolidate the accounts of Universal American and its subsidiaries (collectively the “Company”), American Progressive Life & Health Insurance Company of New York (“American Progressive”), American Pioneer Life Insurance Company (“American Pioneer”), American Exchange Life Insurance Company (“American Exchange”), Pennsylvania Life Insurance Company (“Pennsylvania Life”), Peninsular Life Insurance Company (“Peninsular”), Union Bankers Insurance Company (“Union Bankers”), Constitution Life Insurance Company (“Constitution”), Marquette National Life Insurance Company (“Marquette”), Penncorp Life Insurance Company, a Canadian company (“Penncorp Life (Canada)”), and CHCS Services, Inc.

Collectively the insurance company subsidiaries are licensed to sell life and accident & health insurance and annuities in all fifty states, the District of Columbia and all the provinces of Canada. The principal insurance products are Medicare supplement, fixed benefit accident and sickness disability insurance, long term care, home health care, senior life insurance and fixed annuities. The Company distributes these products through an independent general agency system and a career agency system. The career agents focus on sales for Pennsylvania Life and Penncorp Life (Canada) while the independent general agents sell for American Pioneer, American Progressive and Constitution. CHCS Services, Inc., the Company’s administrative services company, acts as a service provider for both affiliated and unaffiliated insurance companies for senior market insurance and non-insurance programs.

2. Summary of Significant Accounting Policies:

A. BASIS OF PRESENTATION: The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). For the insurance subsidiaries, GAAP differs from statutory accounting practices prescribed or permitted by regulatory authorities. The accompanying consolidated financial statements include the accounts of Universal American and

its wholly-owned subsidiaries, including the operations of acquired companies from the date of their acquisition. All material intercompany transactions and balances have been eliminated. The significant accounting policies followed by Universal American and subsidiaries that materially affect financial reporting are summarized below.

B. USE OF ESTIMATES: The preparation of our financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the amounts of assets and liabilities and disclosures of assets and liabilities reported by us at the date of the financial statements and the revenues and expenses reported during the reporting period. As additional information becomes available or actual amounts become determinable, the recorded estimates may be revised and reflected in operating results. Actual results could differ from those estimates. In our judgment, the accounts involving estimates and assumptions that are most critical to the preparation of our financial statements are policy and claim liabilities, deferred policy acquisition costs, the valuation of certain investments and deferred taxes. There have been no changes in our critical accounting policies during the current year.

C. INVESTMENTS: The Company follows Statement of Financial Accounting Standards (“SFAS”) No. 115, “Accounting for Certain Debt and Equity Securities.” SFAS 115 requires that debt and equity securities be classified into one of three categories and accounted for as follows: Debt securities that the Company has the positive intent and the ability to hold to maturity are classified as “held to maturity” and reported at amortized cost. Debt and equity securities that are held for current resale are classified as “trading securities” and reported at fair value, with unrealized gains and losses included in earnings. Debt and equity securities not classified as held to maturity or as trading securities are classified as “available for sale” and reported at fair value. Unrealized gains and losses on available for sale securities are excluded from earnings and reported as accumulated other comprehensive income, net of tax and deferred policy acquisition cost adjustments.

As of December 31, 2002 and 2001, all fixed maturity securities were classified as available for sale and were carried at fair value, with the unrealized gain or loss, net of tax and other adjustments (deferred policy acquisition costs), included in accumulated other comprehensive income. Equity securities

are carried at current fair value. Policy loans are stated at the unpaid principal balance. Short-term investments are carried at cost, which approximates fair value. Other invested assets include mortgage loans and collateral loans. The collateral loans are carried at cost which is equal to the fair value of their estimated future cash flows at the date of acquisition. Mortgage loans are carried at the unpaid principal balance.

Fair value of investments is based upon quoted market prices, where available, or on values obtained from independent pricing services. For certain mortgage and asset-backed securities, the determination of fair value is based primarily upon the amount and timing of expected future cash flows of the security. Estimates of these cash flows are based current economic conditions, past credit loss experience and other circumstances.

The Company regularly evaluates the amortized cost of its investments compared to the fair value of those investments. Impairments of securities are generally recognized when a decline in fair value below the amortized cost basis is considered to be other-than-temporary. Impairment losses for certain mortgage and asset-backed securities are recognized when an adverse change in the amount or timing of estimated cash flows occurs, unless the adverse change is solely a result of changes in estimated market interest rates. The cost basis for securities determined to be impaired are reduced to their fair value, with the excess of the cost basis over the fair value recognized as a realized investment loss.

Realized investment gains and losses on the sale of securities are based on the specific identification method.

Investment income is generally recorded when earned. Premiums and discounts arising from the purchase of certain mortgage and asset-backed securities are amortized into investment income over the estimated remaining term of the securities, adjusted for anticipated prepayments. The prospective method is used to account for the impact on investment income of changes in the estimated future cash for these securities. Premiums and discounts on other fixed maturity securities are amortized using the interest method over the remaining term of the security.

D. DEFERRED POLICY ACQUISITION COSTS: The cost of acquiring new business, principally commissions and certain expenses of the agency, policy issuance and underwriting departments, all of which vary with, and are primarily related to the production of new and renewal business, have been deferred. These costs are being amortized in relation to the present value of expected gross profits on the policies arising principally from investment,

mortality and expense margins in accordance with SFAS No. 97, "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments," ("SFAS 97") for interest sensitive life and annuity products and in proportion to premium revenue using the same assumptions used in estimating the liabilities for future policy benefits in accordance with SFAS No. 60, "Accounting and Reporting by Insurance Enterprises," ("SFAS 60") for non-interest sensitive life and all accident & health products. Deferred policy acquisition costs are written off to the extent that it is determined that future policy premiums and investment income or gross profits would not be adequate to cover related losses and expenses.

The Company has several reinsurance arrangements in place on its life and accident & health insurance risks (see Note 12). In the accompanying statement of operations, the Company reports commissions incurred on direct premium written and commission and expense allowances on reinsurance ceded on separate lines to correspond to the presentation of the premiums earned by the Company. In determining the amounts capitalized for deferred acquisition costs, the Company includes an amount for gross commissions and direct issue expenses, net of the related allowances received from the reinsurer on these costs.

E. PRESENT VALUE OF FUTURE PROFITS AND GOODWILL: Business combinations accounted for as a purchase result in the allocation of the purchase consideration to the fair values of the assets and liabilities acquired, including the present value of future profits, establishing such fair values as the new accounting basis. The present value of future profits is based on an estimate of the cash flows of the in-force business acquired, discounted to reflect the present value of those cash flows. The discount rate selected depends upon the general market conditions at the time of the acquisition and the inherent risk in the transaction. Purchase consideration in excess of the fair value of net assets acquired, including the present value of future profits and other identified intangibles, for a specific acquisition, is allocated to goodwill. Allocation of purchase price is performed in the period in which the purchase is consummated. Adjustments, if any, in subsequent periods relate to resolution of pre-acquisition contingencies and refinements made to estimates of fair value in connection with the preliminary allocation.

Amortization of present value of future profits is based upon the pattern of the projected cash flows of the in-force business acquired, over periods ranging from ten to forty years. Other identified intangibles are amortized over their estimated lives.

Prior to December 31, 2001, goodwill was amortized on a straight-line basis over periods ranging from twenty to thirty years. Subsequent to December 31, 2001, goodwill is no longer amortized; see “Adoption of New Accounting Pronouncements” below.

On a periodic basis, management reviews the unamortized balances of present value of future profits, goodwill and other identified intangibles to determine whether events or circumstances indicate the carrying value of such assets is not recoverable, in which case an impairment charge would be recognized. Management believes that no impairments of present value of future profits, goodwill or other identified intangibles existed as of December 31, 2002.

F. RECOGNITION OF REVENUES, CONTRACT BENEFITS AND EXPENSES FOR INVESTMENT AND UNIVERSAL LIFE TYPE POLICIES: Revenues for universal life-type policies and investment products consist of mortality charges for the cost of insurance and surrender charges assessed against policyholder account balances during the period. Amounts received for investment and universal life type products are not reflected as premium revenue; rather such amounts are accounted for as deposits, with the related liability included in policyholder account balances. Benefit claims incurred in excess of policyholder account balances are expensed. The liability for policyholder account balances for universal life-type policies and investment products under SFAS 97 are determined following a “retrospective deposit” method. The retrospective deposit method establishes a liability for policy benefits at an amount determined by the account or contract balance that accrues to the benefit of the policyholder, which consists principally of policy account values before any applicable surrender charges. These products have a minimum guaranteed interest rate of 3%, except for New York which is 4%. Current credited interest rates for these products range from 3.75% to 8.05%.

G. RECOGNITION OF PREMIUM REVENUES AND POLICY BENEFITS FOR ACCIDENT & HEALTH INSURANCE PRODUCTS: Premiums are recorded when due and recognized as revenue over the period to which the premiums relate. Benefits and expenses associated with earned premiums are recognized as the related premiums are earned so as to result in recognition of profits over the life of the policies. This association is accomplished by recording a provision for future policy benefits and amortizing deferred policy acquisition costs. The liability for future policy benefits for accident & health policies consists of active life reserves and the estimated present value of the remaining ultimate net cost of incurred claims. Active life reserves include unearned

premiums and additional reserves. The additional reserves are computed on the net level premium method using assumptions for future investment yield, mortality and morbidity experience. The assumptions are based on past experience. Claim reserves are established for future payments not yet due on incurred claims, primarily relating to individual disability and long term care insurance and group long-term disability insurance products. These reserves are initially established based on past experience, continuously reviewed and updated with any related adjustments recorded to current operations. Claim liabilities represent policy benefits due but unpaid at year-end and primarily relates to individual health insurance products.

H. RECOGNITION OF PREMIUM REVENUES AND POLICY BENEFITS FOR TRADITIONAL LIFE AND ANNUITY PRODUCTS: Premiums from traditional life and annuity policies with life contingencies generally are recognized as income when due. Benefits and expenses are matched with such income so as to result in the recognition of profits over the life of the contracts. This match is accomplished by means of the provision for liabilities for future policy benefits and the deferral and subsequent amortization of policy acquisition costs.

I. RECOGNITION OF ADMINISTRATIVE SERVICE REVENUE: Fees for administrative services generally are recognized over the period for which the Company is obligated to provide service.

J. INCOME TAXES: The Company’s method of accounting for income taxes is the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date of a change in tax rates.

The Company establishes valuation allowances on its deferred tax assets for amounts that it determines will not be recoverable based upon an analysis of projected taxable income and its ability to implement prudent and feasible tax planning strategies. Increases in the valuation allowances are recognized as deferred tax expense. Subsequent determinations that portions of the valuation allowances are no longer necessary are reflected as deferred tax benefits. To the extent that valuation allowances were established in conjunction with acquisitions,

changes in those allowances are first applied to increasing or decreasing the goodwill (but not below zero) or other intangibles related to the acquisition and then applied as an increase or decrease in income tax expense.

K. REINSURANCE: Amounts recoverable under reinsurance contracts are included in total assets as amounts due from reinsurers rather than net against the related policy asset or liability. The cost of reinsurance related to long-duration contracts is accounted for over the life of the underlying reinsured policies using assumptions consistent with those used to account for the underlying policies.

L. FOREIGN CURRENCY TRANSLATION: The financial statement accounts of the Company's Canadian operations, which are denominated in Canadian dollars, are translated into U.S. dollars as follows: (i) Canadian currency assets and liabilities are translated at the rates of exchange as of the balance sheet dates and the related unrealized translation adjustments are included as a component of accumulated other comprehensive income, and (ii) revenues, expenses and cash flows, expressed in Canadian dollars, are translated using a weighted average of exchange rates for each period presented.

M. EARNINGS PER COMMON SHARE: Basic EPS excludes dilution and is computed by dividing net income by the weighted average number of shares outstanding for the period. Diluted EPS gives the dilutive effect of the stock options outstanding during the year. At December 31, 2002, there were 960,519 stock options excluded from the computation of diluted EPS because they were antidilutive. As of December 31, 2001, there were no stock options excluded from the computation of diluted EPS because they were antidilutive.

N. STOCK BASED COMPENSATION: The Company has elected to follow Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations in accounting for its employee and director stock options. Accordingly, no expense is recognized for those options issued with an exercise price at or above market on the date of the award. For options issued to employees with an exercise price that is less than market on the date of grant the Company recognizes an expense for the difference between the exercise price and the value of the options on the date of grant. For options issued to agents and others, the Company follows SFAS No. 123 "Accounting for Stock Based Compensation," ("SFAS 123"). Under SFAS 123, the fair value of options awarded to agents and others are expensed over the vesting period of each award.

O. CASH FLOW INFORMATION: Included in cash and cash equivalents are cash on deposit, money market funds, and short term investments that had an original maturity of three months or less from the time of purchase.

P. ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS:

In June 2001, the FASB issued SFAS No. 141, "Business Combinations" ("SFAS 141"). SFAS 141 eliminates the pooling-of-interests method of accounting for business combinations, requiring all business combinations to be accounted for under the purchase method. Accordingly, net assets acquired are recorded at fair value with any excess of cost over net assets assigned to goodwill. SFAS 141 also requires that certain intangible assets acquired in a business combination be recognized apart from goodwill. The provisions of SFAS 141 apply to all business combinations initiated after June 30, 2001. Adoption of SFAS 141 did not have a material impact on the Company's consolidated financial condition or results of operations.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). Under SFAS 142, effective January 1, 2002 amortization of goodwill is precluded; however, its recoverability must be periodically (at least annually) reviewed and tested for impairment.

Goodwill must be tested at the reporting unit level for impairment in the year of adoption, including an initial test performed within six months of adoption. If the initial test indicates a potential impairment, then a more detailed analysis to determine the extent of impairment must be completed within twelve months of adoption. During the first quarter of 2002, the Company completed the review and analysis of its goodwill asset in accordance with the provisions of SFAS 142. The result of the analysis indicated that each reporting unit's fair value exceeded its carrying amount, including goodwill. As a result, goodwill for each reporting unit was not considered impaired. SFAS 142 also requires that useful lives for intangibles other than goodwill be reassessed and remaining amortization periods be adjusted accordingly.

Effective April 1, 2001, the Company adopted Emerging Issues Task Force ("EITF") Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets" ("EITF 99-20"). Under the consensus, investors in certain securities with contractual cash flows, primarily asset-backed securities, are required to periodically update their best estimate of cash flows over the life of the security. If the fair value of the securitized financial asset is less than its carrying amount and there

has been a decrease in the present value of the estimated cash flows since the last revised estimate, considering both timing and amount, an other than temporary impairment charge is recognized. The estimated cash flows are also used to evaluate whether there have been any changes in the securitized asset's estimated yield. All yield adjustments are accounted for on a prospective basis. Adoption of EITF 99-20 did not have a material impact on the Company's consolidated financial condition or results of operations.

Effective January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), as amended by SFAS Nos. 137 and 138. The standard requires, among other things, that all derivatives be carried on the balance sheet at fair value. The standard also specifies hedge accounting criteria under which a derivative can qualify for special accounting. In order to receive special accounting, the derivative instrument must qualify as a hedge of either the fair value or the variability of the cash flow of a qualified asset or liability, or forecasted transaction. Special accounting for qualifying hedges provides for matching the timing of gain or loss recognition on the hedging instrument with the recognition of the corresponding changes in value of the hedged item. The Company does not currently have any derivative instruments and therefore adoption of SFAS 133 did not have a material impact on the Company's consolidated financial condition or results of operations.

Q. PENDING ACCOUNTING PRONOUNCEMENTS: In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS 145"). SFAS 145 requires any gain or loss on extinguishments of debt to be presented as a component of continuing operations (unless specific criteria are met) whereas SFAS No. 4 required that such gains and losses be classified as an extraordinary item in determining net income. The Company will adopt these provisions on January 1, 2003, as required. The other provisions of SFAS No. 145 were not relevant to the Company.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"). SFAS 146 requires costs associated with exit or disposal activities (including restructurings) to be recognized when the costs are incurred, rather than at a date of commitment to an exit or disposal plan. This standard nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination

Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." Under SFAS 146, a liability related to an exit or disposal activity is not recognized until such liability has actually been incurred whereas under EITF Issue No. 94-3 a liability was recognized at the time of a commitment to an exit or disposal plan. The provisions of this standard are effective for exit or disposal activities initiated after December 31, 2002. The Company will adopt this standard on January 1, 2003, as required.

On December 31, 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure" ("SFAS 148"). This standard amends SFAS 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. This standard also requires prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has applied the disclosure provisions of SFAS 148 as of December 31, 2002, as required and presented below.

As permitted by SFAS 123, the Company measured its stock-based compensation for employees and directors using the intrinsic value approach under APB 25. Accordingly, the Company did not recognize compensation expense upon the issuance of its stock options because the option terms were fixed and the exercise price equaled the market price of the underlying common stock on the grant date. The Company complied with the provisions of SFAS 123 by providing pro forma disclosures of net income and related per share data giving consideration to the fair value method provisions of SFAS 123.

The Company does not intend to adopt the fair value method of accounting for stock-based compensation provisions of SFAS 123 until January 1, 2004, as required by SFAS 148. Therefore, the transition provisions of SFAS No. 148 will be adopted concurrently with the fair value based recognition provisions of SFAS No. 123 on January 1, 2004. Subsequently, the Company will expense all future employee stock awards over the vesting period based on the fair value of the award on the date of grant in accordance with the prospective transition method. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period.

The following table illustrates the effect on net income and earnings per share if the fair value based method had been applied during each period presented.

FOR THE YEARS ENDED DECEMBER 31,
(In thousands, except per share amounts)

	2002	2001	2000
Reported net income	\$30,127	\$28,925	\$22,885
Add back: Stock-based compensation expense included in reported net income, net of tax	1,536	1,044	1,262
Less: Stock based compensation expense determined under fair value based method for all awards, net of tax	(2,623)	(1,804)	(1,787)
Pro forma net income	\$29,040	\$28,165	\$22,360
Net income per share:			
Basic, as reported	\$ 0.57	\$ 0.58	\$ 0.49
Basic, pro forma	0.55	0.57	0.48
Diluted, as reported	0.56	0.57	0.49
Diluted, pro forma	0.54	0.56	0.47

Pro forma compensation expense reflected for prior periods is not indicative of future compensation expense that would be recorded by the Company upon its adoption of the fair value based recognition provisions of SFAS 123 on January 1, 2004. Future expense may vary based upon factors such as the number of awards granted by the Company and the then-current fair market value of such awards.

The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

	2002	2001	2000
Risk free interest rates	3.74%–5.44%	4.92%–5.52%	5.11%
Dividend yields	0.0%	0.0%	0.0%
Expected volatility	37.09%–40.84%	40.81%–48.41%	21.75%–43.74%
Expected lives of options (in years)	2.0–9.0	2.0–9.0	1.0–4.5

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can

materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Detailed information for activity in the Company's stock plans can be found in Note 8 – Stock-Based Compensation.

R. RECLASSIFICATIONS: Certain reclassifications have been made to prior years' financial statements to conform to current period classifications.

3. Business Combinations:

Acquisition of CHCS, Services, Inc.

In January 2000, Universal American acquired all of the outstanding shares of CHCS, Services, Inc. (formerly American Insurance Administration Group, Inc. ("AIAG")), a privately held third party administrator located in Clearwater, Florida, for \$5.8 million, including \$2.9 million in cash and 809,860 shares of Universal American common stock. AIAG is a third party administrator of senior supplemental health insurance. This acquisition has generated increased cash flow and strengthened the Company's administrative capabilities while it expands its presence in the senior market and initiates cross-selling opportunities between the Company's Senior Market Brokerage and Career Agency segments.

The fair value of the net assets acquired was \$(0.9) million. The present value of future profits ("PVFP") acquired was \$7.7 million and was offset by related deferred taxes of \$1.0 million. The PVFP was determined using a discount rate of 15%. It is being amortized in proportion to the expected profits from the contracts in force on the date of acquisition. Amortization of the PVFP was \$1.5 million during 2002, \$2.1 million during 2001 and \$2.8 million during 2000. As of December 31, 2002 \$1.3 million, or 17%, of the original amount remains unamortized.

Acquisition of CHCS, Inc. ("CHCS")

In August 2000, Universal American acquired all of the outstanding shares of CHCS, a privately held third party administrator located in Weston, Florida, for \$4.6 million, including \$3.3 million in cash, 64,820 shares on Universal American common stock and future cash payments totaling \$1.0 million over 18 months. CHCS is a third party administrator of long term care and home health care insurance products for unaffiliated insurance companies, as well as the Company's insurance subsidiaries. The fair value of the net assets acquired was \$1.9 million. The excess of the purchase price over the fair value of the net assets acquired was assigned to goodwill.

4. Pending Acquisition:

In December 2002, Pennsylvania Life entered into a definitive contract to acquire Pyramid Life Insurance Company (“Pyramid Life”) from Ceres Group, Inc. for \$56.0 million in cash. The closing of the transaction, which is subject to regulatory approvals and other customary conditions, is scheduled to close by the end of the first quarter of 2003.

Pyramid Life specializes in providing health and life insurance products to the senior market. These products include Medicare supplement, long term care, life insurance, and annuities. Pyramid Life markets its products in 26 states through a career agency sales force of over 1,100 career agents operating out of 29 Senior Solutions Sales Centers. As of the end of 2002, Pyramid Life had approximately \$110.0 million of annualized premium in force and in excess of \$114.0 million of assets.

5. Investments:

The amortized cost and fair value of fixed maturities as of December 31, 2002 and 2001 are as follows:

DECEMBER 31, 2002
(In thousands)

CLASSIFICATION	AMORTIZED COST	GROSS	GROSS	FAIR VALUE
		UNREALIZED GAINS	UNREALIZED LOSSES	
U.S. Treasury securities and obligations of U.S. government	\$ 90,189	\$ 1,670	\$ (9)	\$ 91,850
Corporate debt securities	374,087	30,323	(1,667)	402,743
Foreign debt securities ⁽¹⁾	166,689	10,072	(216)	176,545
Mortgage and asset-backed securities	253,089	12,621	(1,898)	263,812
	\$884,054	\$54,686	\$(3,790)	\$934,950

DECEMBER 31, 2001
(In thousands)

CLASSIFICATION	AMORTIZED COST	GROSS	GROSS	FAIR VALUE
		UNREALIZED GAINS	UNREALIZED LOSSES	
U.S. Treasury securities and obligations of U.S. government	\$ 35,719	\$ 1,262	\$ (11)	\$ 36,970
Corporate debt securities	357,431	8,990	(1,805)	364,616
Foreign debt securities ⁽¹⁾	157,077	2,225	(1,640)	157,662
Mortgage and asset-backed securities	236,617	5,700	(2,347)	239,970
	\$786,844	\$18,177	\$(5,803)	\$799,218

⁽¹⁾ Primarily Canadian dollar denominated bonds supporting our Canadian insurance reserves.

The amortized cost and fair value of fixed maturities at December 31, 2002 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(In thousands)

	AMORTIZED COST	FAIR VALUE
Due in 1 year or less	\$ 44,775	\$ 45,693
Due after 1 year through 5 years	133,904	139,343
Due after 5 years through 10 years	305,472	330,086
Due after 10 years	146,655	156,016
Mortgage and asset-backed securities	253,248	263,812
	\$884,054	\$934,950

Included in fixed maturities at December 31, 2002 and 2001 were securities with carrying values of \$35.3 million and \$32.4 million, respectively, held by various states as security for the policyholders of the Company within such states.

Gross unrealized gains and gross unrealized losses of equity securities as of December 31, 2002 and 2001 are as follows:

(In thousands)

	2002	2001
Gross unrealized gains	\$ 117	\$ 199
Gross unrealized losses	(133)	(339)
Net unrealized losses	\$(16)	\$(140)

The components of the change in unrealized gains and losses included in the consolidated statements of stockholders' equity for the three years ended December 31, 2002 are as follows:

(In thousands)

	2002	2001	2000
Change in net unrealized gains (losses):			
Fixed maturities	\$ 38,522	\$ 6,695	\$ 22,584
Equity securities	124	132	10
Foreign currency	679	(3,996)	(1,434)
Adjustment relating to deferred policy acquisition costs	(1,958)	(1,333)	(2,209)
Change in net unrealized gains (losses) before income tax	37,367	1,498	18,951
Income tax (expense) benefit	(13,083)	(770)	(7,189)
Change in net unrealized gains (losses)	\$ 24,284	\$ 728	\$ 11,762

The details of net investment income for the three years ended December 31, 2002 are as follows:

(In thousands)

	2002	2001	2000
Investment Income:			
Fixed maturities	\$54,553	\$54,100	\$52,478
Cash and cash equivalents	1,044	1,749	1,939
Equity securities	197	238	330
Other	1,279	1,181	1,380
Policy loans	1,697	1,529	1,617
Mortgage loans	134	205	214
Gross investment income	58,904	59,002	57,958
Investment expenses	(1,188)	(1,190)	(1,013)
Net investment income	\$57,716	\$57,812	\$56,945

There were no non-income producing fixed maturities for the year ended December 31, 2002. Fixed maturities with a carrying value of \$0.1 million and \$0.7 million were non-income producing for the years ended December 31, 2001 and 2000, respectively.

Gross realized gains and gross realized losses included in the consolidated statements of operations for the three years ended December 31, 2002 are as follows:

(In thousands)

	2002	2001	2000
Realized gains:			
Fixed maturities	\$ 10,435	\$ 9,301	\$ 1,022
Equity securities and other invested assets	72	14	192
Total realized gains	10,507	9,315	1,214
Realized losses:			
Fixed maturities	(14,914)	(6,237)	(1,019)
Equity securities	(676)	—	(49)
Total realized losses	(15,590)	(6,237)	(1,068)
Net realized gains (losses)	\$ (5,083)	\$ 3,078	\$ 146

The Company wrote down the value of certain fixed maturity securities by \$10.6 million during 2002, primarily as a result of the impairment of our WorldCom bonds. The WorldCom bonds were disposed of in the third quarter of 2002 at a price approximating their carrying value after the other-than-temporary decline was recognized. The Company wrote down the value of certain fixed maturity securities by \$4.2 million during 2001 and by \$0.5 million during 2000. These write downs represent management's estimate of other-than-temporary declines in value and were included in net realized gains (losses) on investments.

For the years ended December 31, 2002 and 2001, the Company held unrated or less-than-investment grade corporate debt securities with carrying and estimated fair values as follows:

(In thousands)

	2002	2001
Carrying value	\$5,266	\$7,750
Estimated fair value	5,266	7,750
Percentage of total assets	0.4%	0.6%

The holdings of less-than-investment grade securities are widely diversified and the investment in any one such security is currently less than \$2.4 million, which is approximately 0.2% of total assets.

6. Income Taxes:

The parent holding company files a consolidated return for federal income tax purposes, which includes all of the non-insurance company subsidiaries as well as American Progressive through March 31, 2002 and American Pioneer through June 30, 2002. American Exchange and its subsidiaries and Penncorp Life (Canada) are not currently included. American Exchange and its subsidiaries, including American Progressive as of April 1, 2002 and American Pioneer as of July 1, 2002, file a separate consolidated federal income tax return. Penncorp Life (Canada) files a separate return with Revenue Canada.

Income before taxes by geographic distribution for the three years ended December 31, 2002 is as follows:

(In thousands)

	2002	2001	2000
United States	\$30,290	\$27,606	\$21,303
Canada	13,740	15,757	11,763
Total income before taxes	\$44,030	\$43,363	\$33,066

The Company's federal and state income tax expense (benefit) for the three years ended December 31, 2002 is shown below:

(In thousands)

	2002	2001	2000
Current – United States	\$ 208	\$ 449	\$ (126)
Current – Canada	4,291	5,451	3,296
Sub total current	4,499	5,900	3,170
Deferred – United States	8,268	8,409	7,281
Deferred – Canada	1,136	129	(270)
Sub total deferred	9,404	8,538	7,011
Total tax expense	\$13,903	\$14,438	\$10,181

A reconciliation of the “expected” tax expense at 35% with the Company's actual tax expense applicable to operating income before taxes reported in the Consolidated Statements of Operations for the three years ended December 31, 2002 is shown below:

(In thousands)

	2002	2001	2000
Expected tax expense	\$15,410	\$15,177	\$11,573
Change in valuation allowance	(1,694)	(737)	(1,343)
Canadian taxes	51	(208)	(390)
Other	136	206	341
Actual tax expense	\$13,903	\$14,438	\$10,181

In addition to federal and state income tax, the Company is subject to state premium taxes, which taxes are included in other operating costs and expenses in the accompanying statements of operations.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying value of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2002 and 2001 are as follows:

(In thousands)

	2002	2001
Deferred tax assets:		
Reserves for future policy benefits	\$ 19,484	\$23,140
Deferred policy acquisition costs	9,970	16,786
Net operating loss carryforward	11,400	16,659
Asset valuation differences	11,845	10,745
Deferred revenues	1,165	1,214
AMT credit carryforward	197	68
Other	2,666	1,394
Total gross deferred tax assets	56,727	70,006
Less valuation allowance	(5,100)	(6,794)
Net deferred tax assets	51,627	63,212
Present value of future profits	314	(244)
Unrealized gains on investments	(16,099)	(3,016)
Total gross deferred tax liabilities	(15,785)	(3,260)
Net deferred tax asset	\$ 35,842	\$59,952

At December 31, 2002, the Company (exclusive of American Exchange and its subsidiaries and Penncorp Life) had tax loss carryforwards of approximately \$2.7 million that expire in the years 2015 to 2016. At December 31, 2002, the Company also had an Alternative Minimum Tax (AMT) credit carryforward for federal income tax purposes of approximately \$0.1 million that can be carried forward indefinitely. At December 31, 2002, American Exchange and its subsidiaries had tax loss carryforwards, most of which relate to the companies acquired in 1999 (and were incurred prior to their acquisition), of approximately \$274 million that expire in the years 2008 to 2017. As a result of changes in ownership of the Company in July 1999, the use of most of the loss carryforwards of the Company are subject to annual limitations.

At December 31, 2002 and 2001, the Company carried valuation allowances of \$5.1 million and \$6.8 million, respectively, with respect to its deferred tax assets. The Company establishes a valuation allowance based upon an analysis of projected taxable income and its ability to implement prudent and feasible tax planning strategies. As a result of the increased profitability of the insurance subsidiaries acquired in 1999, a portion of the valuation allowance on certain of the life tax loss carryforwards were no longer considered necessary at December 31, 2002. The amount of the valuation allowance released during 2002 was \$2.1 million and was recorded as a deferred income tax benefit. As a result of the increased profitability of the Administrative Services segment, valuation allowances on certain of the non-life tax loss carryforwards no longer were considered necessary as of December 31, 2002. The amount of the valuation allowance released during 2002 was \$0.1 million and was also recorded as a deferred income tax benefit. This decrease was partially offset by the establishment of a valuation allowance of \$0.5 million for certain capital losses incurred in 2002 by the Company that are subject to limitation in their use. Management believes it is more likely than not that the Company will realize the recorded net deferred tax assets.

7. Stockholders' Equity:

Preferred Stock

The Company has 2.0 million authorized shares of preferred stock with no such shares issued and outstanding at December 31, 2002 or 2001.

Common Stock

The par value of common stock is \$.01 per share with 80.0 million shares authorized for issuance. The shares issued and outstanding at December 31, 2002 and 2001 were 53.2 million and 52.8 million, respectively. During the years ended December 31, 2002, 2001 and 2000, the Company issued 0.4 million shares, 6.0 million shares (primarily as a result of the equity offering noted below) and 0.9 million shares, respectively, of its common stock.

Equity Offering

On July 12, 2001, the Company entered into an Underwriting Agreement with Banc of America Securities LLC and Raymond James & Associates, Inc., as representatives of the underwriters named therein, and certain shareholders of the Company, with respect to the sale of up to 7,950,000 shares of the Company's common stock (including 750,000 shares of Common Stock subject to an over-allotment option granted to the Underwriters by the Company and some of the selling shareholders). As a result, on July 12, 2001, the Company issued five million shares of common stock at a price of \$5.00 per share, generating proceeds of \$25 million. Expenses for this transaction, including the underwriters' discounts and commissions, amounted to \$2.4 million, resulting in net proceeds of \$22.6 million to the Company. The proceeds from this offering were used to enhance the capital and surplus of certain of our insurance subsidiaries (\$9.3 million), reduce inter-company obligations (\$5.5 million) and the balance to hold at the parent company for general corporate purposes. In connection with this offering, certain shareholders of the company, none of whom were management, sold 2.2 million shares at \$5.00 per share, less the underwriters' discounts and commissions of \$0.3187 per share.

On August 13, 2001, the over-allotment option provided in the underwriting agreement was exercised and, as a result, the Company issued an additional 720,000 shares of common stock at a price of \$5.00 per share, less the underwriters' discounts and commissions of \$0.3187 per share, generating additional net proceeds of \$3.4 million. In connection with the over-allotment option, certain shareholders sold an additional 30,000 shares at \$5.00 per share, less the underwriters' discounts and commissions of \$0.3187 per share.

The net proceeds to the Company of the total offering, including the over-allotment, was \$26.2 million, net of total expenses of \$2.6 million.

Shareholders' Agreement

Universal American, Capital Z, Richard Barasch (the Chairman and Chief Executive Officer of the Company) and several other shareholders of Universal American entered into a shareholders' agreement on July 30, 1999 (the "Shareholders' Agreement"). The Shareholders' Agreement requires that all proposed sales/transfers by the other shareholders who are party to the Shareholders' Agreement must first be offered to Richard Barasch and Capital Z, including its affiliates. However, pledges and some other transfers by any party to the Shareholders' Agreement of less than 1% of Universal American's outstanding common stock at any one time, or 2.5% when aggregated with the other transfers by the shareholder and his, her or its permitted transferees of Universal American's outstanding common stock, are permitted. In addition, Richard Barasch was not permitted to sell more than 3% of his holdings for a three-year period beginning July 30, 1999. The Shareholders' Agreement provides for tag-along and drag-along rights under some circumstances. "Tag-along rights" allow the holder of stock to include his, her or its stock in a sale of common stock initiated by another party to the Shareholders' Agreement. "Drag-along rights" permit a selling party to the Shareholders' Agreement to force the other parties to the Shareholders' Agreement to sell a proportion of the other holder's shares in a sale arranged by the selling shareholder.

Under the terms of the Shareholders' Agreement, of the nine members of Universal American's board of directors, certain shareholders are permitted to nominate directors as follows: Capital Z: four, Richard Barasch: two and Universal American: two. Capital Z and Richard Barasch are each required to vote for the director(s) nominated by the other. The right of Richard Barasch to nominate directors is conditioned upon his continued employment with Universal American. In addition, the right to nominate directors is not transferable, except that Capital Z may transfer its right to a third-party buyer who acquires 10% or more of the outstanding common stock of Universal American from Capital Z.

Treasury Stock

During 2000, the Board of Directors approved a plan to re-purchase up to 0.5 million shares of Company stock in the open market. In March 2002, the Board of Directors approved an amendment of the plan to increase the amount of shares available for repurchase from 0.5 million to 1.0 million shares. The purpose of this plan is to fund employee stock bonuses.

During the year ended December 31, 2002, the Company acquired 0.3 million shares at a cost of \$1.5 million during the year at market prices ranging from \$4.06 to \$7.54 per share. The Company distributed 0.1 million shares in the form of officer and employee bonuses at market prices ranging from \$6.45 to \$6.81 per share at the date of distribution, amounting to \$0.6 million.

During the year ended December 31, 2001, the Company acquired 0.2 million shares at a cost of \$0.8 million during the year at market prices ranging from \$3.75 to \$6.87 per share. The Company distributed 0.2 million shares in the form of officer and employee bonuses at market prices ranging from \$3.88 to \$6.81 per share at the date of distribution, amounting to \$0.8 million.

Additional Paid In Capital

The Company provided loans to certain members of management to purchase shares of common stock in connection with the 1999 acquisition. The loans totaled \$1.0 million at inception and were accounted for as a reduction of additional paid in capital in the financial statements. Repayments of these loans increase additional paid in capital. As of December 31, 2002, the outstanding balance of these loans was \$0.9 million. The terms of these loans include a provision whereby they will be forgiven should the closing price of the Company's common stock reach a level of \$9.50 for each and every day during any period of 60 consecutive calendar days prior to August 1, 2003.

Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income are as follows:

	DECEMBER 31, (In thousands)		
	2002	2001	2000
Net unrealized appreciation on investments	\$ 50,880	\$12,234	\$ 5,406
Deferred acquisition cost adjustment	(2,320)	(361)	972
Foreign currency translation gains (losses)	(2,574)	(3,253)	743
Deferred tax on the above	(16,099)	(3,017)	(2,246)
Accumulated other comprehensive income	\$ 29,887	\$ 5,603	\$ 4,875

8. Stock Based Compensation:

1998 Incentive Compensation Plan

On May 28, 1998, the Company's shareholders approved the 1998 Incentive Compensation Plan (the "1998 ICP"). The

1998 ICP superceded the Company's 1993 Incentive Stock Option Plan. Options previously granted under the Company's Incentive Stock Option Plan will remain outstanding in accordance with their terms and the terms of the respective plans. The 1998 ICP provides for grants of stock options, stock appreciation rights ("SARs"), restricted stock, deferred stock, other stock-related awards, and performance or annual incentive awards that may be settled in cash, stock, or other property ("Awards").

The total number of shares of the Company's Common Stock reserved and available for delivery to participants in connection with Awards under the 1998 ICP is (i) 1.5 million, plus (ii) the number of shares of Common Stock subject to awards under Preexisting Plans that become available (generally due to cancellation or forfeiture) after the effective date of the 1998 ICP, plus (iii) 13% of the number of shares of Common Stock issued or delivered by the Corporation during the term of the 1998 ICP (excluding any issuance or delivery in connection with Awards, or any other compensation or benefit plan of the Corporation), provided, however, that the total number of shares of Common Stock with respect to which incentive stock options ("ISOs") may be granted shall not exceed 1.5 million. As of December 31, 2002, a total of 7.3 million shares were eligible for grant under the plan. There were 4.6 million shares reserved for outstanding options awarded under the 1998 ICP, 1.4 million shares issued pursuant to previous awards and 1.3 million shares reserved for issuance under future Awards at December 31, 2002.

Executive officers, directors, and other officers and employees of the Corporation or any subsidiary, as well as other persons who provide services to the Company or any subsidiary, are eligible to be granted Awards under the 1998 ICP, which is administered by the Board or a Committee established pursuant to the Plan.

The Committee, may, in its discretion, accelerate the exercisability, the lapsing of restrictions, or the expiration of deferral or vesting periods of any Award, and such accelerated exercisability, lapse, expiration and vesting shall occur automatically in the case of a "change in control" of the Company, except to the extent otherwise determined by the Committee at the date of grant or thereafter. The Committee has not yet exercised any of its discretions noted above.

Stock Awards

In accordance with the 1998 ICP, the Company grants restricted stock to its officers and non-officer employees.

These grants vest upon issue. The non-officer grants are expensed and awarded in the same year. The Company granted awards to non-officer employees of 7,721 shares with a fair value of \$5.92 per share during 2002, 11,386 shares with a fair value of \$6.81 per share during 2001 and 32,290 shares with a fair value of \$4.00 per share during 2000. Officer grants are accrued for during the year for which they are earned and awarded the following year. The Company granted awards to officers of 182,000 shares with a fair value of \$5.57 per share for 2002 performance, 103,216 shares with a fair value of \$6.45 per share for 2001 performance and 176,614 shares with a fair value of \$3.94 per share for 2000 performance. The Company recognized compensation expense of \$1.1 million for the year ended December 31, 2002, \$0.7 million for 2001 and \$0.8 million for 2000.

Agent's Stock Purchase Plan

The Company offers shares of its common stock for sale to qualifying agents of the Insurance Subsidiaries pursuant to the Company's Agents Stock Purchase Plan ("ASPP"). Shares are sold at market price and, accordingly, no expense is recognized. Pursuant to the ASPP, agents purchased 30,250 shares

at a weighted average price of \$6.30 per share in 2002, 13,100 shares at a weighted average price of \$4.89 per share in 2001, and 16,050 shares at a weighted average price of \$4.00 per share in 2000.

Agent's Deferred Compensation Plan

The Company also offers shares of Common Stock for sale to its agents pursuant to the Company's Deferred Compensation Plan for Agents ("DCP"). Under the DCP, agents may elect to defer receipt between 5% and 100% of their first year commission, which deferral will be matched by a contribution by the Company, initially set at 25% of the amount of the deferral, up to a maximum of 5% of the agent's commissions. Both the agent's participation in the DCP and the Company's obligation to match the agent's deferral are subject to the agent satisfying and continuing to satisfy minimum earning, production and persistency standards. Shares are sold under the plan at market price and, accordingly, no expense is recognized, except for the fair value of the shares representing the Company match on the date of the contribution to the DCP. Agents deferred commissions amounting to \$0.3 million in 2002, \$0.2 million in 2001 and \$0.1 million in 2000.

Option Awards

A summary of the status of the Company's stock option plans during the three years ended December 31, 2002 and changes during the years ending on those dates is presented below:

(In thousands, except dollar amounts)

FIXED OPTIONS	2002		2001		2000	
	OPTIONS	WEIGHTED-AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED-AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED-AVERAGE EXERCISE PRICE
Outstanding—beginning of year	4,916	\$3.31	4,643	\$3.22	4,388	\$3.09
Granted	940	6.64	485	4.14	682	4.30
Exercised	(284)	3.30	(168)	2.95	(17)	2.60
Terminated	(59)	4.21	(44)	3.60	(410)	3.18
Outstanding—end of year	5,513	\$3.87	4,916	\$3.31	4,643	\$3.22
Options exercisable at end of year	3,601	\$3.51	2,911	\$3.16	2,157	\$2.90

A summary of the weighted average fair value of options granted during the three years ended December 31, 2002 is presented below:

(In thousands, except dollar amounts)

FIXED OPTIONS	2002		2001		2000	
	OPTIONS	WEIGHTED-AVERAGE FAIR VALUE	OPTIONS	WEIGHTED-AVERAGE FAIR VALUE	OPTIONS	WEIGHTED-AVERAGE FAIR VALUE
Above market	176	\$2.11	93	\$1.13	160	\$1.34
At market	629	4.08	382	2.60	286	1.72
Below market	135	3.01	10	2.16	236	1.86
Total granted	940	\$3.55	485	\$2.31	682	\$1.68

The following table summarizes information about stock options outstanding at December 31, 2002:

(In thousands, except dollar amounts)

RANGE OF EXERCISE PRICES	NUMBER	WEIGHTED-	WEIGHTED-	NUMBER	WEIGHTED-
	OUTSTANDING	AVERAGE	AVERAGE	EXERCISABLE	AVERAGE
	AT	REMAINING	EXERCISE	AT	EXERCISE
	DECEMBER 31,	CONTRACTUAL	PRICE	DECEMBER 31,	PRICE
	2002	LIFE		2002	
\$1.88–3.12	994	4.6 years	\$2.49	994	\$2.49
3.15	2,360	5.9 years	3.15	1,456	3.15
3.25–4.79	1,045	5.4 years	4.01	683	3.92
5.00–8.55	1,114	6.7 years	6.50	468	6.18
\$1.88–8.55	5,513	5.7 years	\$3.87	3,601	\$3.51

A summary of the activity relating to the options awarded by the Company for employees, directors and agents for the three years ended December 31, 2002, is as follows:

(In thousands, except dollar amounts)

	EMPLOYEES	DIRECTORS	AGENTS &	TOTAL	RANGE OF
			OTHERS		EXERCISE PRICES
Balance, January 1, 2000	3,286	129	973	4,388	
Granted	471	51	160	682	\$3.15–\$5.06
Exercised	(12)	(5)	—	(17)	\$2.25–\$3.15
Terminated	(375)	—	(35)	(410)	\$2.25–\$4.25
Balance, December 31, 2000	3,370	175	1,098	4,643	
Granted	334	48	103	485	\$3.15–\$6.00
Exercised	(83)	(10)	(75)	(168)	\$2.20–\$4.06
Terminated	(23)	(3)	(18)	(44)	\$3.15–\$4.25
Balance, December 31, 2001	3,598	210	1,108	4,916	
Granted	571	53	316	940	\$4.75–\$8.55
Exercised	(131)	(10)	(143)	(284)	\$2.00–\$5.31
Terminated	(34)	(11)	(14)	(59)	\$2.25–\$6.45
Balance, December 31, 2002	4,004	242	1,267	5,513	

At December 31, 2002, approximately 2.3 million, 0.2 million and 1.1 million options were exercisable by employees, directors and agents, respectively.

Options Granted to Employees

Options are generally granted to eligible employees at a price not less than the market price of the Company's common stock on the date of the grant. Option shares may be exercised subject to the terms prescribed by the individual grant agreement, however, options generally vest 50% after the first year and 50% after the second year. Vested options must be exercised not later than ten years after the date of the grant or following earlier termination of employment. Because these awards are made at a price equal to or greater than market on the date of grant, no compensation cost is recognized for such awards.

The Company issued 2.3 million below market stock options with an exercise price of \$3.15 per share to certain employees and members of management on August 1, 1999. During 2000, the Company issued an additional 0.2 million below market

stock options with an exercise price of \$3.15 per share to certain relocated employees and members of management on July 31, 2000. As of December 31, 2002, the number of these options outstanding decreased to 2.0 million, primarily through employee terminations. These options generally vest 20% upon grant and 20% each subsequent year. However, 0.6 million vest after seven years, subject to certain criteria, which could accelerate vesting to five years. These options must be exercised not later than ten years after the date of the grant or following earlier termination of employment. In accordance with APB 25, the Company recorded an expense for the difference between the exercise price of \$3.15 per share and the value of the options on the date of grant of \$0.6 million for the year ended December 31, 2002, \$0.6 million for 2001 and \$0.8 million for 2000.

Stock Options Issued to Directors

Directors of the Company are eligible for options under the 1998 ICP. The 1998 ICP provides that unless otherwise determined by the Board, each non-employee director would be

granted an option to purchase 4,500 shares of Common Stock upon approval of the 1998 ICP by shareholders or, as to directors thereafter elected, his or her initial election to the Board, and at each annual meeting of shareholders starting in 1999 at which he or she qualifies as a non-employee director. The 1998 ICP also provides that the non-employee directors for American Progressive would be granted an option to purchase 1,500 shares of Common Stock at each annual meeting. Unless otherwise determined by the Board, such options will have an exercise price equal to 100% of the fair market value per share on the date of grant and will become exercisable in three equal installments after each of the first, second and third anniversaries of the date of grant based on continued service as a director. Because these are made at a price equal to market, no compensation expense is recognized for such awards.

Stock Option Plan for Agents and Others

On December 15, 1995, the Board of Directors approved a plan under which up to 200,000 options could be granted to agents of the Company's subsidiaries (subject to insurance law restrictions) and to other persons as to whom the board of directors believes the grant of such options will serve the best interests of the Corporation, provided that no options may be granted under this plan to officers, directors or employees of the Company or of any subsidiary, while they are serving as such. Such options expire ten years from the date of the grant. Options outstanding under this plan total 102,786, all of which are exercisable. In 1998, agents and other persons became eligible for options under the 1998 ICP. Agents were issued a total of 166,200 options with an exercise price of \$8.42 per share in 2002 for 2001 sales performance 159,600 options with an exercise price of \$5.00 per share in 2001 for 2000 sales performance and 142,000 options with an exercise price of \$5.31 per share in 2000 for 1999 sales performance. These options vest in equal installments over a three year period and expire five years from the date of grant.

In connection with the acquisition of the Pennsylvania Life, the Company adopted additional stock option plans for agents and regional managers of the Career segment. The Career agents and managers were eligible to earn stock and stock options based on new premium production at predetermined exercise prices. A total of 1,486,730 shares were eligible for award under this plan, which ended at December 31, 2001. Options and stock awarded to agents under this plan cliff vest 24 months after the end of the year of option grant and expire at the earliest of the termination date as an agent or 30 days after the option becomes exercisable. The Career agents were awarded,

net of terminations, 67,173 options with an exercise price of \$4.79 related to 2001 sales performance, 59,768 options with an exercise price of \$4.17 related to 2000 sales performance and 68,077 options with an exercise price of \$3.62 related to 1999 sales performance. The Career agents were also awarded stock grants, net of terminations of 71,429 shares based on \$4.79 per share for 2001 sales performance, 63,097 shares based on \$4.17 per share for 2000 sales performance and 68,077 shares based on \$3.62 per share for 1999 sales performance. Regional managers of the Career segment were awarded 64,242 options with an exercise price of \$4.79 for 2001 sales performance, 19,904 options with an exercise price of \$4.17 per share for 2000 performance and 37,762 options with an exercise price of \$3.62 for 1999 sales performance.

In accordance with SFAS 123, the fair values of these options are expensed over the vesting period of each award. Total expense relating to the above plans was \$0.7 million for the year ended December 31, 2002, \$0.2 million for 2001 and \$0.5 million for 2000.

9. Statutory Capital and Surplus Requirements and Dividend Restrictions:

Statutory Capital and Surplus Requirements

The insurance subsidiaries' statutory basis financial statements are prepared in accordance with accounting practices prescribed or permitted by their respective domiciliary states. "Prescribed" statutory accounting practices include state laws, regulations and general administrative rules, as well as publications of the NAIC. "Permitted" statutory accounting practices encompass all accounting practices that are not prescribed but are authorized by the relevant insurance departments; such practices may differ from state to state, may differ from company to company within a state and may change in the future.

The insurance subsidiaries are required to maintain minimum amounts of capital and surplus as required by regulatory authorities. Each of the insurance subsidiaries' statutory capital and surplus exceeds its respective minimum requirement. However, substantially more than such minimum amounts are needed to meet statutory and administrative requirements of adequate capital and surplus to support the current level of the Insurance Subsidiaries' operations. At December 31, 2002 and 2001 the statutory capital and surplus, including asset valuation reserve, of the U.S. insurance subsidiaries totaled \$106.5 million and \$107.0 million, respectively. The net statutory loss for the year ended December 31, 2002 was \$9.1 million, which included net realized losses of \$16.8 million. Statutory net income for the year ended December 31, 2001

was \$14.6 million, which included net realized gains of \$1.3 million.

The National Association of Insurance Commissioners (“NAIC”) imposes regulatory risk-based capital (“RBC”) requirements on life insurance enterprises. At December 31, 2002 all of the Insurance Subsidiaries maintained ratios of total adjusted capital to RBC in excess of the Authorized Control Level.

Penncorp Life (Canada) reports to Canadian regulatory authorities based upon Canadian statutory accounting principles that vary in some respects from U.S. statutory accounting principles. Canadian net assets based upon Canadian statutory accounting principles were \$38.1 million and \$58.6 million as of December 31, 2002 and 2001, respectively. Penncorp Life (Canada) maintained a Minimum Continuing Capital and Surplus Requirement Ratio (“MCCSR”) in excess of the minimum requirement at December 31, 2002.

Dividend Restrictions

American Progressive is a New York insurance company. New York State Insurance Law provides that the declaration or payment of a dividend by American Progressive requires the approval of the New York Superintendent of Insurance. Management expects that no dividend would be approved until American Progressive had generated sufficient statutory profits to offset its negative unassigned surplus.

Pennsylvania Life is a Pennsylvania insurance company and American Exchange, Constitution, Marquette and Union Bankers are Texas insurance companies. Pennsylvania and Texas insurance law provides that a life insurer may pay dividends or make distributions from accumulated earnings without the prior approval of the Insurance Department, provided they do not exceed the greater of (i) 10% of the insurer’s surplus as to policyholders as of the preceding December 31st; or (ii) the insurer’s net gain from operations for the immediately preceding calendar year with 30 days advance notification to the insurance department. Accordingly, Pennsylvania Life would be able to pay ordinary dividends of up to \$10.6 million to American Exchange (its direct parent) without the prior approval from the Pennsylvania Insurance Department in 2003. American Exchange, Constitution, Marquette and Union Bankers had negative earned surplus at December 31, 2002 and would not be able to pay dividends in 2003 without special approval.

American Pioneer and Peninsular are Florida insurance companies. Florida State insurance law provides that a life insurer

may pay a dividend or make a distribution without the prior written approval of the department when: a) the dividend is paid from that portion of the accumulated and available surplus of the Company as is derived from the net operating profits of its business and its net realized capital gains; b) the dividend is no more than the greater of (i) 10% of the insurer’s surplus as to policyholders derived from net operating profits on its business and net realized capital gains; or (ii) the insurer’s entire net operating profits and realized net capital gains derived during the immediately preceding calendar year; c) the insurer will have surplus as to policyholders equal to or exceeding 115% of the minimum required statutory surplus as to policyholders after the dividend or distribution is made; and d) the insurer has filed notice with the department at least 10 business days prior to the dividend payment or distribution. American Pioneer and Peninsular had negative unassigned surplus and would not be able to pay dividends in 2003 without special approval.

Penncorp Life (Canada) is a Canadian insurance company. Canadian law provides that a life insurer may pay a dividend after such dividend declaration has been approved by its board of directors and upon at least 10 days prior notification to the Superintendent of Financial Institutions. In considering approval of a dividend, the board of directors must consider whether the payment of such dividend would be in contravention of the Insurance Companies Act of Canada. Accordingly, we anticipate that Penncorp Life (Canada) will be able to pay dividends up to \$6.6 million to Universal American in 2003.

Dividends Paid

During the year ended December 31, 2002, Pennsylvania Life paid ordinary dividends to American Exchange totaling \$3.0 million. Penncorp Life (Canada) paid dividends to Universal American totaling \$5.9 million during 2002. CHCS Services, Inc. also paid dividends to Universal American totaling \$9.1 million in 2002.

During the year ended December 31, 2001, Union Bankers paid an ordinary dividend to American Exchange of \$1.7 million. Union Bankers also distributed its investment in the common stock of Marquette to American Exchange in the form of an extraordinary dividend. Additionally, Peninsular paid an extraordinary dividend of \$1.9 million to American Pioneer in 2001. CHCS Services, Inc. also paid dividends to Universal American totaling \$9.3 million in 2001.

During the year ended December 31, 2000, Pennsylvania Life and Union Bankers paid ordinary dividends to American

Exchange of \$2.9 million and \$2.0 million, respectively. Additionally, Peninsular Life paid an extraordinary dividend of \$1.5 million to Universal American in 2000.

10. Deferred Policy Acquisition Costs:

Details with respect to deferred policy acquisition costs (in thousands) for the three years ended December 31, 2002 are as follows:

Balance at January 1, 2000	\$ 34,943
Capitalized costs	24,200
Adjustment relating to unrealized loss on fixed maturities	(2,209)
Foreign currency adjustment	(8)
Amortization	(6,866)
Adjustment relating to the decision to exit the major medical line of business	(1,409)
Balance at December 31, 2000	48,651
Capitalized costs	29,550
Adjustment relating to unrealized loss on fixed maturities	(1,334)
Foreign currency adjustment	(478)
Amortization	(10,364)
Balance at December 31, 2001	66,025
Capitalized costs	40,550
Adjustment relating to unrealized loss on fixed maturities	(1,958)
Foreign currency adjustment	176
Amortization	(12,700)
Balance at December 31, 2002	\$ 92,093

During the year ended December 31, 2000, the Company decided to exit the major medical line of business. This resulted in a reduction in the projected gross profits for that line of business and accordingly, deferred policy acquisition costs of \$1.4 million were written off as of December 31, 2000. No deferred policy acquisition costs were written off for the years ended December 31, 2002 or 2001.

11. Accident & Health Policy and Contract

Claim Liabilities:

Activity in the accident & health policy and contract claim liability is as follows:

(In thousands)

	2002	2001	2000
Balance at beginning of year	\$ 79,596	\$ 77,884	\$ 72,261
Less reinsurance recoverables	(44,685)	(43,502)	(36,231)
Net balance at beginning of year	34,911	34,382	36,030
Balances acquired	3,198	—	—
Incurred related to:			
Current year	99,491	74,204	59,700
Prior years	(1,506)	(613)	299
Total incurred	97,985	73,591	59,999
Paid related to:			
Current year	68,329	51,627	43,843
Prior years	28,576	21,094	17,631
Total paid	96,905	72,721	61,474
Foreign currency adjustment	102	(341)	(173)
Net balance at end of year	39,291	34,911	34,382
Plus reinsurance recoverables	48,925	44,685	43,502
Balance at end of year	\$ 88,216	\$ 79,596	\$ 77,884

In 2002, the Company acquired, through a 100% quota share reinsurance agreement, a block of Medicare supplement business representing approximately \$20.0 million of annualized premium in force. The balances acquired represent the accident & health claim liabilities acquired in this transaction.

During 2002, the favorable development on the accident and health claims reserves resulted from the improvement in claims management processes in the Career Agency segment. For each of the years ended December 31, 2001 and 2000, the favorable or unfavorable development on accident and health claim reserves was less than two percent of the prior year net balance.

12. Reinsurance:

In the normal course of business, the Company reinsures portions of certain policies that it underwrites. Accordingly, the Company is party to several reinsurance agreements on its life and accident & health insurance risks. The Company's senior market accident & health insurance products are reinsured under coinsurance treaties with unaffiliated insurers, while the life insurance risks are reinsured under either coinsurance

or yearly-renewable term treaties with unaffiliated insurers. Under coinsurance treaties, the reinsurer receives an agreed upon percentage of all premiums and reimburses the Company that same percentage of any losses. In addition, the Company receives certain allowances from the reinsurers to cover commissions, expenses and premium taxes. Under yearly-renewable term treaties, the reinsuring company receives premiums at an agreed upon rate and holds the required reserves for its share of the risk on a yearly-renewable term basis. The Company is also party to certain reinsurance agreements whereby the Company limits its loss in excess of certain thresholds. The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk to minimize its exposure to significant losses from reinsurer insolvencies. A contingent liability exists with respect to reinsurance that may become a liability of the Company in the event that the reinsurers should be unable to meet the obligations that they assumed.

The Company has several quota share reinsurance agreements in place with Hannover Life Re of America (“Hannover”), General & Cologne Life Re of America (“General & Cologne”) and Transamerica Occidental Life (“Transamerica”), (collectively, the “Reinsurers”), which Reinsurers are rated A or better by A.M. Best. These agreements cover various accident & health insurance products written or acquired by the Company and contain ceding percentages ranging between 50% and 100%. At December 31, 2002 and 2001 amounts recoverable from all our reinsurers were as follows:

(In thousands)

	2002	2001
Reinsurer		
General & Cologne	\$ 99,412	\$ 94,296
Hannover	74,302	67,849
Transamerica	15,680	19,430
Other	30,706	30,957
Total	\$220,100	\$212,532

At December 31, 2002, the total amount recoverable from reinsurers included \$216.4 million recoverable on future policy benefits and unpaid claims and \$3.7 million for amounts due from reinsurers on paid claims, commissions and expense allowances net of premiums reinsured. At December 31, 2001, the total amount recoverable from reinsurers included \$207.4 million recoverable on future policy benefits and unpaid claims and \$5.1 million for amounts due from reinsurers on paid claims, commissions and expense allowances net of premiums reinsured.

A summary of reinsurance activity for the three years ended December 31, 2002 is presented below:

AS OF DECEMBER 31,
(In thousands)

	2002	2001	2000
Life insurance in force			
Gross amount	\$3,105,477	\$3,266,564	\$3,651,778
Ceded to other companies	(692,132)	(687,615)	(916,669)
Assumed from other companies	62,423	48,747	51,175
Net amount	\$2,475,768	\$2,627,696	\$2,786,284
Percentage of assumed to net	3%	2%	2%

YEAR ENDED DECEMBER 31,
(In thousands)

	2002	2001	2000
Premiums			
Life insurance	\$ 37,682	\$ 36,411	\$ 41,371
Accident & health	549,004	477,164	409,952
Total gross premiums	586,686	513,575	451,323
Ceded to other companies			
Life insurance	(7,656)	(7,875)	(10,210)
Accident & health	(317,528)	(279,043)	(224,415)
Total ceded premiums	(325,184)	(286,918)	(234,625)
Assumed from other companies			
Life insurance	1,044	2,071	2,538
Accident & health	4,031	478	517
Total assumed premium	5,075	2,549	3,055
Net amount			
Life insurance	31,070	30,607	33,699
Accident & health	235,507	198,599	186,054
Total net premium	\$ 266,577	\$ 229,206	\$ 219,753
Percentage of assumed to net			
Life insurance	3%	7%	8%
Accident & health	2%	—	—
Total assumed to total net	2%	1%	1%
Claims recovered	\$ 224,676	\$ 201,121	\$ 175,700

13. Loan Agreements:

The Company entered into an \$80 million credit facility consisting of a \$70 million term loan and a \$10 million revolving loan facility in connection with the 1999 Acquisition on July 30, 1999. The term loan calls for interest at the London Interbank Offering Rate (“LIBOR”) for one, two, three or six months plus 350 basis points with principal repayment over a seven-year period and a final maturity date of July 31, 2006. The Company incurred loan origination fees of \$3.5 million, which were capitalized and are amortized on a straight-line basis over the life of the loan. At December 31, 2002, the unamortized

balance was \$1.9 million. The term loan is secured by a first priority interest in 100% of the outstanding common stock of American Exchange, American Progressive, WorldNet and 65% of the outstanding common stock of UAFC (Canada) Inc. (the 100% parent of Penncorp Life (Canada)) and a subordinate interest in 100% of the outstanding common stock of American Pioneer. In August 2000, to fund our acquisition of CHCS, the Company drew down \$3.0 million of the revolving loan facility, which amount currently incurs interest at a rate consistent with the term loan and is due to mature on July 31, 2004. The Company pays an annual commitment fee of 50 basis points on the unutilized facility, which is currently

\$7.0 million. For the year ended December 31, 2002, 2001 and 2000, the Company paid \$2.6 million, \$5.2 million, and \$7.1 million, respectively in interest and fees in connection with the credit facility.

The following table shows the schedule of remaining principal payments (in thousands) on the Company's outstanding term loan, with the final payment in July 2006:

2003	\$11,525
2004	12,400
2005	13,275
2006	10,575
Total	\$47,775

The following table sets forth certain summary information with respect to total borrowings of the Company for the three years ended December 31, 2002:

(In thousands)

	AS OF DECEMBER 31,		YEAR ENDED DECEMBER 31,		
	AMOUNT OUTSTANDING	INTEREST RATE	MAXIMUM	WEIGHTED	AVERAGE
			AMOUNT OUTSTANDING	AVERAGE ^(a) AMOUNT OUTSTANDING	AVERAGE INTEREST RATE ^(b)
2002	\$ 50,775	5.33%	\$ 61,475	\$ 55,731	5.44%
2001	\$ 61,475	5.43%	\$ 69,650	\$ 65,490	7.84%
2000	\$ 69,650	10.22%	\$ 71,500	\$ 70,056	10.05%

^(a) The average amounts of borrowings outstanding were computed by determining the arithmetic average of the months' average outstanding in borrowings.

^(b) The weighted-average interest rates were determined by dividing interest expense related to total borrowings by the average amounts outstanding of such borrowings.

In connection with the pending acquisition, the Company intends to refinance the above term loan. It is anticipated that the new credit facility will total \$85 million, consisting of a \$70 million five year term loan with a \$15 million revolver. The Company intends to use the proceeds from the term loan, along with existing cash, to repay the existing term loan and finance the acquisition of Pyramid Life. The refinancing, if consummated, would trigger the immediate amortization of the capitalized loan origination fees from the existing term loan resulting in a pre-tax expense of approximately \$1.9 million.

14. Trust Preferred Securities:

In December 2002, the Company formed Universal American Statutory Trust I, a Connecticut statutory business trust (the "Trust"), and issued, through a private placement, \$15.0 million, thirty year floating rate trust preferred securities (the "Capital Securities"). The Trust will have the right to call the Capital Securities at par after five years from the date of issuance. The proceeds from the sale of the Capital Securities, together with proceeds from the sale by the Trust of its common securities to the Company, were invested in floating rate

junior subordinated deferrable interest debentures of the Company due 2032 (the "Junior Subordinated Debt"). The proceeds were used to support the growth of the Company's insurance subsidiaries and retained at the parent company in anticipation of funding the acquisition of Pyramid Life (see Note 4 – Pending Acquisition).

The Capital Securities represent an undivided beneficial interest in the Trust's assets, which consist solely of the Junior Subordinated Debt. Holders of Capital Securities generally have no voting rights. The Company owns all of the common securities of the Trust. Holders of both the Capital Securities and the Junior Subordinated Debt are entitled to receive cumulative cash distributions accruing from December 4, 2002, the date of issuance, and payable quarterly in arrears commencing March 4, 2003 at a floating rate equal to the three-month LIBOR plus 4.0% (currently 5.4%) of the stated liquidation amount of \$1,000 per Capital Security. The floating rate resets quarterly and is limited to a maximum of 12.5% through December 4, 2007. The Capital Securities are subject to mandatory redemption upon repayment of the Junior

Subordinated Debt at maturity or upon earlier redemption. The Junior Subordinated Debt is unsecured and ranks junior and subordinate in right of payment to all present and future senior debt of the Company and is effectively subordinated to all existing and future obligations of the Company's subsidiaries. The Company has the right to redeem the Junior Subordinated Debt on or after December 4, 2007.

The Company has the right at any time, and from time to time, to defer payments of interest on the Junior Subordinated Debt for a period not exceeding 20 consecutive quarters up to the debentures' maturity date. During any such period, interest will continue to accrue and the Company may not declare or pay any cash dividends or distributions on, or purchase, the Company's capital stock nor make any principal, interest or premium payments on or repurchase any debt securities that rank equally with or junior to the Junior Subordinated Debt. The Company will have the right at any time to dissolve the Trust and cause the Junior Subordinated Debt to be distributed to the holders of the Capital Securities. The Company has guaranteed, on a subordinated basis, all of the Trust's obligations under the Capital Securities including payment of the redemption price and any accumulated and unpaid distributions to the extent of available funds and upon dissolution, winding up or liquidation but only to the extent the Trust has funds available to make such payments.

The Capital Securities have not been and will not be registered under the Securities Act of 1933, as amended (the "Securities Act"), and will only be offered and sold under an applicable exemption from registration requirements under the Securities Act.

15. Commitments and Contingencies:

The Company is obligated under certain lease arrangements for its executive and administrative offices in New York, Florida, Texas, and Ontario, Canada. Rent expense for the three years ended December 2002, 2001 and 2000 was \$1.7 million, \$1.8 million, and \$2.9 million, respectively. The minimum rental commitments, subject to escalation clauses, at December 31, 2002 under non-cancelable operating leases (in thousands) are as follows:

2003	\$ 2,005
2004	1,807
2005	1,279
2006	1,145
2007 and thereafter	3,764
Totals	\$10,000

In addition to the above, Pennsylvania Life is the named lessee on approximately 40 properties occupied by our Career Agents for uses as field offices. Rent for these field offices is reimbursed by the agents. Total annual rent obligation for these field offices is approximately \$633,000.

The Company has litigation in the ordinary course of business, including claims for medical, disability and life insurance benefits, and in some cases, seeking punitive damages. Management and counsel believe that after reserves and liability insurance recoveries, none of these will have a material adverse effect on the Company.

A lawsuit has been commenced against Universal American, its subsidiary American Progressive Life & Health Insurance Company, and Richard Barasch, by Marvin Barasch, the former Chairman of American Progressive. The suit primarily arises out of Marvin Barasch's employment with American Progressive and includes unrelated personal claims against Richard Barasch. The Company and Richard Barasch believe that the allegations are totally without merit and that the likelihood of material recovery by the plaintiff is remote.

16. Universal American Financial Corp.

401(K) Savings Plan:

Effective April 1, 1992, the Company adopted the Universal American Financial Corp. 401(k) Savings Plan ("Savings Plan"). The Savings Plan is a voluntary contributory plan under which employees may elect to defer compensation for federal income tax purposes under Section 401(k) of the Internal Revenue Code of 1986. The employee is entitled to participate in the Savings Plan by contributing through payroll deductions up to 100% of the employee's compensation. The participating employee is not taxed on these contributions until they are distributed. Moreover, the employer's contributions vest at the rate of 25% per plan year, starting at the end of the second year. Currently, the Company matches 50% of the employee's first 4% of contributions to 2% of the employee's eligible compensation with Company common stock. The Company made matching contributions under the Savings Plan of \$0.3 million in 2002, \$0.3 million in 2001, and \$0.3 million in 2000. Employees are required to hold the employer contribution in Company common stock until vested, at which point the employee has the option to transfer the amount to any of the other investments available under the Savings Plan. Amounts credited to employee's accounts under the Savings Plan are invested by the employer-appointed investment committee. At December 31, 2002 and 2001, the Savings Plan held 533,732 and 468,943 shares, respectively, of the Company's common

stock, which represents 37.5% of total plan assets as of December 31, 2002 and 34.4% of total plan assets as of December 31, 2001. Generally, a participating employee is entitled to distributions from the Savings Plan upon termination of employment, retirement, death or disability. Savings Plan participants who qualify for distributions may receive a single lump sum, have the assets transferred to another qualified plan or individual retirement account, or receive a series of specified installment payments.

17. Disclosures About Fair Values of Financial Instruments:

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

A. FIXED MATURITIES AVAILABLE FOR SALE: Fair value of fixed maturities is based upon quoted market prices, where available, or on values obtained from independent pricing services. For certain mortgage and asset-backed securities, the determination of fair value is based primarily upon the amount and timing of expected future cash flows of the security. Estimates

of these cash flows are based current economic conditions, past credit loss experience and other circumstances.

B. EQUITY SECURITIES: For equity securities carried at fair value, fair value equals quoted market price.

C. CASH AND CASH EQUIVALENTS AND POLICY LOANS: For cash and cash equivalents and policy loans, the carrying amount is a reasonable estimate of fair value.

D. INVESTMENT CONTRACT LIABILITIES: For annuity and universal life type contracts, the carrying amount is the policyholder account value (see Note 2); estimated fair value equals the policyholder account value less surrender charges.

E. LOAN PAYABLE AND TRUST PREFERRED SECURITIES: Fair value for the loan payable and trust preferred securities is equal to the carrying amount.

F. ACCOUNTS RECEIVABLE AND UNCOLLECTED PREMIUMS: Accounts receivable and uncollected premiums are primarily insurance contract related receivables, which are determined based upon the underlying insurance liabilities and added reinsurance amounts.

The estimated fair values of the Company's financial instruments as of December 31, 2002 and 2001 are as follows:

(In thousands)

	2002		2001	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
Financial assets:				
Fixed maturities available for sale	\$934,950	\$934,950	\$799,218	\$799,218
Equity securities	1,645	1,645	4,199	4,199
Policy loans	23,745	23,745	24,043	24,043
Other invested assets ^(a)	1,305	—	1,362	—
Mortgage loans ^(a)	1,503	—	2,411	—
Cash and cash equivalents	36,754	36,754	47,990	47,990
Financial liabilities:				
Investment contract liabilities	271,578	253,288	236,742	219,330
Loan payable	50,775	50,775	61,475	61,475
Trust preferred securities	15,000	15,000	—	—

^(a) Mortgage loans are carried at the aggregate unpaid balances and the fair market value was not determined as the amount involved was considered to be immaterial. Other invested assets consists mainly of collateralized loans which are carried at cost. The determination of fair value for these invested assets is not practical because there is no active trading market for such invested assets.

18. Earnings Per Share:

The reconciliation of the numerators and the denominators for the computation of basic and diluted EPS for the years ended December 31, 2002, 2001 and 2000 is as follows:

FOR THE YEAR ENDED DECEMBER 31, 2002
(In thousands, per share amounts in dollars)

	INCOME (NUMER- ATOR)	SHARES (DENOMI- NATOR)	PER SHARE AMOUNT
Weighted average common stock outstanding		53,071	
Less: Weighted average treasury shares		(132)	
Basic EPS			
Net income applicable to common shareholders	\$30,127	52,939	\$0.57
Effect of dilutive securities			
Stock options		4,853	
Treasury stock purchased from proceeds of exercise of options		(3,534)	
Diluted EPS			
Net income applicable to common shareholders plus assumed conversions	\$30,127	54,258	\$0.56

FOR THE YEAR ENDED DECEMBER 31, 2001
(In thousands, per share amounts in dollars)

	INCOME (NUMER- ATOR)	SHARES (DENOMI- NATOR)	PER SHARE AMOUNT
Weighted average common stock outstanding		49,591	
Less: Weighted average treasury shares		(66)	
Basic EPS			
Net income applicable to common shareholders	\$28,925	49,525	\$0.58
Effect of Dilutive Securities			
Stock options		4,113	
Treasury stock purchased from proceeds of exercise of options		(3,181)	
Diluted EPS			
Net income applicable to common shareholders plus assumed conversions	\$28,925	50,457	\$0.57

FOR THE YEAR ENDED DECEMBER 31, 2000
(In thousands, per share amounts in dollars)

	INCOME (NUMER- ATOR)	SHARES (DENOMI- NATOR)	PER SHARE AMOUNT
Weighted average common stock outstanding		46,761	
Less: Weighted average treasury shares		(31)	
Basic EPS			
Net income applicable to common shareholders	\$22,885	46,730	\$0.49
Effect of Dilutive Securities			
Stock options		1,881	
Treasury stock purchased from proceeds of exercise of options		(1,496)	
Diluted EPS			
Net income applicable to common shareholders plus assumed conversions	\$22,885	47,115	\$0.49

19. Other Comprehensive Income:

The components of other comprehensive income, and the related tax effects for each component, for the years ended December 31, 2002, 2001 and 2000 are as follows:

YEAR ENDED DECEMBER 31, 2002
(In thousands)

	BEFORE TAX AMOUNT	TAX EXPENSE (BENEFIT)	NET OF TAX AMOUNT
Net unrealized gain arising during the year (net of deferred acquisition costs)	\$31,605	\$11,066	\$20,539
Reclassification adjustment for gains included in net income	5,083	1,779	3,304
Net unrealized gains	36,688	12,845	23,843
Foreign currency translation adjustment	679	238	441
Other comprehensive income	\$37,367	\$13,083	\$24,284

YEAR ENDED DECEMBER 31, 2001
(In thousands)

	BEFORE	TAX	NET OF
	TAX	EXPENSE	TAX
	AMOUNT	(BENEFIT)	AMOUNT
Net unrealized gain arising during the year (net of deferred acquisition costs)	\$ 8,572	\$ 3,001	\$ 5,571
Reclassification adjustment for gains included in net income	(3,078)	(1,078)	(2,000)
Net unrealized gains	5,494	1,923	3,571
Foreign currency translation adjustment	(3,996)	(1,153)	(2,843)
Other comprehensive income	\$ 1,498	\$ 770	\$ 728

YEAR ENDED DECEMBER 31, 2000
(In thousands)

	BEFORE	TAX	NET OF
	TAX	EXPENSE	TAX
	AMOUNT	(BENEFIT)	AMOUNT
Net unrealized gain arising during the year (net of deferred acquisition costs)	\$20,531	\$ 7,498	\$13,033
Reclassification adjustment for gains included in net income	(146)	(51)	(95)
Net unrealized gains	20,385	7,447	12,938
Foreign currency translation adjustment	(1,434)	(258)	(1,176)
Other comprehensive income	\$18,951	\$ 7,189	\$11,762

20. Condensed Quarterly Results of Operations (Unaudited):

The quarterly results of operations for the three years ended December 31, 2002 are presented below. Due to the use of weighted average shares outstanding when determining the denominator for earnings per share, the sum of the quarterly per common share amounts may not equal the per common share amounts.

2002

(In thousands)

THREE MONTHS ENDED	MARCH 31,	JUNE 30,	SEPTEMBER 30,	DECEMBER 31,
Total revenue	\$82,166	\$76,690	\$83,956	\$88,711
Total benefits, claims & other expenses	70,541	72,217	71,079	73,656
Income before income taxes	11,625	4,473	12,877	15,055
Income tax expense	4,127	1,155	4,558	4,063
Net income applicable to common shareholders	\$ 7,498	\$ 3,318	\$ 8,319	\$10,992
Basic earnings per share	\$ 0.14	\$ 0.06	\$ 0.16	\$ 0.21
Diluted earnings per share	\$ 0.14	\$ 0.06	\$ 0.15	\$ 0.20

2001

(In thousands)

THREE MONTHS ENDED	MARCH 31,	JUNE 30,	SEPTEMBER 30,	DECEMBER 31,
Total revenue	\$76,671	\$74,764	\$73,851	\$75,657
Total benefits, claims & other expenses	65,750	65,298	63,132	63,401
Income before income taxes	10,921	9,466	10,719	12,256
Income tax expense	3,885	3,392	3,797	3,364
Net income applicable to common shareholders	\$ 7,036	\$ 6,074	\$ 6,922	\$ 8,892
Basic earnings per share	\$ 0.15	\$ 0.13	\$ 0.13	\$ 0.17
Diluted earnings per share	\$ 0.15	\$ 0.13	\$ 0.13	\$ 0.16

2000

(In thousands)

THREE MONTHS ENDED	MARCH 31,	JUNE 30,	SEPTEMBER 30,	DECEMBER 31,
Total revenue	\$70,770	\$71,826	\$71,469	\$70,026
Total benefits, claims & other expenses	61,956	62,990	63,203	62,876
Income before income taxes	8,814	8,836	8,266	7,150
Income tax expense	3,155	3,207	2,853	966
Net income applicable to common shareholders	\$ 5,659	\$ 5,629	\$ 5,413	\$ 6,184
Basic earnings per share	\$ 0.12	\$ 0.12	\$ 0.12	\$ 0.13
Diluted earnings per share	\$ 0.12	\$ 0.12	\$ 0.12	\$ 0.13

Significant Fourth Quarter Adjustments

During the fourth quarter, the Company performs an annual evaluation of the recoverability of its tax net operating loss carryforwards, based on a projection of future taxable income. As a result of the continued profitability of the Company's operating segments, valuation allowances on certain of the Company's tax loss carryforwards were no longer considered necessary. The tax valuation allowance released through deferred tax expense was \$1.6 million, or \$0.03 per diluted share, during the fourth quarter of 2002, \$0.7 million, or \$0.01 per diluted share, during 2001, and \$1.3 million, or \$0.03 per diluted share, during 2000. During the fourth quarter of 2000, management decided to exit the individual major medical business to the extent possible. Based on this decision the deferred acquisition costs for that line of business were written off, resulting in a pre tax charge of \$1.4 million (\$0.02 per diluted share after tax) in the fourth quarter of 2000.

21. Business Segment Information:

The Company's principal business segments are: Career Agency, Senior Market Brokerage and Administrative Services. The Company also reports the corporate activities of our holding company in a separate segment. During 2002 we modified the way we report segment information by combining our previously defined Senior Market Brokerage and Special Markets segments into one segment, Senior Market Brokerage. Our decision to combine the two segments was based on the significant reduction in the insurance in force in the Special Markets segment as a result of our exit from the major medical line of business. Reclassifications have been made to conform prior year amounts to the current year presentation. A description of these segments follows:

CAREER AGENCY – The Career Agency segment is comprised of the operations of Pennsylvania Life and Penncorp Life (Canada), both of which we acquired in 1999. Penncorp Life (Canada) operates exclusively in Canada, while Pennsylvania Life operates in the United States. The Career Agency segment includes the operations of a career agency field force, which

distributes fixed benefit accident and sickness disability insurance, life insurance, supplemental senior health insurance and annuities in the United States and Canada. The career agents are under exclusive contract with either Pennsylvania Life or Penncorp Life (Canada).

SENIOR MARKET BROKERAGE – This segment includes the operations of our other insurance subsidiaries, primarily American Pioneer, American Progressive and Constitution, which distribute senior market products through general agency and brokerage distribution systems. The products include Medicare supplement/select, long term care, senior life insurance and annuities. In 2002, we combined our Special Markets segment with our Senior Market Brokerage segment.

ADMINISTRATIVE SERVICES – CHCS Services, Inc. acts as a third party administrator and service provider for both affiliated and unaffiliated insurance companies, primarily with respect to senior market insurance products and non-insurance products. The services that we perform include policy underwriting and issuance, telephone and face-to-face verification, policyholder services, claims adjudication, case management, care assessment and referral to health care facilities.

CORPORATE – This segment reflects the activities of our holding company, including the payment of interest on our debt, certain senior executive compensation, and the expense of being a public company.

Intersegment revenues and expenses are reported on a gross basis in each of the operating segments but eliminated in the consolidated results. These intersegment revenues and expenses affect the amounts reported on the individual financial statement line items, but are eliminated in consolidation and do not change operating income before taxes. The significant items eliminated include intersegment revenue and expense relating to services performed by the Administrative Services segment for the Career Agency and Senior Market Brokerage segments and interest on notes issued by the Corporate segment to the other operating segments.

Financial data by segment for the three years ended December 31, 2002 is as follows:

(In thousands)

	2002		2001		2000	
	SEGMENT INCOME		SEGMENT INCOME		SEGMENT INCOME	
	SEGMENT REVENUE	(LOSS) BEFORE INCOME TAXES	SEGMENT REVENUE	(LOSS) BEFORE INCOME TAXES	SEGMENT REVENUE	(LOSS) BEFORE INCOME TAXES
Career Agency	\$159,215	\$33,470	\$160,295	\$28,427	\$161,719	\$28,814
Senior Market Brokerage	165,498	14,904	128,441	13,716	116,825	10,281
Administrative Services	43,218	7,632	33,153	6,625	24,207	3,844
Subtotal	367,931	56,006	321,889	48,768	302,751	42,939
Corporate		(6,893)	360	(8,483)	358	(10,019)
Intersegment revenues	(31,325)	—	(24,384)	—	(19,164)	—
Segment operating total ⁽¹⁾	336,606	49,113	297,865	40,285	283,945	32,920
Adjustments to segment total						
Net realized (losses) gains ⁽¹⁾	(5,083)	(5,083)	3,078	3,078	146	146
Total	\$331,523	\$44,030	\$300,943	\$43,363	\$284,091	\$33,066

⁽¹⁾ We evaluate the results of operations of our segments based on operating income by segment. Operating revenue and income excludes realized gains and losses. This differs from generally accepted accounting principles, which includes the effect of realized gains and losses in the determination of total revenue and net income. Management believes that realized gains and losses are not indicative of overall operating trends. The schedule above reconciles our segment revenue to total revenue and operating income to net income in accordance with generally accepted accounting principles.

Identifiable assets by segment as of December 31, 2002 and 2001 are as follows:

AS OF DECEMBER 31,
(In thousands)

	2002	2001
Career Agency	\$ 683,720	\$ 605,758
Senior Market Brokerage	707,967	663,069
Administrative Services	19,332	30,930
Subtotal	1,411,019	1,299,757
Corporate	375,219	304,434
Intersegment assets ⁽¹⁾	(384,570)	(333,975)
Total Assets	\$1,401,668	\$1,270,216

⁽¹⁾ Intersegment assets includes the elimination of the parent holding company's investment in its subsidiaries as well as the elimination of other intercompany balances.

22. Foreign Operations:

A portion of the operations of the Company's Career Agency segment is conducted in Canada through Penncorp Life (Canada). These assets and liabilities are located in Canada

where the insurance risks are written. Revenues, excluding capital gains and losses, of the Career Agency segment by geographic area are as follows:

FOR THE YEAR ENDED DECEMBER 31,
(In thousands)

	2002	2001	2000
Revenues			
United States	\$103,480	\$103,432	\$104,848
Canada	55,735	56,863	56,871
Total	\$159,215	\$160,295	\$161,719

Total assets and liabilities of Penncorp Life (Canada), located entirely in Canada, are as follows:

AS OF DECEMBER 31,
(In thousands)

	2002	2001
Assets	\$175,365	\$173,911
Liabilities	\$124,843	\$111,211

INDEPENDENT
AUDITORS' REPORT

The Board of Directors and Stockholders
Universal American Financial Corp.:

We have audited the accompanying consolidated balance sheets of Universal American Financial Corp. and subsidiaries as of December 31, 2002 and 2001 and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the

accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Universal American Financial Corp. and subsidiaries at December 31, 2002 and 2001 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States.

Ernst + Young LLP

New York, New York
February 20, 2003

MARKET FOR UNIVERSAL AMERICAN'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Price Range of Publicly Traded Securities

Our common stock is quoted on the Nasdaq National Market under the symbol UHCO. The following table sets forth the high and low sales prices per share of our common stock for the periods indicated.

COMMON STOCK	HIGH	LOW
2003		
First Quarter	\$6.06	\$5.20
2002		
Fourth Quarter	\$7.27	\$3.84
Third Quarter	7.10	4.90
Second Quarter	7.89	6.24
First Quarter	6.99	5.61
2001		
Fourth Quarter	\$7.65	\$5.27
Third Quarter	6.31	4.51
Second Quarter	7.00	4.63
First Quarter	5.56	3.44

As of March 3, 2003, there were approximately 1,774 holders of record of our common stock.

CORPORATE INFORMATION

Available Information

Universal American files annual, quarterly and current reports, proxy statements and other documents with the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934 (the "Exchange Act"). The SEC maintains an Internet website that contains reports, proxy and information statements, and other information regarding issuers, including Universal American, that file electronically with the SEC. The public can obtain any documents that Universal American files with the SEC. These documents are available at www.sec.gov.

Universal American also makes available free of charge on or through its Internet website (www.UAFC.com) its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after Universal American electronically files such material with, or furnishes it to, the SEC. Visit www.UAFC.com for additional information about Universal American, including press releases and conference calls.

Dividends

We have neither declared nor paid dividends on our common stock and we are currently prohibited from paying dividends to stockholders under our current credit agreement. There are also various legal limitations governing the extent to which the Company's insurance subsidiaries may extend credit, pay dividends or otherwise provide funds to Universal American Financial Corp. Any future decision to pay dividends will be made by our board of directors in light of conditions then existing, including our results of operations, financial condition and requirements, loan covenants, insurance regulatory restrictions, business conditions and other factors. In addition, our ability to pay cash dividends, if and when we should wish to do so, may depend on the ability of our subsidiaries to pay dividends to our holding company and on compliance with the covenants in our credit facility. See "Regulation – Dividend Restrictions."

Shareholders may receive, without charge, a copy of the documents filed with the Securities and Exchange Commission as exhibits to this report by submitting a written request to Universal American Financial Corp., Director, Shareholder Relations, Six International Drive, Rye Brook, NY 10573-1068, by calling 914-934-5200, or by completing and submitting the information request form in the Request Info page of our website.

Corporate Headquarters

Universal American Financial Corp.
Six International Drive, Rye Brook, NY 10573-1068
(914) 934-5200

Registrar and Transfer Agent

Correspondence concerning your account or address changes should be addressed to:
American Stock Transfer & Trust Co.
59 Maiden Lane, New York, NY 10038
(212) 936-5100

©2003 Universal American Financial Corp. All rights reserved.

UNIVERSAL AMERICAN
FINANCIAL CORP.

officers

Richard A. Barasch
Chairman and Chief Executive Officer

Gary W. Bryant, CPA
Executive Vice President and
Chief Operating Officer

Robert A. Waegelein, CPA
Executive Vice President and
Chief Financial Officer

Gary Jacobs
Senior Vice President,
Corporate Development

Sarah E. Bell
Vice President, Corporate Marketing

**Michael A. Colliflower, JD, CLU,
ChFC, FLMI, AIRC**
Vice President, Legal and Compliance

William H. Cushman, CPA
Vice President, Financial Reporting

Clyde McCrary
Director, Internal Audit

Joan M. Ferrarone
Secretary

directors

Richard A. Barasch
Chairman

Bradley E. Cooper
Partner,
Capital Z Partners, L.P.

Susan S. Fleming
Partner,
Capital Z Partners, L.P.

Mark M. Harmeling
Managing Director,
TA Associates Realty

Bertram Harnett, Esq.
President,
Harnett, Lesnick, and Ripps, PA

Patrick J. McLaughlin
Managing Director,
Emerald Capital Group

Robert A. Spass
Partner,
Capital Z Partners, L.P.

Francis S. Wilson
Managing Partner,
AAM Capital Partners, L.P.

Robert F. Wright
President,
Robert F. Wright Associates, Inc.

AMERICAN PROGRESSIVE LIFE &
HEALTH INSURANCE COMPANY OF
NEW YORK

officers

Richard A. Barasch
President and Chief Executive Officer

William M. Daly
Senior Vice President, Marketing

Judy M. Borrell
Vice President, Administration

Richard M. Cannone
Vice President, Finance

AMERICAN PIONEER LIFE
INSURANCE COMPANY

officers

Gary W. Bryant, CPA
President and Chief Executive Officer

Donald M. Gray, CPA
Senior Vice President, Finance and Treasurer

Neil Lund, FSA, MAAA
Senior Vice President, Chief Actuary

**Bradley D. Leonard,
FSA, MAAA, CLU, ChFC**
Senior Vice President, Actuary

Dana Adams
Vice President, Marketing

David Detmer
Vice President, Information Processing

Suzanne Grieder
Vice President, Human Resources

Harold W. Jenkins
Vice President, Marketing

James Kalmer
Vice President, Underwriting

John T. Mackin
Vice President, Compliance

Garry Reed
Vice President, Actuarial

Frederick Taylor
Vice President, Group Operations

Thomas Thompson
Vice President, Marketing

Mark Yeager
Vice President, Marketing

PENNSYLVANIA LIFE
INSURANCE COMPANY

officers

William E. Wehner, CLU, FLMI
President

George T. Eldridge, Jr.
Senior Vice President, Information Services

Peter English
Senior Vice President, Marketing

Stephen Bontell
Vice President, Marketing

Carl C. Cochrane, CPA
Vice President, Tax

Michael Grau
Vice President, Marketing and
Administration

Russell J. Snyder
Vice President, Agent Services and Payments

Chung-Sing Sya
Vice President, Actuarial

Pat Zintgraff
Vice President, Information Technology

PENNCORP LIFE INSURANCE
COMPANY (CANADA)

officers

J. Paul Edmondson
President and Chief Executive Officer

Lynn Grenier-Lew, FSA, FCIA, MAAA
Senior Vice President, Finance

Roslind Nelles
Senior Vice President, Administration

Yvonne Lindgren
Vice President, Policyholder Service

Mark Turkiewicz
Vice President, Claims

Phirozali Vassanji
Vice President, Insurance Operations

Sylvain Goulet, FSA, FCIA, MAAA
Appointed Actuary, Eckler Partners, Ltd.

CHCS SERVICES, INC.

officers

Gary Jacobs
President

Jason Israel
Chief Operating Officer

Patrick Boudreaux
Senior Vice President, Information
Technology

Larry DeRemus
Senior Vice President, Special Projects

Maureen Lillis
Senior Vice President, Long Term Care

Felisse Pinsky, A.R.N.P.
Senior Vice President, Customer Contact

Larry Pope
Senior Vice President, Client Relations

Conner Taylor, CPA
Senior Vice President
and Chief Financial Officer

INSURANCE SUBSIDIARIES

directors

David F. Bolger
Chief Executive Officer,
Bolger & Co., Inc.

Douglas A. Brunt
Retired

Michael J. Gough
Partner,
Osler, Haskin & Harcourt

Walter L. Harris
President,
Tanenbaum-Harber Co., Inc.

Harry B. Henshel
Vice Chairman,
Bulova Corporation

Douglas J. Hicks
Retired

Jeffrey Laikind
Managing Director,
Shikiar Asset Management

Gerald Weiner
President,
PennCorp Canada

UNIVERSAL AMERICAN
FINANCIAL CORP.

Six International Drive

Rye Brook, New York 10573-1068

tel (914) 934-5200 ~ fax (914) 934-0700

website www.uafc.com

NASDAQ: UHCO