

GREAT AMERICAN FINANCIAL RESOURCES INC
Form 10-Q
November 14, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the Quarterly Period Ended
September 30, 2002

Commission File
No. 1-11632

GREAT AMERICAN FINANCIAL RESOURCES, INC.

Incorporated under
the Laws of Delaware

IRS Employer I.D.

No. 06-1356481

250 East Fifth Street, Cincinnati, Ohio 45202
(513) 333-5300

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

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

As of November 1, 2002, there were 42,408,108 shares of the Registrant's Common Stock outstanding.

Page 1 of 32

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

PART I

FINANCIAL INFORMATION

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

(Dollars in millions)

	September 30, <u>2002</u>	December 31, <u>2001</u>
Assets		
Investments:		
Fixed maturities - at market (amortized cost - \$6,791.2 and \$6,302.1)	\$7,089.1	\$6,431.1
Equity securities - at market (cost - \$42.0 and \$37.8)	62.1	59.0
Mortgage loans on real estate	18.6	24.8
Real estate	79.1	69.4
Policy loans	215.0	211.3
Short-term investments	<u>349.4</u>	<u>131.9</u>
 Total investments	 7,813.3	 6,927.5

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

Cash	17.5	39.0
Accrued investment income	90.7	95.0
Unamortized insurance acquisition costs, net	629.5	556.1
Other assets	304.5	253.2
Variable annuity assets (separate accounts)	<u>437.0</u>	<u>529.6</u>
	<u>\$9,292.5</u>	<u>\$8,400.4</u>
Liabilities and Capital		
Annuity benefits accumulated	\$6,233.3	\$5,832.1
Life, accident and health reserves	939.9	638.5
Notes payable	222.9	223.0
Payable to affiliates, net	63.4	95.7
Deferred taxes on unrealized gains	98.8	47.2
Accounts payable, accrued expenses and other liabilities	283.2	142.6
Variable annuity liabilities (separate accounts)	<u>437.0</u>	<u>529.6</u>
Total liabilities	8,278.5	7,508.7
Mandatorily redeemable preferred securities of subsidiary trusts	142.9	142.9
Stockholders' Equity:		
Common Stock, \$1 par value		
-100,000,000 shares authorized		
- 42,406,640 and 42,353,464 shares outstanding	42.4	42.3
Capital surplus	346.9	346.7
Retained earnings	291.3	270.0
Unrealized gains on marketable securities, net	<u>190.5</u>	<u>89.8</u>
Total stockholders' equity	<u>871.1</u>	<u>748.8</u>

\$9,292.5\$8,400.4

2

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED INCOME STATEMENT

(In millions, except per share amounts)

	Three months ended		Nine months ended	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Revenues				
:				
Life, accident and health premiums	\$ 81.0	\$ 69.1	\$224.6	\$208.8
Net investment income	131.8	129.2	395.0	376.9
Realized losses on investments	(21.4)	(1.3)	(51.6)	(25.8)
Other income	<u>30.3</u>	<u>25.3</u>	<u>71.5</u>	<u>76.0</u>
	221.7	222.3	639.5	635.9
Costs and Expenses				
:				
Annuity benefits	68.7	74.0	215.2	214.0
Life, accident and health benefits	69.6	53.9	184.9	160.2
Insurance acquisition expenses	31.1	22.9	81.1	64.0
Trust preferred distribution requirement	3.2	4.6	9.7	13.8
Interest and other debt expenses	2.7	2.4	8.1	7.9
Other expenses	<u>45.3</u>	<u>37.6</u>	<u>118.1</u>	<u>115.8</u>
	<u>220.6</u>	<u>195.4</u>	<u>617.1</u>	<u>575.7</u>

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

Operating earnings before income taxes	1.1	26.9	22.4	60.2
Provision (credit) for income taxes	<u>(0.9)</u>	<u>8.5</u>	<u>1.1</u>	<u>18.3</u>
)			
Income before accounting change	2.0	18.4	21.3	41.9
Cumulative effect of accounting change, net of tax	<u>-</u>	<u>-</u>	<u>-</u>	<u>(5.5)</u>
)			
Net Income	<u>\$ 2.0</u>	<u>\$ 18.4</u>	<u>\$ 21.3</u>	<u>\$ 36.4</u>
Earnings per common share:				
Basic earnings per common share:				
Income before accounting change	\$ 0.05	\$ 0.43	\$ 0.50	\$ 0.99
Accounting change	<u>-</u>	<u>-</u>	<u>-</u>	<u>(0.13)</u>
)			
Net income	<u>\$ 0.05</u>	<u>\$ 0.43</u>	<u>\$ 0.50</u>	<u>\$ 0.86</u>
Diluted earnings per common share:				
Income before accounting change	\$ 0.05	\$ 0.43	\$ 0.50	\$ 0.98
Accounting change	<u>-</u>	<u>-</u>	<u>-</u>	<u>(0.13)</u>
)			
Net income	<u>\$ 0.05</u>	<u>\$ 0.43</u>	<u>\$ 0.50</u>	<u>\$ 0.85</u>
Average number of common shares:				
Basic	42.4	42.3	42.4	42.3
Diluted	42.6	42.7	42.7	42.7

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(In millions)

	Nine months ended <u>September 30,</u>	
	<u>2002</u>	<u>2001</u>
Common Stock:		
Balance at beginning of period	\$ 42.3	\$ 42.3
Common Stock issued	0.2	-
Common Stock retired	<u>(0.1)</u>	<u>-</u>
)
Balance at end of period	<u>\$ 42.4</u>	<u>\$ 42.3</u>
Capital Surplus:		
Balance at beginning of period	\$346.7	\$348.5
Common Stock issued	1.7	0.5
Common Stock retired	(1.5)	(0.3)
Capital transaction of subsidiary	<u>-</u>	<u>(0.5)</u>
)
Balance at end of period	<u>\$346.9</u>	<u>\$348.2</u>
Retained Earnings:		
Balance at beginning of period	\$270.0	\$237.0
Net income	<u>21.3</u>	<u>36.4</u>
Balance at end of period	<u>\$291.3</u>	<u>\$273.4</u>

Unrealized Gains, Net:		
Balance at beginning of period	\$ 89.8	\$ 43.9
Change during period	<u>100.7</u>	<u>100.6</u>
Balance at end of period	<u>\$190.5</u>	<u>\$144.5</u>
Comprehensive Income:		
Net income	\$ 21.3	\$ 36.4
Other comprehensive income - change in net unrealized gains	<u>100.7</u>	<u>100.6</u>
Comprehensive income	<u>\$122.0</u>	<u>\$137.0</u>

4

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q
GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

(In millions)

	Nine months ended <u>September 30,</u>	
	<u>2002</u>	<u>2001</u>
Cash Flows from Operating Activities:		
Net income	\$ 21.3	\$ 36.4
Adjustments:		
Cumulative effect of accounting change	-	5.5
Increase in life, accident and health reserves	64.0	34.2

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

Benefits to annuity policyholders	215.2	214.0
Amortization of insurance acquisition costs	81.1	64.0
Depreciation and amortization	19.9	8.9
Realized losses on investments	51.6	25.8
Increase in insurance acquisition costs	(121.2)	(111.4)
Decrease in other liabilities	(10.6)	(17.3)
Increase (decrease) in payable to affiliates, net	(32.3)	20.8
Other, net	<u>(32.0)</u>	<u>(16.7)</u>
))
	<u>257.0</u>	<u>264.2</u>

Cash Flows from Investing Activities:

Purchases of and additional investments in:

Fixed maturity investments	(2,214.3)	(884.6)
Equity securities	(3.6)	(3.3)
Real estate, mortgage loans and other assets	(15.7)	(10.2)
Purchase of subsidiary	(48.5)	-
Cash and short-term investments of acquired subsidiary	4.6	-
Maturities and redemptions of fixed maturity investments	887.2	387.3
Sales of:		
Fixed maturity investments	1,117.0	309.3
Equity securities	0.7	1.2
Real estate, mortgage loans and other assets	6.2	20.4
Decrease (increase) in policy loans	<u>4.4</u>	<u>(1.3)</u>
))
	<u>(262.0)</u>	<u>(181.2)</u>

Cash Flows from Financing Activities:

Fixed annuity receipts	599.2	454.2
Annuity surrenders, benefits and withdrawals	(410.6)	(483.0)
Net transfers from variable annuity assets	12.3	3.2
Additions to notes payable	-	87.5
Reductions of notes payable	(0.2)	(15.4)
Issuance of Common Stock	1.9	0.5
Retirement of Common Stock	(1.6)	(0.3)
Repurchase of trust preferred securities	<u>-</u>	<u>(75.0)</u>

)	
	<u>201.0</u>	<u>(28.3)</u>
)	
Net increase in cash and short-term investments	196.0	54.7
Beginning cash and short-term investments	<u>170.9</u>	<u>87.5</u>
Ending cash and short-term investments	<u>\$ 366.9</u>	<u>\$142.2</u>

5

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A.

Description of the Company

Great American Financial Resources, Inc. ("GAFRI" or "the Company") markets retirement products, primarily fixed and variable annuities, and various forms of life and supplemental health insurance through independent agents, payroll deduction plans, financial institutions and in-home sales.

American Financial Group, Inc. ("AFG") and its subsidiaries owned 83% of GAFRI's Common Stock at November 1, 2002.

B.

Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements for GAFRI and its subsidiaries are unaudited; however, management believes that all adjustments (consisting only of normal recurring accruals unless otherwise disclosed herein) necessary for fair presentation have been made. The results of operations for interim periods are not necessarily indicative of results to be expected for the year. The financial statements have been prepared in accordance with the instructions to Form 10-Q and therefore do not include all information and footnotes necessary to be in conformity with generally accepted accounting principles.

Certain reclassifications have been made to prior periods to conform to the current period's presentation. All significant intercompany balances and transactions have been eliminated. All acquisitions have been treated as purchases. The results of operations of companies since their formation or acquisition are included in the consolidated financial statements.

The preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Changes in circumstances could cause actual results to differ materially from those estimates.

Investments

All fixed maturity securities are considered "available for sale" and reported at fair value with unrealized gains and losses reported as a separate component of stockholders' equity. Short-term investments are carried at cost; mortgage loans on real estate are generally carried at amortized cost; policy loans are stated at the aggregate unpaid balance. Premiums and discounts on mortgage-backed securities are amortized over a period based on estimated future principal payments and adjusted to reflect actual payments.

Gains or losses on securities are determined on the specific identification basis. When a decline in the value of a specific investment is considered to be other than temporary, a provision for impairment is charged to earnings and the cost basis of that investment is reduced.

Emerging Issues Task Force Issue No. 99-20 ("EITF 99-20") established a new standard for recognizing interest income and impairment on certain asset-backed investments. Interest income on these investments is recorded at a yield based on projected cash flows. The yield is adjusted prospectively to reflect actual cash flows and changes in projected amounts. Impairment losses on these investments must be recognized when (i) the fair value of the security is less than its cost basis and (ii) there has been an adverse change in the expected cash flows. The new standard became effective on April 1, 2001. Impairment losses at initial application of this rule were recognized as the cumulative effect of an accounting change. Subsequent impairments are recognized as a component of net realized gains and losses.

6

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Goodwill

Goodwill represents the excess of cost of subsidiaries over GAFRI's equity in their underlying net assets. Through December 31, 2001, goodwill was being amortized over periods of 20 to 40 years. Effective January 1, 2002,

GAFRI implemented Statement of Financial Accounting Standards ("SFAS") No. 142, under which goodwill is no longer amortized but is subject to an impairment test at least annually. As required under SFAS No. 142, GAFRI will complete the transitional test for goodwill impairment (as of January 1, 2002) by the end of 2002. Any resulting write-down will be reported by restating first quarter 2002 results for the cumulative effect of a change in accounting principle.

Insurance Acquisition Costs and Expenses

Unamortized insurance acquisition costs consist of deferred policy acquisition costs ("DPAC"), net of unearned revenues, and the present value of future profits on business in force ("VOBA") of acquired insurance companies.

Insurance acquisition expenses in the income statement reflect primarily the amortization of DPAC and VOBA. In addition, certain commission costs are expensed as paid and included in insurance acquisition expenses. All other uncanceled acquisition costs such as marketing and underwriting expenses are included in "Other Expenses."

Deferred Policy Acquisition Costs

DPAC (principally commissions, advertising, underwriting, policy issuance and sales expenses that vary with and are primarily related to the production of new business) is deferred to the extent that such costs are deemed recoverable.

DPAC related to annuities and universal life insurance products is amortized, with interest, in relation to the present value of expected gross profits on the policies. These expected gross profits consist principally of estimated future net investment income and surrender, mortality and other policy charges, less estimated future interest on policyholders' funds, policy administration expenses and death benefits in excess of account values. DPAC is reported net of unearned revenue relating to certain policy charges that represent compensation for future services. These unearned revenues are recognized as income using the same assumptions and factors used to amortize DPAC.

To the extent that realized gains and losses result in adjustments to the amortization of DPAC related to annuities, such adjustments are reflected as components of realized gains. DPAC related to annuities is also adjusted, net of tax, for the change in amortization that would have been recorded if the unrealized gains (losses) from securities had actually been realized. This adjustment is included in unrealized gains (losses) on marketable securities.

DPAC related to traditional life and health insurance is amortized over the expected premium paying period of the related policies, in proportion to the ratio of annual premium revenues to total anticipated premium revenues. Such anticipated premium revenues were estimated using the same assumptions used for computing liabilities for future policy benefits.

Life and health insurance contracts are reviewed periodically using actuarial assumptions revised based on actual and anticipated experience, by blocks of business, to determine if there is a potential premium deficiency. If any such deficiency exists, it is recognized by a charge to income and a reduction in unamortized acquisition costs.

Present Value of Future Profits

Included in insurance acquisition costs are amounts representing the present value of future profits on business in force of the acquired insurance companies, which represent the portion of the costs to acquire such companies that is allocated to the value of the right to receive future cash flows from insurance contracts existing at the date of acquisition.

7

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

These amounts are amortized with interest over the estimated remaining life of the acquired policies for annuities and universal life products and over the expected premium paying period for traditional life and health insurance products.

Annuity Benefits Accumulated

Annuity receipts and benefit payments are recorded as increases or decreases in "annuity benefits accumulated" rather than as revenue and expense. Increases in this liability for interest credited are charged to expense and decreases for surrender charges are credited to other income.

Life, Accident and Health Reserves

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

Liabilities for future policy benefits under traditional life, accident and health policies are computed using the net level premium method. Computations are based on the original projections of investment yields, mortality, morbidity and surrenders and include provisions for unfavorable deviations. Reserves established for accident and health claims are modified as necessary to reflect actual experience and developing trends.

The liability for future policy benefits for interest sensitive life and universal life policies is equal to the sum of the accumulated fund balances under such policies.

Variable Annuity Assets and Liabilities

Separate accounts related to variable annuities represent deposits invested in underlying investment funds on which GAFRI earns a fee. Investment funds are selected and may be changed only by the policyholder, who retains all investment risk. Accordingly, GAFRI's liability for these accounts equals the value of the account assets.

Life, Accident and Health Premiums and Benefits

For traditional life, accident and health products, premiums are recognized as revenue when legally collectible from policyholders. Policy reserves have been established in a manner which allocates policy benefits and expenses on a basis consistent with the recognition of related premiums and generally results in the recognition of profits over the premium paying period of the policies.

For interest sensitive life and universal life products, premiums are recorded in a policyholder account which is reflected as a liability. Revenue is recognized as amounts are assessed against the policyholder account for mortality coverage and contract expenses. Surrender benefits reduce the account value. Death benefits are expensed when incurred, net of the account value.

Income Taxes

GAFRI and Great American Life Insurance Company ("GALIC") have separate tax allocation agreements with American Financial Corporation ("AFC"), a subsidiary of AFG, which designate how tax payments are shared by members of the tax group. In general, both companies compute taxes on a separate return basis. GALIC is obligated to make payments to (or receive benefits from) AFC based on taxable income without regard to temporary differences. If GALIC's taxable income (computed on a statutory accounting basis) exceeds a current period net operating loss of GAFRI, the taxes payable or receivable by GALIC associated with the excess are payable to or receivable from AFC. If the AFC tax group utilizes any of GAFRI's net operating losses or deductions that originated prior to GAFRI's entering AFC's consolidated tax group, AFC will pay to GAFRI an amount equal to the benefit received. The tax allocation agreements with AFC have not impacted the recognition of income tax expense and income tax payable in GAFRI's financial statements.

8

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Deferred income tax assets and liabilities are determined based on differences between financial reporting and tax basis and are measured using enacted tax rates. The Company recognizes deferred tax assets if it is more likely than not

that a benefit will be realized. Current and deferred tax assets and liabilities of companies in AFC's consolidated tax group are aggregated with other amounts receivable from or payable to affiliates.

Stock-Based Compensation

As permitted under Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation", GAFRI accounts for stock options and other stock-based compensation plans using the intrinsic value based method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Under GAFRI's stock option plan, options are granted to officers, directors, and key employees at exercise prices equal to the fair value of the shares at the dates of grant. No compensation expense is recognized for stock option grants.

Benefit Plans

GAFRI provides retirement benefits to qualified employees of participating companies through an Employee Stock Ownership Retirement Plan ("ESORP") and a 401(k) plan. Under the ESORP, contributions are at the discretion of the GAFRI Board of Directors and are invested primarily in GAFRI securities. Under the 401(k) plan, GAFRI matches a specific portion of employee contributions. Matching contributions are invested primarily in AFG securities. Company contributions to the ESORP and 401(k) plans are charged against earnings in the year for which they are declared.

GAFRI and certain of its subsidiaries provide certain benefits to eligible retirees. The projected future cost of providing these benefits is expensed over the period the employees earn such benefits.

Derivatives

Derivatives included in GAFRI's balance sheet consist primarily of investments in common stock warrants (included in equity securities), the equity-based component of certain annuity products (included in annuity benefits accumulated) and call options (included in other assets) used to mitigate the risk embedded in the equity-indexed annuity products. Changes in the fair value of derivatives are included in current earnings.

Earnings Per Share

Basic earnings per share is calculated using the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share include the effect of the assumed exercise of dilutive common stock options.

Statement of Cash Flows

For cash flow purposes, "investing activities" are defined as making and collecting loans and acquiring and disposing of debt or equity instruments and property and equipment. "Financing activities" include annuity receipts, benefits and withdrawals and obtaining resources from owners and providing them with a return on their investments. All other activities are considered "operating." Short-term investments having original maturities of three months or less when purchased are considered to be cash equivalents for purposes of the financial statements.

C. Acquisition

Manhattan National Life Insurance

On June 28, 2002, GAFRI's principal insurance subsidiary acquired Manhattan National Life Insurance Company ("MNL") from a subsidiary of Consec, Inc. for \$48.5 million in cash. The Company expects to reinsure up to 90% of the business in force.

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

D. Segments of Operations

GAFRI's life and annuity operations offer fixed and variable annuity products and traditional life insurance products. GAFRI's annuity products are sold through managing general agents and independent agents to employees of primary and secondary educational institutions, hospitals and in the non-qualified markets. Traditional term, universal and whole life insurance products are sold through national marketing organizations.

GAFRI's supplemental insurance businesses (United Teacher Associates Insurance Company ("UTA") and Loyal American Life Insurance Company) offer a variety of supplemental health and life products. UTA offers its products through independent agents. At December 31, 2001, Loyal reinsured a substantial portion of its life insurance business and has reduced its marketing efforts in that line of business.

GA Life of Puerto Rico sells in-home life and supplemental health products through a network of company-employed agents. Sales in Puerto Rico accounted for approximately 20% of GAFRI's life, accident and health premiums in the first nine months of 2002 and 2001.

Corporate and other consists primarily of GAFRI (parent) and AAG Holding (intermediate holding company). The following table shows GAFRI's revenues and operating profit by significant business segment (in millions):

	Three months ended		Nine months ended	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
<u>Revenues</u>				
Life and annuity products	\$165.2	\$147.8	\$458.4	\$431.4
Supplemental insurance products	58.4	57.1	174.9	175.8
GA Life of Puerto Rico	18.2	16.3	53.2	47.6
Corporate and other	<u>1.3</u>	<u>2.4</u>	<u>4.6</u>	<u>6.9</u>
Total operating revenues	243.1	223.6	691.1	661.7
Realized losses on investments	<u>(21.4)</u>	<u>(1.3)</u>	<u>(51.6)</u>	<u>(25.8)</u>
Total revenues per income statement	<u>\$221.7</u>	<u>\$222.3</u>	<u>\$639.5</u>	<u>\$635.9</u>

Operating profit - pretax

Life and annuity products	\$ 26.0	\$ 31.7	\$ 85.3	\$102.7
Supplemental insurance products	2.0	-	5.7	(0.9)
GA Life of Puerto Rico	3.1	2.7	8.8	7.7
Corporate and other	<u>(8.6)</u>	<u>(6.2)</u>	<u>(25.8)</u>	<u>(23.5)</u>
))))
Pretax earnings from operations	22.5	28.2	74.0	86.0
Realized losses on investments	<u>(21.4)</u>	<u>(1.3)</u>	<u>(51.6)</u>	<u>(25.8)</u>
))))
Total pretax income per income statement	<u>\$ 1.1</u>	<u>\$ 26.9</u>	<u>\$ 22.4</u>	<u>\$ 60.2</u>

10

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

E. Goodwill

Effective January 1, 2002, goodwill is no longer amortized but is subject to annual impairment testing under a two step process. Under the first step, an entity's net assets are broken down into reporting units and compared to their fair value. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. GAFRI has completed the first step of its transitional impairment test and has identified potential impairment of goodwill primarily in its supplemental insurance segment. The second step of the impairment test, that will measure the amount of impairment loss, will be completed by the end of the year with any resulting impairment charge reported by restating first quarter 2002 results for the cumulative effect of a change in accounting principle. Net intangible assets, which are included in other assets on the Consolidated Balance Sheet, totaled approximately \$41 million at September 30, 2002 and December 31, 2001. Management estimates that the impairment charge will be between 25% and 50% of the net carrying value of goodwill at September 30, 2002.

If the \$0.4 million and \$1.3 million (\$0.01 per share and \$0.03 per share) of goodwill amortization had not been expensed in the third quarter and first nine months of 2001, net earnings for those periods would have been \$18.8 million and \$37.6 million (\$0.44 per share and \$0.88 per share), respectively.

F. Unamortized Insurance Acquisition Costs

Unamortized insurance acquisition costs consisted of the following (in millions):

	September 30, <u>2002</u>	December 31, <u>2001</u>
Deferred policy acquisition costs	\$670.2	\$621.0
Present value of future profits acquired	93.3	71.2
Unearned revenues	<u>(134.0)</u>	<u>(136.1)</u>
)	<u>\$629.5</u>	<u>\$556.1</u>

G. Notes Payable

Notes payable consisted of the following (in millions):

	September 30, <u>2002</u>	December 31, <u>2001</u>
Direct obligations of GAFRI	\$ 1.8	\$ 1.9
Obligations of AAG Holding (guaranteed by GAFRI):		
6-7/8% Senior Notes due 2008	100.0	100.0
Bank Credit Line	<u>121.1</u>	<u>121.1</u>
Total	<u>\$222.9</u>	<u>\$223.0</u>

AAG Holding has an unsecured credit agreement with a group of banks under which it can borrow up to \$155 million. Borrowings bear interest at floating rates based on prime or Eurodollar rates and mature on December 31, 2004. At September 30, 2002, the weighted-average interest rate on amounts borrowed under the credit line was 2.56%. In November 2002, AAG Holding borrowed an additional \$20 million under the credit line to partially fund a capital contribution to GALIC.

At September 30, 2002, scheduled principal payments on debt for the remainder of 2002 and the subsequent five years were as follows (in millions):

<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
\$0.1	\$0.2	\$121.3	\$0.2	\$0.2	\$0.1

H. Mandatorily Redeemable Preferred Securities of Subsidiary Trusts

Wholly-owned subsidiary trusts of GAFRI issued preferred securities and, in turn, purchased a like amount of subordinated debt which provides interest and principal payments to fund the trusts' obligations. The preferred securities are mandatorily redeemable upon maturity or redemption of the subordinated debt. GAFRI effectively provides an unconditional guarantee of the trusts' obligations. The preferred securities consisted of the following:

Date of <u>Issuance</u>	<u>Issue (Maturity Date)</u>	<u>09/30/02</u>	<u>12/31/01</u>	<u>Optional Redemption Dates</u>
November 1996	9-1/4% TOPrS (2026)	\$72,912,500	\$72,912,500	Currently redeemable
March 1997	8-7/8% Pfd (2027)	70,000,000	70,000,000	On or after 3/1/2007

I. Stockholders' Equity

The Company is authorized to issue 25,000,000 shares of Preferred Stock, par value \$1.00 per share.

At September 30, 2002, there were 4.8 million shares of GAFRI Common Stock reserved for issuance under GAFRI's employee stock option plan. Under the plan, the exercise price of each option equals the market price of GAFRI Common Stock at the date of grant. Options generally become exercisable at the rate of 20% per year commencing one year after grant. All options expire ten years after the date of grant.

The change in net unrealized gains on marketable securities for the nine months ended September 30 included the following (in millions):

	<u>2002</u>			<u>2001</u>		
	<u>Pretax</u>	<u>Taxes</u>	<u>Net</u>	<u>Pretax</u>	<u>Taxes</u>	<u>Net</u>
Unrealized holding gains on securities arising during the period	\$100.5	(\$33.6)	\$66.9	\$121.2	(\$41.9)	\$ 79.3
Adoption of EITF 99-20	-	-	-	8.4	(2.9)	5.5
Realized losses on securities	<u>51.8</u>	<u>(18.0)</u>	<u>33.8</u>	<u>24.3</u>	<u>(8.5)</u>	<u>15.8</u>
))		
Change in net unrealized gains on marketable securities	<u>\$152.3</u>	<u>(\$51.6)</u>	<u>\$100.7</u>	<u>\$153.9</u>	<u>(\$53.3)</u>	<u>\$100.6</u>

J. Earnings Per Share

The number of common shares outstanding used in calculating diluted earnings per share in the third quarter and first nine months of 2002 includes 0.2 million shares and 0.3 million shares, respectively, compared to 0.4 million shares for the same periods in 2001 for the effect of the assumed exercise of GAFRI's dilutive stock options.

12

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

K. Additional Information

Statutory Information

Insurance companies are required to file financial statements with state insurance regulatory authorities prepared on an accounting basis prescribed or permitted by such authorities (statutory basis). Certain statutory amounts for GALIC, GAFRI's primary insurance subsidiary, were as follows (in millions):

	September 30, <u>2002</u>	December 31, <u>2001</u>
Capital and surplus	\$324.2	\$388.4
Asset valuation reserve	70.1	76.9
Interest maintenance reserve	16.1	11.0
	<u>Nine months ended September 30</u>	
	<u>2002</u>	<u>2001</u>
Pretax income from operations	\$47.5	\$62.8
Net income from operations	27.4	39.6
Net income (loss)	(33.7)	24.1

The decrease in GALIC's statutory capital and surplus reflects the effects of impairments on fixed maturity investments and the acquisition of Manhattan National Life Insurance Company in June 2002. GALIC expects to reinsure up to 90% of Manhattan's business in force in the fourth quarter of 2002; any such reinsurance will result in an increase in GALIC's statutory capital and surplus.

In January 2001, GAFRI's insurance subsidiaries implemented the codification of statutory accounting principles. The cumulative effect of these changes at implementation was not material.

Dividends which can be paid by GAFRI's insurance subsidiaries without prior approval of regulatory authorities are subject to restrictions relating to capital and surplus and statutory net income. Based on capital

and surplus at December 31, 2001, GALIC and GA Life of Puerto Rico may pay \$38.8 million and \$24.0 million, respectively, in dividends in 2002 without prior approval. In the first nine months of 2002, GALIC paid \$23.0 million in dividends. In November 2002, GAFRI made a capital contribution of \$25.0 million in cash to GALIC.

Effective December 31, 2001, Loyal entered into a reinsurance treaty whereby a substantial portion of its life insurance was ceded to an unaffiliated company.

13

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Condensed Consolidating Information

GAFRI has guaranteed all of the outstanding debt of AAG Holding and the preferred securities of the Trusts. Condensed consolidating financial statements for GAFRI are as follows:

CONDENSED CONSOLIDATING BALANCE SHEET

(In millions)

	AAG	TOTAL	ALL	CONS		
	GAFRI	HOLDING	TRUSTS	OTHER	ENTRIES	
<u>SEPTEMBER 30, 2002</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>ENTRIES</u>	<u>CONS</u>
Assets						
Cash and investments	\$ 11.5	\$ -	\$ -	\$7,820.9	(\$ 1.6)	\$7,830.8
Investment in subsidiaries	804.7	1,172.1	-	1.0	(1,977.8)	-
Notes receivable from AAG Holding	102.4	-	154.6	-	(257.0)	-
Unamortized insurance acquisition costs, net	-	-	-	629.5	-	629.5
Other assets	17.6	1.9	3.0	331.3	41.4	395.2
Variable annuity assets (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>437.0</u>	<u>-</u>	<u>437.0</u>
	<u>\$936.2</u>	<u>\$1,174.0</u>	<u>\$157.6</u>	<u>\$9,219.7</u>	<u>(\$2,195.0)</u>	<u>\$9,292.5</u>

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

Liabilities and Capital

Insurance liabilities	\$ -	\$ -	\$ -	\$7,178.6	(\$ 5.4)	\$7,173.2
Notes payable to GAFRI	-	102.4	-	0.1	(102.5)	-
Notes payable to Trusts	-	154.6	-	-	(154.6)	-
Other notes payable	1.8	221.1	-	-	-	222.9
Other liabilities	63.3	2.3	2.9	380.6	(3.7)	445.4
Variable annuity liabilities (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>437.0</u>	<u>-</u>	<u>437.0</u>
	65.1	480.4	2.9	7,996.3	(266.2)	8,278.5
Mandatorily redeemable preferred securities of subsidiary trusts	-	-	150.0	-	(7.1)	142.9
Total stockholders' equity	<u>871.1</u>	<u>693.6</u>	<u>4.7</u>	<u>1,223.4</u>	<u>(1,921.7)</u>	<u>871.1</u>
)		
	<u>\$936.2</u>	<u>\$1,174.0</u>	<u>\$157.6</u>	<u>\$9,219.7</u>	<u>(\$2,195.0)</u>	<u>\$9,292.5</u>

DECEMBER 31, 2001

Assets

Cash and investments	\$ 11.4	\$ -	\$ -	\$6,956.8	(\$ 1.7)	\$6,966.5
Investment in subsidiaries	689.1	1,080.6	-	1.9	(1,771.6)	-
Notes receivable from AAG Holding	102.4	-	154.6	-	(257.0)	-
Unamortized insurance acquisition costs, net	-	-	-	556.1	-	556.1
Other assets	17.2	1.4	4.7	282.2	42.7	348.2
Variable annuity assets (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>529.6</u>	<u>-</u>	<u>529.6</u>
	<u>\$820.1</u>	<u>\$1,082.0</u>	<u>\$159.3</u>	<u>\$8,326.6</u>	<u>(\$1,987.6)</u>	<u>\$8,400.4</u>

Liabilities and Capital

Insurance liabilities	\$ -	\$ -	\$ -	\$6,475.3	(\$ 4.7)	\$6,470.6
-----------------------	------	------	------	-----------	----------	-----------

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

Notes payable to GAFRI	-	102.4	-	0.1	(102.5)	-
Notes payable to Trusts	-	154.6	-	-	(154.6)	-
Other notes payable	1.9	221.1	-	-	-	223.0
Other liabilities	69.4	10.8	4.6	209.4	(8.7)	285.5
Variable annuity liabilities (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>529.6</u>	<u>-</u>	<u>529.6</u>
	71.3	488.9	4.6	7,214.4	(270.5)	7,508.7
Mandatorily redeemable preferred securities of subsidiary trusts	-	-	150.0	-	(7.1)	142.9
Total stockholders' equity	<u>748.8</u>	<u>593.1</u>	<u>4.7</u>	<u>1,112.2</u>	<u>(1,710.0)</u>	<u>748.8</u>
)		
	<u>\$820.1</u>	<u>\$1,082.0</u>	<u>\$159.3</u>	<u>\$8,326.6</u>	<u>(\$1,987.6)</u>	<u>\$8,400.4</u>

14

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

CONDENSED CONSOLIDATING INCOME STATEMENT

(In millions)

FOR THE THREE MONTHS ENDED	AAG		TOTAL	ALL	CONS	
	GAFRI	HOLDING	TRUSTS	OTHER	ENTRIES	CONS
<u>SEPTEMBER 30, 2002</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>ENTRIES</u>	<u>CONS</u>
Revenues						
:						
Life, accident and health premiums	\$ -	\$ -	\$ -	\$ 81.0	\$ -	\$ 81.0
Net investment income and other revenue	4.9	-	-	140.8	(5.0)	140.7
Interest income on AAG Holding notes	-	-	3.5	-	(3.5)	-
Equity in earnings (loss) of subsidiaries	<u>(1.5)</u>	<u>7.0</u>	<u>-</u>	<u>-</u>	<u>(5.5)</u>	<u>-</u>

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

))			
	3.4	7.0	3.5	221.8	(14.0)	221.7
Costs and Expenses:						
Insurance benefits and expenses	-	-	-	169.4	-	169.4
Interest expense on AAG Holding notes	-	3.5	-	-	(3.5)	-
Other interest and debt expenses	0.1	5.1	-	-	0.7	5.9
Other expenses	<u>2.2</u>	<u>2.5</u>	<u>-</u>	<u>42.8</u>	<u>(2.2)</u>	<u>45.3</u>
))			
	2.3	11.1	-	212.2	(5.0)	220.6
Earnings (loss) before income taxes	1.1	(4.1)	3.5	9.6	(9.0)	1.1
Provision (credit) for income taxes	<u>(0.9)</u>	<u>(1.6)</u>	<u>-</u>	<u>1.8</u>	<u>(0.2)</u>	<u>(0.9)</u>
))))	
Net income (loss)	<u>\$ 2.0</u>	<u>(\$ 2.5)</u>	<u>\$ 3.5</u>	<u>\$ 7.8</u>	<u>(\$ 8.8)</u>	<u>\$ 2.0</u>

FOR THE NINE MONTHS ENDED
SEPTEMBER 30, 2002

Revenues

:						
Life, accident and health premiums	\$ -	\$ -	\$ -	\$224.6	\$ -	\$224.6
Net investment income and other revenue	16.6	-	-	412.6	(14.3)	414.9
Interest income on AAG Holding notes	-	-	10.5	-	(10.5)	-
Equity in earnings of subsidiaries	<u>12.6</u>	<u>38.9</u>	<u>-</u>	<u>-</u>	<u>(51.5)</u>	<u>-</u>
))			
	29.2	38.9	10.5	637.2	(76.3)	639.5

Costs and Expenses:

Insurance benefits and expenses	-	-	-	481.2	-	481.2
Interest expense on AAG Holding notes	-	10.5	-	-	(10.5)	-
Other interest and debt expenses	0.1	15.3	-	-	2.4	17.8
Other expenses	<u>6.7</u>	<u>7.1</u>	<u>-</u>	<u>110.6</u>	<u>(6.3)</u>	<u>118.1</u>

	6.8	32.9	-	591.8	(14.4)	617.1
Earnings before income taxes	22.4	6.0	10.5	45.4	(61.9)	22.4
Provision for income taxes	<u>1.1</u>	<u>1.6</u>	<u>-</u>	<u>11.4</u>	<u>(13.0)</u>	<u>1.1</u>
Net income	<u>\$21.3</u>	<u>\$ 4.4</u>	<u>\$10.5</u>	<u>\$ 34.0</u>	<u>(\$ 48.9)</u>	<u>\$ 21.3</u>

15

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
CONDENSED CONSOLIDATING INCOME STATEMENT
(In millions)

FOR THE THREE MONTHS ENDED	AAG		TOTAL	ALL OTHER		CONS
<u>SEPTEMBER 30, 2001</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>ENTRIES</u>	<u>CONS</u>
Revenues						
:						
Life, accident and health premiums	\$ -	\$ -	\$ -	\$ 69.1	\$ -	\$ 69.1
Net investment income and other revenue	6.5	-	-	152.4	(5.7)	153.2
Interest income on AAG Holding notes	-	-	4.9	-	(4.9)	-
Equity in earnings of subsidiaries	<u>23.3</u>	<u>32.0</u>	<u>-</u>	<u>-</u>	<u>(55.3)</u>	<u>-</u>
	29.8	32.0	4.9	221.5	(65.9)	222.3
Costs and Expenses:						
Insurance benefits and expenses	-	-	-	150.8	-	150.8
Interest expense on AAG Holding notes	-	4.9	-	-	(4.9)	-

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

Other interest and debt expenses	-	4.9	-	-	2.1	7.0
Other expenses	<u>2.9</u>	<u>1.7</u>	<u>-</u>	<u>36.2</u>	<u>(3.2)</u>	<u>37.6</u>
)		
	2.9	11.5	-	187.0	(6.0)	195.4
Earnings before income taxes	26.9	20.5	4.9	34.5	(59.9)	26.9
Provision for income taxes	<u>8.5</u>	<u>7.1</u>	<u>-</u>	<u>10.7</u>	<u>(17.8)</u>	<u>8.5</u>
)		
Net income	<u>\$18.4</u>	<u>\$13.4</u>	<u>\$4.9</u>	<u>\$ 23.8</u>	<u>(\$42.1)</u>	<u>\$ 18.4</u>

FOR THE NINE MONTHS ENDED
SEPTEMBER 30, 2001

Revenues

:						
Life, accident and health premiums	\$ -	\$ -	\$ -	\$208.8	\$ -	\$208.8
Net investment income and other revenue	19.9	-	-	422.5	(15.3)	427.1
Interest income on AAG Holding notes	-	-	14.7	-	(14.7)	-
Equity in earnings of subsidiaries	<u>50.6</u>	<u>79.0</u>	<u>-</u>	<u>-</u>	<u>(129.6)</u>	<u>-</u>
)		
	70.5	79.0	14.7	631.3	(159.6)	635.9

Costs and Expenses:

Insurance benefits and expenses	-	-	-	438.2	-	438.2
Interest expense on AAG Holding notes	-	14.7	-	-	(14.7)	-
Other interest and debt expenses	0.1	15.1	-	-	6.5	21.7
Other expenses	<u>10.2</u>	<u>6.4</u>	<u>-</u>	<u>106.8</u>	<u>(7.6)</u>	<u>115.8</u>
)		
	10.3	36.2	-	545.0	(15.8)	575.7
Earnings before income taxes	60.2	42.8	14.7	86.3	(143.8)	60.2
Provision for income taxes	<u>18.3</u>	<u>14.6</u>	<u>-</u>	<u>26.0</u>	<u>(40.6)</u>	<u>18.3</u>

)	
Income before accounting change	41.9	28.2	14.7	60.3	(103.2)	41.9
Cumulative effect of accounting change, net of tax	<u>(5.5)</u>	<u>-</u>	<u>-</u>	<u>(5.5)</u>	<u>5.5</u>	<u>(5.5)</u>
)))	
Net income	<u>\$36.4</u>	<u>\$28.2</u>	<u>\$14.7</u>	<u>\$ 54.8</u>	<u>(\$ 97.7)</u>	<u>\$ 36.4</u>

16

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

(In millions)

FOR THE NINE MONTHS ENDED	AAG		TOTAL	ALL OTHER	CONS	
<u>SEPTEMBER 30, 2002</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>ENTRIES</u>	<u>CONS</u>
Cash Flows from Operating Activities:						
Net income	\$21.3	\$ 4.4	\$10.5	\$ 34.0	(\$48.9)	\$ 21.3
Adjustments:						
Equity in net earnings of subsidiaries and affiliates	(11.7)	(26.9)	-	-	38.6	-
Increase in life, accident and health reserves	-	-	-	64.0	-	64.0
Benefits to annuity policyholders	-	-	-	215.2	-	215.2
Amortization of insurance acquisition costs	-	-	-	81.1	-	81.1
Depreciation and amortization	0.1	0.2	-	19.6	-	19.9
Realized (gains) losses	(0.3)	-	-	51.9	-	51.6
Increase in insurance acquisition costs	-	-	-	(121.2)	-	(121.2)

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

Decrease in other liabilities	(2.4)	-	-	(8.2)	-	(10.6)
Decrease in payable to affiliates, net	(3.7)	-	-	(28.6)	-	(32.3)
Other, net	<u>2.3</u>	<u>(6.6)</u>	<u>-</u>	<u>(27.5)</u>	<u>(0.2)</u>	<u>(32.0)</u>
))))	
	<u>5.6</u>	<u>(28.9)</u>	<u>10.5</u>	<u>280.3</u>	<u>(10.5)</u>	<u>257.0</u>
))))	
Cash Flows from Investing Activities:						
Purchases of investments and other assets	-	-	-	(2,233.6)	-	(2,233.6)
Purchase of subsidiary	-	-	-	(43.9)	-	(43.9)
Maturities and redemptions of fixed maturity investments	6.4	-	-	880.8	-	887.2
Sales of investments and other assets	2.3	-	-	1,121.6	-	1,123.9
Decrease in policy loans	<u>-</u>	<u>-</u>	<u>-</u>	<u>4.4</u>	<u>-</u>	<u>4.4</u>
	<u>8.7</u>	<u>-</u>	<u>-</u>	<u>(270.7)</u>	<u>-</u>	<u>(262.0)</u>
))))	
Cash Flows from Financing Activities:						
Fixed annuity receipts	-	-	-	599.2	-	599.2
Annuity surrenders, benefits and withdrawals	-	-	-	(410.6)	-	(410.6)
Net transfers from variable annuity assets	-	-	-	12.3	-	12.3
Reductions of notes payable	(0.2)	-	-	-	-	(0.2)
Issuance of Common Stock	1.9	-	-	-	-	1.9
Capital contribution from parent (to subsidiary)	(41.3)	41.3	-	-	-	-
Dividends from subsidiaries (to parent)	35.4	(12.4)	-	(23.0)	-	-
Retirement of Common Stock	(1.6)	-	-	-	-	(1.6)
Trust dividend requirements	<u>-</u>	<u>-</u>	<u>(10.5)</u>	<u>-</u>	<u>10.5</u>	<u>-</u>
	<u>(5.8)</u>	<u>28.9</u>	<u>(10.5)</u>	<u>177.9</u>	<u>10.5</u>	<u>201.0</u>
)))))	
Net increase in cash and short-term investments	8.5	-	-	187.5	-	196.0

Beginning cash and short-term investments	<u>0.9</u>	<u>-</u>	<u>-</u>	<u>170.0</u>	<u>-</u>	<u>170.9</u>
Ending cash and short-term investments	<u>\$ 9.4</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 357.5</u>	<u>\$ -</u>	<u>\$366.9</u>

17

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

(In millions)

FOR THE NINE MONTHS ENDED	AAG		TOTAL	ALL OTHER		CONS
<u>SEPTEMBER 30, 2001</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>ENTRIES</u>	<u>CONS</u>
Cash Flows from Operating Activities:						
Net income	\$36.4	\$28.2	\$14.7	\$ 54.8	(\$97.7)	\$ 36.4
Adjustments:						
Cumulative effect of accounting change	5.5	-	-	5.5	(5.5)	5.5
Equity in net earnings of subsidiaries and affiliates	(35.8)	(34.0)	-	-	69.8	-
Increase in life, accident and health reserves	-	-	-	34.2	-	34.2
Benefits to annuity policyholders	-	-	-	214.0	-	214.0
Amortization of insurance acquisition costs	-	-	-	64.0	-	64.0
Depreciation and amortization	0.5	3.7	-	4.7	-	8.9
Realized losses	2.7	-	-	23.1	-	25.8
Increase in insurance acquisition costs	-	-	-	(111.4)	-	(111.4)
Decrease in other liabilities	(2.9)	-	-	(14.4)	-	(17.3)
Increase (decrease) in payable to affiliates, net	(0.4)	-	-	21.2	-	20.8
Other, net	<u>5.9</u>	<u>(15.0)</u>	<u>-</u>	<u>(6.1)</u>	<u>(1.5)</u>	<u>(16.7)</u>

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

)))))
	<u>11.9</u>	<u>(17.1)</u>	<u>14.7</u>	<u>289.6</u>	<u>(34.9)</u> <u>264.2</u>
)))))
Cash Flows from Investing Activities:					
Purchases of investments and other assets	-	-	-	(898.1)	- (898.1)
Maturities and redemptions of fixed maturity investments	-	-	-	387.3	- 387.3
Sales of investments and other assets	7.7	-	-	323.2	- 330.9
Decrease in policy loans	-	-	-	(1.3)	- (1.3)
Decrease in intercompany notes receivable	<u>(1.5)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1.5</u> <u>-</u>
)))))
	<u>6.2</u>	<u>-</u>	<u>-</u>	<u>(188.9)</u>	<u>1.5</u> <u>(181.2)</u>
)))))
Cash Flows from Financing Activities:					
Fixed annuity receipts	-	-	-	454.2	- 454.2
Annuity surrenders, benefits and withdrawals	-	-	-	(483.0)	- (483.0)
Net transfers from variable annuity assets	-	-	-	3.2	- 3.2
Additions to notes payable	0.1	87.4	-	-	- 87.5
Reductions of notes payable	(0.2)	(14.8)	-	(0.4)	- (15.4)
Issuance of Common Stock	0.5	-	-	-	- 0.5
Retirement of Common Stock	(0.3)	-	-	-	- (0.3)
Capital contribution from parent (to subsidiary)	(19.5)	19.5	-	(18.7)	18.7 -
Repurchase of trust preferred securities	-	(75.0)	-	-	- (75.0)
Trust dividend requirements	<u>-</u>	<u>-</u>	<u>(14.7)</u>	<u>-</u>	<u>14.7</u> <u>-</u>
)))))
	<u>(19.4)</u>	<u>17.1</u>	<u>(14.7)</u>	<u>(44.7)</u>	<u>33.4</u> <u>(28.3)</u>
)))))
Net increase (decrease) in cash and short-term investments	(1.3)	-	-	56.0	- 54.7
Beginning cash and short-term investments	<u>3.2</u>	<u>-</u>	<u>-</u>	<u>84.3</u>	<u>-</u> <u>87.5</u>

Ending cash and short-term investments	<u>\$ 1.9</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$140.3</u>	<u>\$ -</u>	<u>\$142.2</u>
----------------------------------------	---------------	-------------	-------------	----------------	-------------	----------------

18

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations

GENERAL

Great American Financial Resources, Inc. ("GAFRI" or "the Company") and its subsidiary, AAG Holding Company, Inc., are organized as holding companies with nearly all of their operations being conducted by their subsidiaries. These companies, however, have continuing expenditures for administrative expenses, corporate services and for the payment of interest and principal on borrowings and stockholder dividends.

Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Some of the forward-looking statements can be identified by the use of forward-looking words such as "believes", "could", "expects", "may", "will", "should", "seeks", "intends", "plans", "estimates", "anticipates" or the negative version of those words or other comparable terminology. Examples of such forward-looking statements relate to: expectations concerning market and other conditions and their effect on future premiums, revenues, earning and investment activities; recoverability of asset values; the adequacy of reserves for environmental pollution and expected expense savings resulting from recent initiatives.

Actual results could differ materially from those contained in or implied by such forward-looking statements for a variety of factors including:

- * changes in economic conditions, including interest rates, performance of securities markets, and the availability of capital;
- * trends in mortality and morbidity;
- * regulatory actions;
- * changes in legal environment;
- * tax law changes;
- * availability of reinsurance;
- * competitive pressures; and
- * changes in debt and claims paying ratings.

Forward-looking statements included in this Form 10-Q are made only as of the date of this report and under Section 27A of The Securities Act and Section 21E of The Exchange Act; we do not have any obligation to update any forward-looking statement to reflect subsequent events or circumstances.

LIQUIDITY AND CAPITAL RESOURCES

Ratios

GAFRI's consolidated debt to capital ratio was 21% at September 30, 2002, and 22% at December 31, 2001. For purposes of the calculation of consolidated debt to capital, capital represents the sum of consolidated debt, redeemable preferred securities of subsidiary trusts and stockholders' equity (excluding unrealized gains on marketable securities).

The National Association of Insurance Commissioners' ("NAIC") risk-based capital ("RBC") formulas determine the amount of capital that an insurance company needs to ensure that it has an acceptable expectation of not becoming financially impaired. At September 30, 2002, the capital ratio of GAFRI's principal insurance subsidiary was 4.7 times its authorized control level RBC.

Sources and Uses of Funds

To pay interest and principal on borrowings and other holding company costs, GAFRI (parent) and AAG Holding use cash and investments on hand, capital distributions from their principal subsidiary, Great American Life Insurance Company ("GALIC") and bank borrowings. Capital distributions from

19

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

GAFRI's insurance subsidiaries are subject to restrictions relating to statutory surplus and earnings. The maximum amount of dividends payable in 2002 by GALIC without prior regulatory approval is \$38.8 million. In the first nine months of 2002, GALIC paid \$23.0 million in dividends.

The Company has an unsecured credit agreement with a group of banks under which it can borrow up to \$155 million until December 31, 2004. In September 2001, GAFRI redeemed its ROPES for \$75 million in cash using bank borrowings. At November 8, 2002, GAFRI had approximately \$14 million available under the credit line. (See Note G.)

Based upon the current level of operations and anticipated growth, GAFRI believes that it will have sufficient resources to meet its liquidity requirements.

Independent Ratings

The Company's principal insurance subsidiaries ("Insurance Companies") are rated by A.M. Best, Standard & Poor's and Fitch. GALIC is rated A3 (good financial security) by Moody's. Such ratings are generally based on items of concern to policyholders and agents and are not directed toward the protection of investors.

	<u>A.M. Best</u>	<u>Standard & Poor's</u>	<u>Fitch</u>
GALIC	A (Excellent)	A- (Good)	A+ (Strong)
AILIC	A (Excellent)	A- (Good)	A+ (Strong)
Loyal	A (Excellent)	Not rated	A+ (Strong)
UTA	A-(Excellent)	Not rated	Not rated
GAPR	A (Excellent)	Not rated	Not rated

In evaluating a company, independent rating agencies review such factors as the company's: (i) profitability; (ii) leverage and liquidity; (iii) book of business; (iv) quality and estimated market value of assets; (v) adequacy of policy reserves; (vi) experience and competency of management and (vii) operating profile.

Management believes that the ratings assigned by independent insurance rating agencies are important because potential policyholders often use a company's rating as an initial screening device in considering annuity products. Management believes that (i) a rating of "A" by A.M. Best (its third highest rating) is necessary to successfully market tax-deferred annuities to public education employees and other not-for-profit groups and (ii) a rating in the "A" category by at least one rating agency is necessary to successfully compete in other annuity markets.

GAFRI's insurance entities also compete in markets other than the sale of tax-deferred annuities. Ratings are an important competitive factor; management believes that these entities can successfully compete in these markets with their respective ratings.

The Company's insurance ratings were recently affirmed by Fitch and Moody's; its ratings were downgraded by Standard & Poor's (with a negative outlook). GAFRI's operations could be materially and adversely affected by additional downgrades. In connection with recent reviews by independent ratings agencies, management indicated that it intends to maintain the capital of its significant insurance subsidiaries at levels currently indicated by the rating agencies as appropriate for the current ratings.

20

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

2002 Acquisition

On June 28, 2002, GALIC acquired Manhattan National Life Insurance Company ("MNL") from a subsidiary of Conseco, Inc. for \$48.5 million in cash. The Company expects to reinsure up to 90% of the business in force. At June 30, 2002, MNL had approximately \$290 million of assets and \$27.5 million of capital and surplus.

Investments

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

GAFRI invests primarily in fixed income investments which, including loans and short-term investments, comprised 98% of its investment portfolio at September 30, 2002. GAFRI generally invests in securities having intermediate-term maturities with an objective of optimizing interest yields while maintaining an appropriate relationship of maturities between GAFRI's assets and expected liabilities.

At September 30, 2002, GAFRI had pretax net unrealized gains of \$297.9 million on fixed maturities and \$20.1 million on equity securities. Individual portfolio securities are sold creating gains or losses as market opportunities exist. Since all of these securities are carried at market value in the balance sheet, there is virtually no effect on liquidity or financial condition upon the sale and ultimate realization of unrealized gains and losses.

The NAIC assigns quality ratings to publicly traded as well as privately placed securities. At September 30, 2002, 94% of GAFRI's fixed maturity portfolio was comprised of investment grade bonds (NAIC rating of "1" or "2"). Management believes that a high quality investment portfolio is more likely to generate a stable and predictable investment return.

At September 30, 2002, GAFRI's mortgage-backed securities ("MBSs") portfolio represented more than 40% of its fixed maturity investments. MBSs are subject to significant prepayment risk due to the fact that, in periods of declining interest rates, mortgages may be repaid more rapidly than scheduled as borrowers refinance higher rate mortgages to take advantage of the lower current rates. Due to the decline in the general level of interest rates in 2002, GAFRI has experienced an increase in the level of prepayments on its MBS portfolio; these prepayments have not been reinvested at interest rates comparable to the rates on the prepaid MBSs.

More than 95% of GAFRI's MBSs are rated "AAA" with substantially all being investment grade quality. The market in which these securities trade is highly liquid. Aside from the interest rate risk referred to above, GAFRI does not believe a material risk (relative to earnings or liquidity) is inherent in holding such investments.

21

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

Summarized information for the unrealized gains and losses recorded in GAFRI's balance sheet at September 30, 2002, is shown in the following table (dollars in millions). Approximately \$280 million of "Fixed Maturities" and \$7 million of "Equity Securities" had no unrealized gains or losses at September 30, 2002.

	Securities with Unrealized <u>Gains</u>	Securities with Unrealized <u>Losses</u>
<u>Fixed maturities</u>		
Market value of securities	\$6,059	\$ 750
Amortized cost of securities	\$5,665	\$ 846

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

Gross unrealized gain or loss	\$ 394	\$ 96
Market value as % of amortized cost	107%	89%
Number of security positions	1,264	302
Concentration of gains or losses by type or industry (exceeding 5% of unrealized):		
Mortgage-backed securities	\$139.2	\$ 5.9
Banks	33.9	-
U.S. government	28.3	0.8
State and municipal	22.2	2.4
Electric services	17.0	7.4
Asset-backed securities	13.8	7.4
Petroleum refining	5.2	4.9
Air transportation	4.2	31.1
Telephone communications	2.6	4.8
Cable television	1.3	5.0
Percentage rated investment grade	98%	70%

Equity securities

Market value of securities	\$50	\$5
Cost of securities	\$29	\$6
Gross unrealized gain or loss	\$21	\$1
Market value as % of cost	172%	83%

GAFRI's investment in equity securities of Provident Financial Group, a Cincinnati-based commercial banking and financial services company, represents \$20 million of the \$21 million in unrealized gains on equity securities at September 30, 2002.

The table below sets forth the scheduled maturities of fixed maturity securities (by separate gain/loss segments and in total) at September 30, 2002, based on their market values.

<u>Maturity</u>	Securities with Unrealized <u>Gains</u>	Securities with Unrealized <u>Losses</u>
One year or less	5%	4%
After one year through five years	14	25
After five years through ten years	20	36
After ten years	<u>14</u>	<u>18</u>
	53	83

Mortgage-backed securities	<u>47</u>	<u>17</u>
	<u>100</u>	<u>100</u>
	%	%

22

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

GAFRI realized aggregate losses of \$4.9 million during the third quarter of 2002 on \$38.9 million in sales of fixed maturity securities (11 issuers; 12 issues) that had unrealized losses at June 30, 2002. Market values of five of the issues increased an aggregate of \$410,000 from June 30 to date of sale. Two of the securities were AAA-rated interest-only mortgage-backed securities that decreased in value by \$1.9 million from June 30 to the date of sale due to the decline in market interest rates. Market values of the remaining five securities decreased an aggregate of \$931,000 from June 30 to the sale date. Two of the twelve issues had unrealized losses greater than \$500,000 at June 30. Actual losses on the sale of these two securities were approximately equal to the unrealized loss at June 30. Although GAFRI had the ability to continue holding these investments, its intent to hold them changed due primarily to deterioration in the issuer's credit, decisions to lessen exposure to a particular credit or industry, or to modify asset allocation within the portfolio. None of the securities were sold out of a necessity to raise cash. GAFRI has the ability and intent to hold securities with unrealized losses at September 30, 2002, for a period of time sufficient to allow for a recovery in market value.

The table below (dollars in millions) summarizes the length of time securities have been in an unrealized gain or loss position at September 30, 2002.

	Aggregate Market Value	Aggregate Unrealized Gain (Loss)	Market Value as % of Cost Basis
<u>Fixed Maturities</u>			
Securities with unrealized gains at 9/30/02:			
Exceeding \$500,000 and for:			
Less than one year (217 issues)	\$2,214	\$ 186	109.2%
More than one year (45 issues)	528	63	113.5
Less than \$500,000 and an unrealized gain for:			
Less than one year (515 issues)	1,869	74	104.1
More than one year (487 issues)	<u>1,448</u>	<u>71</u>	105.2
	<u>\$6.059</u>	<u>\$ 394</u>	107.0%

Securities with unrealized losses at 9/30/02:

Exceeding \$500,000 and for:

Less than one year (49 issues)	\$ 221	(\$ 63)	77.8%
More than one year (7 issues)	38	(7)	84.4

Less than \$500,000 and an unrealized loss for:

Less than one year (213 issues)	438	(22)	95.2
More than one year (33 issues)	<u>53</u>	<u>(4)</u>	93.0

)			
	<u>\$ 750</u>	<u>(\$ 96)</u>	88.7%

Equity Securities

Securities with unrealized gains at 9/30/02:

Exceeding \$500,000 and for:

Less than one year (1 issue)	\$ 6	\$ 1	120.0%
More than one year (1 issues)	37	20	217.6

Less than \$500,000 and an unrealized gain for:

Less than one year (7 issues)	7	-	100.0
More than one year (0 issue)	<u>-</u>	<u>-</u>	-

	<u>\$50</u>	<u>\$ 21</u>	172.4%
--	-------------	--------------	--------

Securities with unrealized losses at 9/30/02:

Exceeding \$500,000 and for:

Less than one year (0 issues)	\$-	\$ -	- %
More than one year (0 issues)	-	-	-

Less than \$500,000 and an unrealized loss for:

Less than one year (5 issues)	4	(1)	80.0
More than one year (2 issues)	<u>1</u>	<u>-</u>	100.0

	<u>\$ 5</u>	<u>(\$ 1)</u>	83.3%
--	-------------	---------------	-------

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

When a decline in the value of a specific investment is considered to be "other than temporary," a provision for impairment is charged to earnings (accounted for as a realized loss) and the cost basis of that investment is reduced, regardless of whether the security is actually sold. The determination of whether unrealized losses are "other than temporary" requires judgment based on subjective as well as objective factors. A listing of factors considered and resources used is contained in the discussion of "Investments" under Management's Discussion and Analysis in GAFRI's 2001 Form 10-K.

Based on its analysis, management believes (i) GAFRI will recover its cost basis in the securities with unrealized losses and (ii) that GAFRI has the ability and intent to hold the securities until they mature or recover in value. Should either of these beliefs change with regard to a particular security, a charge for impairment would likely be required. While it is not possible to accurately predict if or when a specific security will become impaired, charges for other than temporary impairment could be material to results of operations in a future period. Management believes it is not likely that future impairment charges will have a significant effect on GAFRI's liquidity.

RESULTS OF OPERATIONS

General

Management believes the concept of net operating earnings (or "core" earnings) is helpful in comparing the operating performance of GAFRI with that of similar companies. However, core earnings should not be considered a substitute for the net income reported in the Consolidated Income Statement as an indication of GAFRI's overall performance. The following table (in millions, except per share amounts) compares the Company's core earnings for the following periods.

	Three months ended		Nine months ended	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Revenues per income statement	\$221.7	\$222.3	\$639.5	\$635.9
Add back realized losses on investments	<u>21.4</u>	<u>1.3</u>	<u>51.6</u>	<u>25.8</u>
Core operating revenues	243.1	223.6	691.1	661.7
Expenses per income statement	<u>220.6</u>	<u>195.4</u>	<u>617.1</u>	<u>575.7</u>
Core operating earnings before tax	22.5	28.2	74.0	86.0

Income tax expense	<u>6.6</u>	<u>9.0</u>	<u>19.0</u>	<u>27.4</u>
Net core operating earnings	<u>\$ 15.9</u>	<u>\$ 19.2</u>	<u>\$ 55.0</u>	<u>\$ 58.6</u>
Net core operating earnings per common share (diluted)	<u>\$ 0.37</u>	<u>\$ 0.45</u>	<u>\$ 1.29</u>	<u>\$ 1.37</u>

The decrease in GAFRI's net core operating earnings in the third quarter and first nine months of 2002 compared to the comparable periods in 2001 is due primarily to the effects of adverse mortality in GAFRI's life insurance operations and the impact of declines in the equity markets on the Company's variable annuity operations. These decreases were partially offset by higher earnings in the Company's supplemental health and fixed annuity operations.

GAFRI's net core operating earnings for the nine months ended September 30, 2001 were favorably impacted by operating gains realized on the sale of certain real estate operations.

24

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

Retirement Products

The following table summarizes GAFRI's premiums for its retirement annuities (in millions).

	Three months ended		Nine months ended	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
<u>Annuity Premiums</u>				
Single premium fixed rate annuities	\$197	\$130	\$439	\$304
Flexible premium fixed rate annuities	34	32	119	111
Single premium variable annuities	18	29	80	74
Flexible premium variable annuities	<u>19</u>	<u>20</u>	<u>66</u>	<u>68</u>
	<u>\$268</u>	<u>\$211</u>	<u>\$704</u>	<u>\$557</u>

Management believes that fixed annuity sales increased over the same period in the prior year due to newly-recruited agencies, the introduction of a new product, the volatile equity markets, and the relative attractiveness of fixed

annuities compared to other interest bearing instruments.

Life, Accident and Health Premiums and Benefits

The following table summarizes GAFRI's life, accident and health premiums and benefits as shown in the Consolidated Income Statement (in millions).

	<u>Three months ended</u>		<u>Nine months ended</u>	
	<u>September 30.</u>		<u>September 30.</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
<u>Premiums</u>				
Supplemental insurance products	\$49	\$46	\$144	\$143
GA Life of Puerto Rico	15	14	45	40
Life products (excluding MNL)	10	9	29	26
Manhattan National Life	<u>7</u>	<u>-</u>	<u>7</u>	<u>-</u>
	<u>\$81</u>	<u>\$69</u>	<u>\$225</u>	<u>\$209</u>
<u>Benefits</u>				
Supplemental insurance products	\$40	\$40	\$122	\$119
GA Life of Puerto Rico	7	7	23	21
Life products (excluding MNL)	12	7	29	20
Manhattan National Life	<u>11</u>	<u>-</u>	<u>11</u>	<u>-</u>
	<u>\$70</u>	<u>\$54</u>	<u>\$185</u>	<u>\$160</u>

GAFRI continues to experience adverse mortality in GALIC's life division. Further adverse mortality could result in a charge to income and a reduction in unamortized insurance acquisition costs.

Net Investment Income

Net investment income increased in the third quarter and first nine months of 2002 compared to the respective periods in 2001 due primarily to higher average invested assets (partially as a result of the MNL acquisition), offset by lower average investment yields in the portfolio. The yield on GAFRI's investment portfolio was approximately 7.1% at September 30, 2002, compared to approximately 7.5% at December 31, 2001.

Realized Losses on Investments

Realized losses on investments included the following provisions for other than temporary impairment: third quarter of 2002 and 2001 - \$30.7 million and \$11.3 million; nine months of

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-Q

2002 and 2001 - \$77.2 million and \$34.3 million, respectively. The increase in impairment charges in 2002 reflects primarily the downturn in the communications and airline industries and writedowns of certain asset-backed securities.

25

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

Other Income

Other income increased \$5.0 million in the third quarter of 2002 compared to the third quarter of 2001 due primarily to the June 2002 Manhattan acquisition and higher hotel revenues (see below). Other income decreased \$4.5 million in the first nine months of 2002 compared to the same period in 2001 due primarily to income from the sale of real estate in 2001 (see below). This decrease was partially offset by the Manhattan acquisition and higher hotel revenues mentioned above.

Real Estate Operations

GAFRI is engaged in a variety of real estate operations including hotels and marinas; GAFRI also owns several parcels of land. Revenues and expenses of these operations, including gains on disposal, are included in GAFRI's Consolidated Income Statement as shown below (in millions).

		Three months ended	Nine months ended	
		<u>September 30,</u>	<u>September 30,</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Other income	\$15.5	\$13.8	\$31.8	\$39.8
Other expenses	10.1	9.7	24.4	24.0

Other income included a pretax gain on the sale of real estate assets of \$10.6 million in the first nine months of 2001, none of which were realized in the third quarter.

Annuity Benefits

Annuity benefits reflect amounts accrued on annuity policyholders' funds accumulated. The majority of GAFRI's fixed rate annuity products permit GAFRI to change the crediting rate at any time (subject to minimum interest rate guarantees of 3% or 4% per annum). Historically, management has been able to react to changes in market interest rates and maintain a desired interest rate spread. The recent interest rate environment has resulted in a spread compression, which could continue through 2003.

On its deferred annuities (annuities in the accumulation phase), GAFRI generally credits interest to policyholders' accounts at their current stated "surrender" interest rates. Furthermore, for "two-tier" deferred annuities (annuities under which a higher interest amount can be earned if a policy is annuitized rather than surrendered), GAFRI accrues an additional liability to provide for expected deaths and annuitizations. Changes in crediting rates, actual surrender, death and annuitization experience or modifications in actuarial assumptions can affect this accrual. In the third quarter and first nine months of 2002, this accrual was reduced by \$7 million and \$14 million, respectively, due to (i)

decreases in crediting rates on certain fixed annuity products, partially offset by (ii) a modification in projected investment yields in the second quarter of 2002. Significant modifications in projected investment yields could result in additional charges to earnings.

Insurance Acquisition Expenses

Insurance acquisition expenses include amortization of deferred policy acquisition costs ("DPAC") as well as certain commissions on sales of life insurance products. Insurance acquisition expenses also include amortization of the present value of future profits of businesses acquired amounting to \$8.5 million in the first nine months of 2002 and \$7.3 million in the first nine months of 2001.

The increase in insurance acquisition expenses in the third quarter and the first nine months of 2002 compared to the same periods in 2001 reflects (i) higher average DPAC balances due to internal growth and acquisitions and (ii) changes in actuarial assumptions. Included in the third quarter and first nine months of 2002 were DPAC writeoffs related to variable annuities of \$2.9 million and \$6.9 million, respectively, resulting from the actual performance of the equity markets and a reduction of assumed future returns. Poor performance in the equity markets could lead to additional DPAC writeoffs or a charge to earnings in order to accrue for guaranteed minimum death benefits included in the variable products (See Proposed Accounting Standard).

26

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

Included in the third quarter and first nine months of 2001 was a DPAC writeoff of \$3.0 million related primarily to actual performance of the equity markets.

Trust Preferred Distribution Requirement

The decrease in trust preferred distribution requirement in 2002 reflects the Company's September 2001 redemption of one issue of its trust preferred securities.

Other Expenses

Other expenses increased in the third quarter and first nine months of 2002 compared to the comparable periods in 2001 due primarily to a third quarter reduction to the amount of expenses capitalized in GAFRI's life insurance operations on policies issued in 2002.

Income Taxes

The provision (credit) for income taxes in all periods presented reflects the effects of non-taxable foreign operations. In the first nine months of 2002, the provision for income taxes also reflects reductions of the valuation allowance associated with certain deferred tax assets.

Cumulative Effect of Accounting Change

The cumulative effect of accounting change represents the implementation of a new accounting standard (EITF 99-20) which resulted in a write down of \$8.4 million (\$5.5 million or \$0.13 per share after tax) of the carrying value of certain collateralized debt obligations as of April 1,

2001.

Proposed Accounting Standard

GAFRI's variable annuity contracts contain a guaranteed minimum death benefit ("GMDB") (which may exceed the value of the policyholder's account) to be paid if the annuityholder dies before the annuity payout period commences. Payment of any difference between the GMDB and the related account balance is borne by GAFRI and expensed when paid. In periods of declining equity markets, the GMDB difference increases as the variable annuity account value decreases. At September 30, 2002, and December 31, 2001, the aggregate GMDB values (assuming every policyholder died on those dates) exceeded the market value of the underlying variable annuities by \$253 million and \$136 million, respectively. Industry practice varies, but GAFRI does not establish GAAP reserves for this mortality risk. If a proposed accounting standard becomes effective, GAFRI would be required to record a liability for the present value of expected GMDB payments. Initial recognition of a GAAP liability (estimated to be between 2% and 4% of the aggregate difference) would be accounted for as the cumulative effect of a change in accounting principles.

PART II

OTHER INFORMATION

Item 3

Quantitative and Qualitative Disclosure at Market Risk

Other than the effect that the recent interest rate environment has had on GAFRI's investment portfolio (see Management's Discussion and Analysis, "Investments" and "Net Investment Income"), as of September 30, 2002, there were no material changes to the information provided in GAFRI's Form 10-K for 2001 under the caption "Exposure to Market Risk" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

27

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

PART II

OTHER INFORMATION

Item 4

Evaluation of Disclosure Controls and Procedures

GAFRI's chief executive officer and chief financial officer, with the participation of management, have evaluated GAFRI's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-14(c)) as of a date within 90 days prior to filing this report. Based on the evaluation, they concluded that the controls and procedures are effective. There have been no significant changes in GAFRI's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

Item 6

Exhibits and Reports on Form 8-K

(a) Exhibits: None

(b) Reports on Form 8-K: None

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned duly authorized.

GREAT AMERICAN FINANCIAL RESOURCES, Inc.

November 14, 2002

BY: /s/Christopher P. Miliano

Christopher P. Miliano

Chief Financial Officer

28

Certification of Principal Executive Officer

Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

and Securities and Exchange Commission Release 34-46427

I, S. Craig Lindner, the principal executive officer of Great American Financial Resources, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Great American Financial Resources, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

(c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ S. Craig Lindner
S. Craig Lindner
Chief Executive Officer

I, Christopher P. Miliano, the principal financial officer of Great American Financial Resources, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Great American Financial Resources, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective

actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Christopher P. Miliano

Christopher P. Miliano

Chief Financial Officer

30

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the filing with the Securities and Exchange Commission of the Quarterly Report of Great American Financial Resources, Inc. on Form 10-Q for the period ending September 30, 2002 (the "Report"), I, S. Craig Lindner, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ S. Craig Lindner

S. Craig Lindner

Chief Executive Officer

November 14, 2002

31

CERTIFICATION OF CHIEF FINANCIAL OFFICER

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the filing with the Securities and Exchange Commission of the Quarterly Report of Great American Financial Resources, Inc. on Form 10-Q for the period ending September 30, 2002 (the "Report"), I, Christopher P. Miliano, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Christopher P. Miliano

Christopher P. Miliano

Chief Financial Officer

November 14, 2002