National Western Life Group, Inc.
Form 10-Q
November 04, 2016

UNITED
STATES
SECURITIES
AND
EXCHANGE
COMMISSION
Washington, D.C.
20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2016
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to __________

Commission File Number: 000-55522

NATIONAL WESTERN LIFE GROUP, INC.
(Exact name of Registrant as specified in its charter)

DELAWARE	47-3339380
(State of Incorporation)	(I.R.S. Employer Identification Number)
850 EAST ANDERSON LANE	
AUSTIN, TEXAS 78752-1602	(512) 836-1010
(Address of Principal Executive Offices)	(Telephone Number)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). :
Yes x   No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated file" in Rule 12b-2 of the Exchange Act.
Large accelerated filer o   Accelerated filer x   Non-accelerated filer o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o   No x
As of November 3, 2016, the number of shares of Registrant's common stock outstanding was: Class A – 3,436,166 and Class B - 200,000.

TABLE OF CONTENTS

2

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

ASSETS	(Unaudited) September 30, 2016	December 31, 2015
Investments:		
Securities held to maturity, at amortized cost (fair value: $7,542,335 and $7,335,436)	$ 7,106,373	7,173,967
Securities available for sale, at fair value (cost: $2,934,609 and $2,847,414)	3,106,794	2,879,583
Mortgage loans, net of allowance for possible losses ($650 and $650)	146,913	108,311
Policy loans	59,218	61,957
Derivatives, index options	90,097	38,409
Other long-term investments	51,980	26,787
Short-term investments	14,972	—
Total investments	10,576,347	10,289,014
Cash and cash equivalents	177,288	106,007
Deferred policy acquisition costs	795,210	853,451
Deferred sales inducements	138,793	159,166
Accrued investment income	101,237	99,619
Federal income tax receivable	—	12,512
Other assets	91,729	92,807
Total assets	$ 11,880,604	11,612,576

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

LIABILITIES AND STOCKHOLDERS' EQUITY	(Unaudited) September 30, 2016	December 31, 2015
LIABILITIES:		
Future policy benefits:		
Universal life and annuity contracts	$ 9,661,675	9,561,358
Traditional life reserves	136,423	138,000
Other policyholder liabilities	150,087	155,261
Deferred Federal income tax liability	84,717	49,333
Federal income tax payable	9,149	—
Other liabilities	103,235	96,638
Total liabilities	10,145,286	10,000,590
COMMITMENTS AND CONTINGENCIES (Note 8)		
STOCKHOLDERS' EQUITY:		
Common stock:		
Class A - $.01 par value; 7,500,000 shares authorized; 3,436,166 issued and outstanding in 2016 and 2015	34	34
Class B - $.01 par value; 200,000 shares authorized, issued, and outstanding in 2016 and 2015	2	2
Additional paid-in capital	41,716	41,716
Accumulated other comprehensive income	46,381	329
Retained earnings	1,647,185	1,569,905
Total stockholders' equity	1,735,318	1,611,986
Total liabilities and stockholders' equity	$ 11,880,604	11,612,576

Note: The Condensed Consolidated Balance Sheet at December 31, 2015 has been derived from the audited Consolidated Financial Statements as of that date.

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
For the Three Months Ended September 30, 2016 and 2015
(Unaudited)
(In thousands, except per share amounts)

	2016	2015
Premiums and other revenues:		
Universal life and annuity contract charges	$40,333	39,175
Traditional life premiums	4,631	4,840
Net investment income	126,981	56,209
Other revenues	4,476	5,067
Net realized investment gains (losses):		
Total other-than-temporary impairment (“OTTI”) gains (losses)	27	284
Portion of OTTI (gains) losses recognized in other comprehensive income	(27)	(284)
Net OTTI losses recognized in earnings	—	—
Other net investment gains (losses)	5,426	813
Total net realized investment gains (losses)	5,426	813
Total revenues	181,847	106,104
Benefits and expenses:		
Life and other policy benefits	17,430	14,181
Amortization of deferred policy acquisition costs	24,395	32,058
Universal life and annuity contract interest	67,776	16,259
Other operating expenses	23,595	18,482
Total benefits and expenses	133,196	80,980
Earnings before Federal income taxes	48,651	25,124
Federal income taxes	14,915	8,903
Net earnings	$33,736	16,221
Basic earnings per share:		
Class A	$9.54	$4.59
Class B	$4.77	$2.29
Diluted earnings per share:		
Class A	$9.54	$4.59
Class B	$4.77	$2.29

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
For the Nine Months Ended September 30, 2016 and 2015
(Unaudited)
(In thousands, except per share amounts)

	2016	2015
Premiums and other revenues:		
Universal life and annuity contract charges	$123,791	114,833
Traditional life premiums	13,721	14,349
Net investment income	335,732	258,391
Other revenues	14,050	15,590
Net realized investment gains (losses):		
Total other-than-temporary impairment ("OTTI") gains (losses)	80	442
Portion of OTTI (gains) losses recognized in other comprehensive income	(80)	(549)
Net OTTI losses recognized in earnings	—	(107)
Other net investment gains (losses)	10,589	6,156
Total net realized investment gains (losses)	10,589	6,049
Total revenues	497,883	409,212
Benefits and expenses:		
Life and other policy benefits	48,571	49,567
Amortization of deferred policy acquisition costs	88,581	87,780
Universal life and annuity contract interest	179,592	114,729
Other operating expenses	66,306	57,794
Total benefits and expenses	383,050	309,870
Earnings before Federal income taxes	114,833	99,342
Federal income taxes	37,553	32,937
Net earnings	$77,280	66,405
Basic earnings per share:		
Class A	$21.85	$18.78
Class B	$10.93	$9.39
Diluted earnings per share:		
Class A	$21.85	$18.77
Class B	$10.93	$9.39

See accompanying notes to condensed consolidated financial statements (unaudited).

6

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
For the Three Months Ended September 30, 2016 and 2015
(Unaudited)
(In thousands)

	2016	2015
Net earnings	$33,736	16,221
Other comprehensive income (loss), net of effects of deferred costs and taxes:		
Unrealized gains (losses) on securities:		
Net unrealized holding gains (losses) arising during period	2,824	(7,334)
Net unrealized liquidity gains (losses)	9	95
Reclassification adjustment for net amounts included in net earnings	(1,398)	(96)
Net unrealized gains (losses) on securities	1,435	(7,335)
Foreign currency translation adjustments	22	54
Benefit plans:		
Amortization of net prior service cost and net gain (loss)	(283)	(303)
Other comprehensive income (loss)	1,174	(7,584)
Comprehensive income (loss)	$34,910	8,637

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
For the Nine Months Ended September 30, 2016 and 2015
(Unaudited)
(In thousands)

	2016	2015
Net earnings	$77,280	66,405
Other comprehensive income, net of effects of deferred costs and taxes:		
Unrealized gains (losses) on securities:		
Net unrealized holding gains (losses) arising during period	48,927	(19,164)
Net unrealized liquidity gains (losses)	27	188
Reclassification adjustment for net amounts included in net earnings	(1,971)	(2,116)
Net unrealized gains (losses) on securities	46,983	(21,092)
Foreign currency translation adjustments	(81)	42
Benefit plans:		
Amortization of net prior service cost and net gain (loss)	(850)	(910)
Other comprehensive income (loss)	46,052	(21,960)
Comprehensive income (loss)	$123,332	44,445

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Nine Months Ended September 30, 2016 and 2015
(Unaudited)
(In thousands)

	2016	2015
Common stock:		
Balance at beginning of period	$ 36	3,636
Shares exercised under stock option plan	—	—
Balance at end of period	36	3,636
Additional paid-in capital:		
Balance at beginning of period	41,716	38,116
Shares exercised under stock option plan	—	—
Balance at end of period	41,716	38,116
Accumulated other comprehensive income:		
Unrealized gains on non-impaired securities:		
Balance at beginning of period	12,347	54,229
Change in unrealized gains (losses) during period, net of tax	46,956	(21,280)
Balance at end of period	59,303	32,949
Unrealized losses on impaired held to maturity securities:		
Balance at beginning of period	(240)	(1,262)
Amortization	52	357
Other-than-temporary impairments, non-credit, net of tax	—	—
Additional credit loss on previously impaired securities	—	—
Change in shadow deferred policy acquisition costs	(25)	(169)
Balance at end of period	(213)	(1,074)
Unrealized losses on impaired available for sale securities:		
Balance at beginning of period	(1)	(1)
Other-than-temporary impairments, non-credit, net of tax	—	—
Change in shadow deferred policy acquisition costs	—	—
Recoveries, net of tax	—	—
Balance at end of period	(1)	(1)

Continued on Next Page

9

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY(continued)
For the Nine Months Ended September 30, 2016 and 2015
(Unaudited)
(In thousands)

	2016	2015
Foreign currency translation adjustments:		
Balance at beginning of period	2,825	2,685
Change in translation adjustments during period	(81)	42
Balance at end of period	2,744	2,727
Benefit plan liability adjustment:		
Balance at beginning of period	(14,602)	(13,865)
Amortization of net prior service cost and net loss, net of tax	(850)	(910)
Balance at end of period	(15,452)	(14,775)
Accumulated other comprehensive income at end of period	46,381	19,826
Retained earnings:		
Balance at beginning of period	1,569,905	1,472,782
Net earnings	77,280	66,405
Stockholder dividends	—	—
Balance at end of period	1,647,185	1,539,187
Total stockholders' equity	$1,735,318	$1,600,765

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2016 and 2015
(Unaudited)
(In thousands)

	2016	2015
Cash flows from operating activities:		
Net earnings	$77,280	66,405
Adjustments to reconcile net earnings to net cash from operating activities:		
Universal life and annuity contract interest	179,592	114,729
Surrender charges and other policy revenues	(34,955)	(13,302)
Realized (gains) losses on investments	(10,589)	(6,049)
Accretion/amortization of discounts and premiums, investments	51	9
Depreciation and amortization	5,823	2,317
(Increase) decrease in value of derivatives	(8,307)	69,884
(Increase) decrease in deferred policy acquisition and sales inducement costs	10,799	(632)
(Increase) decrease in accrued investment income	(1,618)	(4,592)
(Increase) decrease in other assets	(3,683)	(6,578)
Increase (decrease) in liabilities for future policy benefits	3,408	6,887
Increase (decrease) in other policyholder liabilities	(5,175)	7,382
Increase (decrease) in Federal income taxes liability	21,661	(22,703)
Increase (decrease) in deferred Federal income tax	10,587	31,047
Increase (decrease) in other liabilities	1,352	2,452
Net cash provided by operating activities	246,226	247,256
Cash flows from investing activities:		
Proceeds from sales of:		
Securities held to maturity	—	—
Securities available for sale	16,087	14,011
Other investments	3,947	2,182
Proceeds from maturities and redemptions of:		
Securities held to maturity	304,190	343,494
Securities available for sale	134,208	219,676
Derivatives, index options	13,273	83,835
Purchases of:		
Securities held to maturity	(231,804)	(684,725)
Securities available for sale	(229,932)	(423,672)
Derivatives, index options	(57,224)	(66,395)
Other investments	(27,525)	(1,340)
Net change in short-term investments	(14,972)	—

Continued on Next Page

11

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2016 and 2015
(Unaudited)
(In thousands)

	2016	2015
Principal payments on mortgage loans	17,295	66,830
Cost of mortgage loans acquired	(55,796)	(5,040)
Decrease (increase) in policy loans	2,739	2,034
Net cash used in investing activities	(125,514)	(449,110)
Cash flows from financing activities:		
Deposits to account balances for universal life and annuity contracts	626,083	679,128
Return of account balances on universal life and annuity contracts	(675,389)	(668,037)
Net cash provided by (used in) financing activities	(49,306)	11,091
Effect of foreign exchange	(125)	42
Net increase (decrease) in cash and cash equivalents	71,281	(190,721)
Cash and cash equivalents at beginning of period	106,007	277,078
Cash and cash equivalents at end of period	$177,288	$86,357
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid (received) during the period for:		
Interest	$33	30
Income taxes	$5,032	24,127
Noncash operating activities:		
Deferral of sales inducements	$(7,146)	(9,171)

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) CONSOLIDATION AND BASIS OF PRESENTATION

On October 1, 2015, National Western Life Insurance Company ("National Western", "NWLIC", or "company") completed its previously announced holding company reorganization. As a result of the reorganization, National Western became a wholly owned subsidiary of National Western Life Group, Inc. ("NWLGI"), a Delaware Corporation, and NWLGI replaced National Western as the publicly held company.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for annual financial statements. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments necessary to present fairly the financial position of NWLGI and its subsidiaries (“Company”) as of September 30, 2016, and the results of its operations and its cash flows for the three and nine months ended September 30, 2016 and 2015. Such adjustments are of a normal recurring nature. The results of operations for the nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the full year. It is recommended that these condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 and are accessible free of charge through the Company's internet site at www.nwlgi.com or the Securities and Exchange Commission internet site at www.sec.gov. The Condensed Consolidated Balance Sheet at December 31, 2015 has been derived from the audited consolidated financial statements as of that date.

Prior to the reorganization, the accompanying consolidated financial statements included the accounts of National Western and its wholly owned subsidiaries: The Westcap Corporation, Regent Care San Marcos Holdings, LLC, NWL Investments, Inc., NWL Services, Inc., NWLSM, Inc., and NWL Financial, Inc. During the fourth quarter of 2015, subsequent to the reorganization, National Western transferred ownership of Regent Care San Marcos Holdings, LLC, NWL Investments, Inc., and NWL Services, Inc. to NWLGI via a dividend transaction resulting in those entities becoming wholly owned subsidiaries of NWLGI.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Significant estimates in the accompanying condensed consolidated financial statements include (1) liabilities for future policy benefits, (2) valuation of derivative instruments, (3) recoverability and amortization of deferred policy acquisition costs, (4) valuation allowances for deferred tax assets, (5) other-than-temporary impairment losses on debt securities, (6) commitments and contingencies, and (7) valuation allowances for mortgage loans and real estate.

The table below shows the unrealized gains and losses on available-for-sale securities that were reclassified out of accumulated other comprehensive income for the three and nine months ended September 30, 2016 and 2015.

Affected Line Item in the Statements of Earnings	Amount Reclassified From Accumulated Other Comprehensive Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Other net investment gains (losses)	$2,151	147	3,033	3,362
Net OTTI losses recognized in earnings	—	—	—	(107)
Earnings before Federal income taxes	2,151	147	3,033	3,255
Federal income taxes	753	51	1,062	1,139
Net earnings	$1,398	96	1,971	2,116

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(2) NEW ACCOUNTING PRONOUNCEMENTS

In June 2014, the Financial Accounting Standards Board ("FASB") issued guidance that applies to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. It requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition and follows existing accounting guidance for the treatment of performance conditions. The standard is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015, with early adoption permitted. The Company adopted this standard during the three month period ended March 31, 2016. The adoption of this standard did not have a material impact on the Company’s financial position, results of operations or cash flows.
In January 2016, the FASB released accounting standards update 2016-01, Recognition and Measurement of Financial Assets and Liabilities. The main provisions of the update are to eliminate the available for sale classification of accounting for equity securities and to adjust the fair value disclosures for financial instruments carried at amortized costs such that the disclosed fair values represent an exit price as opposed to an entry price. The provisions of this update will require that equity securities be carried at fair market value on the balance sheet and any periodic changes in value will be adjustments to the income statement. The provisions of this update become effective for interim and annual periods beginning after December 15, 2017. The Company does not expect the requirements of this update to have a material impact on the Company’s financial position, results of operations or cash flows.

In June 2016, the FASB released accounting standards update 2016-13, Financial Instruments-Credit Losses, which revises the credit loss recognition criteria for certain financial assets measured at amortized cost. The new guidance replaces the existing incurred loss recognition model with an expected loss recognition model. The objective of the expected credit loss model is for the reporting entity to recognize its estimate of expected credit losses for affected financial assets in a valuation allowance deducted from the amortized cost basis of the related financial assets that results in presenting the net carrying value of the financial assets at the amount expected to be collected. The guidance is effective for interim and annual periods beginning after December 15, 2019, and for most affected instruments must be adopted using a modified retrospective approach, with a cumulative effect adjustment recorded to beginning retained income. Adoption of the guidance is not expected to have a material effect on the Company’s results of operations or financial position.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not, or are not believed by management to, have a material impact on the Company’s present or future consolidated financial statements.

(3) STOCKHOLDERS' EQUITY

NWLIC is restricted by state insurance laws as to dividend amounts which may be paid to stockholders without prior approval from the Colorado Division of Insurance. The restrictions are based on the greater of statutory earnings from operations excluding capital gains or 10% of statutory surplus of the company. The maximum dividend payment which may be made without prior approval in 2016 is $117.1 million. National Western did declare a cash dividend of $3.0 million payable to its sole shareholder, NWLGI, on August 19, 2016. The cash dividend was subsequently paid on October 3, 2016.

As discussed in Note 1, Consolidation and Basis of Presentation, on October 1, 2015, NWLIC completed its previously announced holding company reorganization and became a wholly owned subsidiary of NWLGI. While remaining under the same Colorado Division of Insurance restrictions pertaining to dividend amounts, dividends declared by NWLIC from that date forward are payable entirely to NWLGI as the sole owner of NWLIC.

The reorganization effective October 1, 2015 provided for the conversion of each share of Class A common stock, par value $1.00 per share, and each share of Class B common stock, par value $1.00 per share, of NWLIC issued and outstanding immediately prior to the effective time of the merger, into one duly issued, fully paid and non-assessable share of Class A common stock, par value $0.01 per share, and Class B common stock, par value $0.01 per share, of NWLGI. Consequently, NWLGI replaced NWLIC as the publicly held company and is the successor issuer to NWLIC.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(4) EARNINGS PER SHARE

Basic earnings per share of common stock are computed by dividing net income by the weighted-average basic common shares outstanding during the period. Diluted earnings per share assumes the issuance of common shares applicable to stock options in the denominator. Net income for the periods shown is allocated between Class A shares and Class B shares based upon (1) the proportionate number of shares issued and outstanding as of the end of the period, and (2) the per share dividend rights of the two classes under the Company's Restated Certificate of Incorporation (the Class B dividend per share is equal to one-half the Class A dividend per share).

	Three Months Ended September 30,			
	2016		2015	
	Class A	Class B	Class A	Class B
	(In thousands except per share amounts)			
Numerator for Basic and Diluted Earnings Per Share:				
Net income	$33,736		16,221	
Dividends - Class A shares	—		—	
Dividends - Class B shares	—		—	
Undistributed income	$33,736		16,221	
Allocation of net income:				
Dividends	$—	—	—	—
Allocation of undistributed income	32,782	954	15,763	458
Net income	$32,782	954	15,763	458
Denominator:				
Basic earnings per share - weighted-average shares	3,436	200	3,436	200
Effect of dilutive stock options	—	—	1	—
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,436	200	3,437	200
Basic Earnings Per Share	$9.54	4.77	4.59	2.29
Diluted Earnings Per Share	$9.54	4.77	4.59	2.29

Stock options that were outstanding during the three months ended September 30, 2016 and 2015, but were not included in the computation of diluted earnings per share because the effect was anti-dilutive, were approximately 27,300 and 20,800, respectively.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

	Nine Months Ended September 30,			
	2016		2015	
	Class A	Class B	Class A	Class B
	(In thousands except per share amounts)			
Numerator for Basic and Diluted Earnings Per Share:				
Net income	$77,280		66,405	
Dividends - Class A shares	—		—	
Dividends - Class B shares	—		—	
Undistributed income	$77,280		66,405	
Allocation of net income:				
Dividends	$—	—	—	—
Allocation of undistributed income	75,095	2,185	64,527	1,878
Net income	$75,095	2,185	64,527	1,878
Denominator:				
Basic earnings per share - weighted-average shares	3,436	200	3,436	200
Effect of dilutive stock options	—	—	1	—
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,436	200	3,437	200
Basic Earnings Per Share	$21.85	10.93	18.78	9.39
Diluted Earnings Per Share	$21.85	10.93	18.77	9.39

Stock options that were outstanding during the nine months ended September 30, 2016 and 2015, but were not included in the computation of diluted earnings per share because the effect was anti-dilutive were approximately 22,900 and 21,100, respectively.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(5) PENSION AND OTHER POSTRETIREMENT PLANS

(A) Defined Benefit Pension Plans

National Western sponsors a qualified defined benefit pension plan covering employees enrolled prior to 2008. The plan provides benefits based on the participants' years of service and compensation. The company makes annual contributions to the plan that complies with the minimum funding provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). On October 19, 2007, National Western's Board of Directors approved an amendment to freeze the pension plan as of December 31, 2007. The freeze ceased future benefit accruals to all participants and closed the plan to any new participants. In addition, all participants became immediately 100% vested in their accrued benefits as of that date. Fair values of plan assets and liabilities are measured as of the prior December 31 for each respective year. The following table summarizes the components of net periodic benefit cost.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Service cost	$26	51	79	153
Interest cost	250	246	750	738
Expected return on plan assets	(304)	(330)	(912)	(991)
Amortization of prior service cost	—	1	—	3
Amortization of net loss	193	196	579	588
Net periodic benefit cost	$165	164	496	491

The service costs shown in the above table represent plan expenses expected to be paid out of plan assets. Under the clarified rules of the Pension Protection Act, plan expenses paid from plan assets are to be included in the plan's service cost component.

The company's minimum required contribution for the 2016 plan year is $0.2 million. There was no remaining contribution payable for the 2015 plan year as of September 30, 2016. As of September 30, 2016, the company had contributed a total of $0.1 million to the plan for the 2016 plan year.

National Western also sponsors a nonqualified defined benefit plan primarily for senior officers. The plan provides benefits based on the participants' years of service and compensation. The pension obligations and administrative responsibilities of the plan are maintained by a pension administration firm, which is a subsidiary of American National Insurance Company ("ANICO"). ANICO has guaranteed the payment of pension obligations under the plan. However, the company has a contingent liability with respect to the plan should these entities be unable to meet their obligations under the existing agreements. Also, the company has a contingent liability with respect to the plan in the event that a plan participant continues employment with National Western beyond age seventy, the aggregate average annual participant salary increases exceed 10% per year, or any additional employees become eligible to participate in the plan. If any of these conditions are met, the company would be responsible for any additional pension obligations resulting from these items. Amendments were made to the plan to allow an additional employee to participate and to change the benefit formula for the then Chairman of the company. As previously mentioned, these additional obligations are a liability to the company. Effective December 31, 2004, this plan was frozen with respect to the continued accrual of benefits of the then Chairman and the then President of the company in order to comply with law changes under the American Jobs Creation Act of 2004 ("Act").

Effective July 1, 2005, National Western established a second nonqualified defined benefit plan for the benefit of the then Chairman and the then President of the company. This plan is intended to provide for post-2004 benefit accruals that mirror and supplement the pre-2005 benefit accruals under the previously discussed nonqualified defined benefit plan, while complying with the requirements of the Act.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The following table summarizes the components of net periodic benefit costs for the then Chairman in 2005 and the then President's nonqualified defined benefit plans.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Service cost	$109	64	327	192
Interest cost	265	219	794	657
Amortization of prior service cost	15	14	45	44
Amortization of net loss	501	379	1,503	1,136
Net periodic benefit cost	$890	676	2,669	2,029

The company expects to contribute $2.0 million to these plans in 2016. As of September 30, 2016, the company has contributed $1.3 million to the plans.

(B) Defined Benefit Postretirement Healthcare Plans

National Western sponsors two healthcare plans to provide postretirement benefits to certain fully-vested individuals. The following table summarizes the components of net periodic benefit costs.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Interest cost	$30	33	90	98
Amortization of prior service cost	26	25	78	77
Amortization of net loss	—	15	—	45
Net periodic benefit cost	$56	73	168	220

The company expects to contribute minimal amounts to the plan in 2016.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(6) SEGMENT AND OTHER OPERATING INFORMATION

The Company defines its reportable operating segments as domestic life insurance, international life insurance, and annuities. These segments are organized based on product types and geographic marketing areas. A summary of segment information for the three and nine months ended September 30, 2016 and September 30, 2015 is provided below.

Selected Segment Information:

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
September 30, 2016					
Condensed Consolidated Balance Sheet Items:					
Deferred policy acquisition costs and sales inducements	$85,547	239,685	608,771	—	934,003
Total segment assets	961,205	1,248,425	9,232,802	293,963	11,736,395
Future policy benefits	809,493	923,235	8,065,370	—	9,798,098
Other policyholder liabilities	18,058	14,103	117,926	—	150,087
Three Months Ended September 30, 2016					
Condensed Consolidated Statement of Earnings:					
Premiums and contract revenues	$8,507	31,066	5,391	—	44,964
Net investment income	12,294	12,763	97,384	4,540	126,981
Other revenues	7	10	139	4,320	4,476
Total revenues	20,808	43,839	102,914	8,860	176,421
Life and other policy benefits	5,338	5,038	7,054	—	17,430
Amortization of deferred policy acquisition costs	(4,331)	7,296	21,430	—	24,395
Universal life and annuity contract interest	9,795	11,287	46,694	—	67,776
Other operating expenses	4,847	6,691	7,526	4,531	23,595
Federal income taxes (benefit)	1,667	3,591	6,549	1,209	13,016
Total expenses	17,316	33,903	89,253	5,740	146,212
Segment earnings (loss)	$3,492	9,936	13,661	3,120	30,209

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Nine months ended September 30, 2016					
Condensed Consolidated Statement of Earnings:					
Premiums and contract revenues	$ 24,814	95,291	17,407	—	137,512
Net investment income	28,011	30,203	261,579	15,939	335,732
Other revenues	37	50	145	13,818	14,050
Total revenues	52,862	125,544	279,131	29,757	487,294
Life and other policy benefits	13,629	14,789	20,153	—	48,571
Amortization of deferred acquisition costs	989	11,720	75,872	—	88,581
Universal life and annuity contract interest	20,855	19,643	139,094	—	179,592
Other operating expenses	11,745	17,867	23,044	13,650	66,306
Federal income taxes (benefit)	1,833	19,977	6,808	5,229	33,847
Total expenses	49,051	83,996	264,971	18,879	416,897
Segment earnings (loss)	$ 3,811	41,548	14,160	10,878	70,397

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Selected Segment Information:

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
September 30, 2015					
Condensed Consolidated Balance Sheet Items:					
Deferred policy acquisition costs and sales inducements	$ 73,746	252,632	665,738	—	992,116
Total segment assets	831,407	1,260,628	8,999,978	262,310	11,354,323
Future policy benefits	720,998	944,618	7,976,312	—	9,641,928
Other policyholder liabilities	11,437	17,835	117,331	—	146,603
Three Months Ended September 30, 2015					
Condensed Consolidated Statement of Earnings:					
Premiums and contract revenues	$ 8,259	29,773	5,983	—	44,015
Net investment income	2,095	448	49,518	4,148	56,209
Other revenues	3	5	12	5,047	5,067
Total revenues	10,357	30,226	55,513	9,195	105,291
Life and other policy benefits	3,545	5,002	5,634	—	14,181
Amortization of deferred acquisition costs	1,594	6,834	23,630	—	32,058
Universal life and annuity contract interest	14	(854)	17,099	—	16,259
Other operating expenses	2,397	3,929	7,254	4,902	18,482
Federal income taxes (benefit)	911	5,363	825	1,520	8,619
Total expenses	8,461	20,274	54,442	6,422	89,599
Segment earnings (loss)	$ 1,896	9,952	1,071	2,773	15,692

21

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Nine months ended September 30, 2015					
Condensed Consolidated Statement of Earnings:					
Premiums and contract revenues	$ 22,683	89,470	17,029	—	129,182
Net investment income	17,265	17,847	208,263	15,016	258,391
Other revenues	23	66	31	15,470	15,590
Total revenues	39,971	107,383	225,323	30,486	403,163
Life and other policy benefits	12,540	16,794	20,233	—	49,567
Amortization of deferred acquisition costs	6,473	11,347	69,960	—	87,780
Universal life and annuity contract interest	10,413	13,203	91,113	—	114,729
Other operating expenses	9,554	15,063	18,866	14,311	57,794
Federal income taxes (benefit)	327	16,840	8,309	5,344	30,820
Total expenses	39,307	73,247	208,481	19,655	340,690
Segment earnings (loss)	$ 664	34,136	16,842	10,831	62,473

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Reconciliations of segment information to the Company's condensed consolidated financial statements are provided below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Premiums and Other Revenues:				
Premiums and contract revenues	$44,964	44,015	137,512	129,182
Net investment income	126,981	56,209	335,732	258,391
Other revenues	4,476	5,067	14,050	15,590
Realized gains (losses) on investments	5,426	813	10,589	6,049
Total condensed consolidated premiums and other revenues	$181,847	106,104	497,883	409,212

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Federal Income Taxes:				
Total segment Federal income taxes	$13,016	8,619	33,847	30,820
Taxes on realized gains (losses) on investments	1,899	284	3,706	2,117
Total condensed consolidated Federal income taxes	$14,915	8,903	37,553	32,937

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Net Earnings:				
Total segment earnings	$30,209	15,692	70,397	62,473
Realized gains (losses) on investments, net of taxes	3,527	529	6,883	3,932
Total condensed consolidated net earnings	$33,736	16,221	77,280	66,405

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

	September 30,	
	2016	2015
	(In thousands)	
Assets:		
Total segment assets	$11,736,395	11,354,323
Other unallocated assets	144,209	191,822
Total condensed consolidated assets	$11,880,604	11,546,145

(7) SHARE-BASED PAYMENTS

The company had a stock and incentive plan ("1995 Plan") which provided for the grant of any or all of the following types of awards to eligible employees: (1) stock options, including incentive stock options and nonqualified stock options; (2) stock appreciation rights, in tandem with stock options or freestanding; (3) restricted stock or restricted stock units; and, (4) performance awards. The 1995 Plan began on April 21, 1995, and was amended on June 25, 2004 to extend the termination date to April 20, 2010. The number of shares of Class A, $1.00 par value, common stock which were allowed to be issued under the 1995 Plan, or as to which stock appreciation rights ("SARs") or other awards were allowed to be granted, could not exceed 300,000. Effective June 20, 2008, the Company's shareholders approved a 2008 Incentive Plan (“2008 Plan”). The 2008 Plan is substantially similar to the 1995 Plan and authorized an additional number of Class A, $0.01 par value, common stock shares eligible for issue not to exceed 300,000. These plans were assumed by NWLGI from National Western pursuant to the terms of the reorganization. On June 15, 2016, stockholders of NWLGI approved the Incentive Plan, which is a stock and incentive plan essentially similar to the 2008 Plan. The Incentive Plan includes additional provisions, most notably regarding the definition of performance objectives which could be used in the issuance of the fourth type of award noted above (performance awards).

All of the employees of the Company and its subsidiaries are eligible to participate in the current Incentive Plan. In addition, directors of the Company are eligible to receive the same types of awards as employees except that they are not eligible to receive incentive stock options. Company directors, including members of the Compensation and Stock Option Committee, are eligible for nondiscretionary stock options. Employee grants vest 20% annually following three years of service following the grant date. Directors' grants vest 20% annually following one year of service from the date of grant.

Effective during March 2006, the company adopted and implemented a limited stock buy-back program with respect to the 1995 Plan which provides option holders the additional alternative of selling shares acquired through the exercise of options directly back to the Company. Option holders may elect to sell such acquired shares back to the Company at any time within ninety (90) days after the exercise of options at the prevailing market price as of the date of notice of election. The buy-back program did not alter the terms and conditions of the 1995 Plan; however, the program necessitated a change in accounting from the equity classification to the liability classification. In August 2008, the company implemented another limited stock buy-back program, substantially similar to the 2006 program, for shares issued under the 2008 Plan.

On February 17, 2016, the Company granted 14,643 SARs to officers of National Western at the closing market price per Class A common share of $216.48. These SARs, unlike prior grants, will vest annually at a rate of 33.3% per year from the date of grant. No stock option or SAR awards were issued during the first nine months of 2015.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

While not previously utilized, the Incentive Plan allows for certain other share or unit awards which are solely paid out in cash based on the value of the Company's shares, or changes therein, as well as the financial performance of the Company under pre-determined target performance metrics. Certain awards, such as restricted stock units (RSUs) provide solely for cash settlement based upon the market price of the Company's Class A commons shares, often referred to as "phantom stock-based awards". Unlike share-settled awards, which have a fixed grant-date fair value, the fair value of unsettled or unvested liability awards is remeasured at the end of each reporting period based on the change in fair value of a share. The liability and corresponding expense are adjusted accordingly until the award is settled. Other awards may involve performance share units (PSUs) which are units granted at a specified dollar amount per unit, typically linked to the Company's Class A common share price, that are subsequently multiplied by an attained performance factor to derive the number of PSUs to be paid as cash compensation at the vesting date.

On February 17, 2016, the Company granted 5,727 PSUs and 3,661 RSUs to officers of National Western based upon the closing market price per Class A common share of $216.48. Both the PSUs and RSUs vest three years from the date of grant. The RSUs are payable in cash at the vesting date equal to the closing price of the Company's Class A common share at that time. For PSUs, the performance period begins the first day of the calendar year, in this case January 1, 2016, and runs three years. At that time, the three-year performance outcome will be measured against the pre-defined target amounts to determine the number of PSUs earned as compensation.

On April 14, 2016, the Company granted 2,563 RSUs to directors of NWLGI, based upon the closing market price per Class A common share of $226.84. The RSUs vest one year from the date of grant, and are payable in cash at the vesting date equal to the closing price of the Company's Class A common share at that time.

The Company uses the current fair value method to measure compensation cost. As of September 30, 2016 and 2015, the liability balance was $6.4 million and $6.2 million, respectively. A summary of shares available for grant and activity is detailed below.

		Options Outstanding	
	Shares Available For Grant	Shares	Weighted-Average Exercise Price
Stock Options:			
Balance at January 1, 2016	291,000	27,768	$ 243.26
Exercised	—	—	$ —
Forfeited	—	(500)	$ 255.13
Expired	—	—	$ —
Stock options granted	—	—	$ —
Balance at September 30, 2016	291,000	27,268	$ 243.04

Liability Awards		
SAR	RSU	PSU

Balance at January 1, 2016	86,261	—	—
Exercised	(1,275)	—	—
Forfeited	(2,826)	(106)	—
Granted	14,643	6,224	5,727
Balance at September 30, 2016	96,803	6,118	5,727

25

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Stock options and SARs shown as forfeited in the above tables represent vested and unvested awards not exercised by plan participants prior to their termination from the Company. Forfeited stock options, if any, are not shown as being added back to the "Shares Available For Grant" balance as they were awarded under the 1995 Plan which was terminated during calendar year 2010.

The total intrinsic value of SARs exercised was $0.1 million and $0.4 million for the nine months ended September 30, 2016 and 2015, respectively. The total share-based liabilities paid for the exercised SARs were $0.1 million and $0.4 million for the nine months ended September 30, 2016 and 2015, respectively. The total fair value of stock options and SARs vested during the nine months ended September 30, 2016 and 2015 was $0.3 million and $0.6 million, respectively. For the nine months ended September 30, 2016 and 2015, the total cash received from the exercise of stock options under the Plans was $0.0 million and $0.0 million, respectively.

The following table summarizes information about stock options and SARs outstanding at September 30, 2016.

	Options/SARs Outstanding		
	Number Outstanding	Weighted-Average Remaining Contractual Life	Number Exercisable
Exercise prices:			
255.13 (options)	20,268	1.5 years	20,268
208.05 (options)	7,000	1.7 years	7,000
114.64 (SARs)	22,768	2.4 years	22,768
132.56 (SARs)	26,818	5.2 years	13,008
210.22 (SARs)	33,000	7.2 years	3,600
216.48 (SARs)	14,217	9.4 years	—
Totals	124,071		66,644
Aggregate intrinsic value (in thousands)	$4,018		$ 3,013

The aggregate intrinsic value in the table above is based on the closing stock price of $205.37 per share on September 30, 2016.

In estimating the fair value of the share based awards outstanding at September 30, 2016 and December 31, 2015, the Company employed the Black-Scholes option pricing model with assumptions detailed below.

	September 30, 2016	December 31, 2015
Expected term of options	1.5 to 9.4 years	2.3 to 8.0 years

Expected volatility:		
Range	22.53% to 28.81%	21.11% to 37.77%
Weighted-average	23.83 %	23.89 %
Expected dividend yield	0.18 %	0.14 %
Risk-free rate:		
Range	0.54% to 1.52%	0.22% to 1.67%
Weighted-average	1.03 %	0.63 %

26

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The Company reviewed the contractual term relative to the options as well as perceived future behavior patterns of exercise. Volatility is based on the Company's historical volatility over the expected term of the option's expected exercise date.

The pre-tax compensation cost (benefit) recognized in the financial statements related to the two plans defined above was $1.7 million and $(1.1) million for the three and nine months ended September 30, 2016, and $(1.0) million and $(2.6) million for the three and nine months ended September 30, 2015, respectively. The related tax (expense)/benefit recognized was $(0.6) million and $0.4 million for the three and nine months ended September 30, 2016 and to $0.4 million and $0.9 million for the three and nine months ended September 30, 2015, respectively.

As of September 30, 2016, the total compensation cost related to nonvested share based awards not yet recognized was $3.1 million. This amount is expected to be recognized over a weighted-average period of 1.5 years. The Company recognizes compensation cost over the graded vesting periods.

(8) COMMITMENTS AND CONTINGENCIES

(A) Legal Proceedings

In the normal course of business, the Company is involved or may become involved in various legal actions in which claims for alleged economic and punitive damages have been or may be asserted, some for substantial amounts. In recent years, carriers offering life insurance and annuity products have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices, and similar claims. Given the uncertainty involved in these types of actions, the ability to make a reliable evaluation of the likelihood of an unfavorable outcome or an estimate of the amount of or range of potential loss is endemic to the particular circumstances and evolving developments of each individual matter on its own merits.

On October 26, 2011 the Brazilian Superintendence of Private Insurance ("SUSEP") attempted to serve National Western with a subpoena regarding an administrative proceeding initiated by SUSEP in which it alleged that National Western was operating as an insurance company in Brazil without due authorization. National Western had been informed that SUSEP was attempting to impose a penal fine, based on currency exchange rates at that time, of approximately $6.0 billion on the company. SUSEP unsuccessfully attempted to serve National Western with notice regarding this matter. National Western does not transact business in Brazil and has no officers, employees, property, or assets in Brazil. National Western believes that SUSEP has no jurisdiction over the company, that SUSEP's attempts at service of process were invalid, and that any penal fine would be unenforceable. In addition, due to a new law recently enacted in Brazil the penal fine has been limited to 3 million reais (approximately $960,000 based on current exchange rates). For the reasons described above, the Company does not believe that this matter meets the definition of a material pending legal proceeding as such term is defined in Item 103 of Regulation S-K. However, the Company had included the foregoing description solely due to the amount of the fine initially sought by SUSEP. National Western will continue its discussions with SUSEP in an effort to resolve this matter. No conclusion can be drawn at this time as to the outcome of these discussions, or whether they will continue, or how any such outcome may impact the Company's business, results of operations, or financial condition. However, in light of the pendency of discussions with Brazilian authorities, National Western has ceased accepting new applications from residents in Brazil.

National Western was the named defendant in the case of Damaris Maldonado Vinas, et al. vs. National Western Life Insurance, in which the plaintiffs, after National Western had paid the death benefits to the beneficiary (Francisco Iglesias-Alvarez) upon the annuitant's (Carlos Iglesias-Alvarez) death, sought to annul two annuity policies issued by National Western at the behest of Carlos Iglesias-Alvarez and which named Francisco Iglesias-Alvarez as their beneficiary. On March 31, 2016, the United States District Court for the District of Puerto Rico (the "Court") issued its Opinion and Order on the pending Motions for Summary Judgment submitted by the parties, and therein denied National Western's motion and granted plaintiffs' motion voiding the two annuities and requesting a refund of the premiums paid ($2.9 million). National Western vigorously defended the case and believes that the Court's Opinion and Order is contrary to applicable law. As such, National Western filed a Motion for Reconsideration of Opinion and Order and Corresponding Judgment with the Court on April 27, 2016, which the Court denied on May 5, 2016. National Western filed its Appeal Brief on September 12, 2016.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Although there can be no assurances, at the present time, the Company does not anticipate that the ultimate liability arising from any other potential, pending, or threatened legal actions will have a material adverse effect on the financial condition or operating results of the Company.
Separately, the Brazilian authorities have commenced an investigation into possible violations of Brazilian criminal law in connection with the issuance of National Western insurance policies to Brazilian residents, and in assistance of such investigation a Commissioner appointed by the U.S. District Court for the Western District of Texas has issued a subpoena upon the company to provide information relating to such possible violations. No conclusion can be drawn at this time as to its outcome or how such outcome may impact the Company’s business, results of operations, or financial condition. National Western is cooperating with the relevant governmental authorities in regard to this matter.
(B) Financial Instruments

In order to meet the financing needs of its customers in the normal course of business, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments are commitments to extend credit which involve elements of credit and interest rate risk in excess of the amounts recognized in the Condensed Consolidated Balance Sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amounts, assuming that the amounts are fully advanced and that collateral or other security is of no value. Commitments to extend credit are legally binding agreements to lend to a customer that generally have fixed expiration dates or other termination clauses and may require payment of a fee. Commitments do not necessarily represent future liquidity requirements, as some could expire without being drawn upon. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Company controls the credit risk of these transactions through credit approvals, limits, and monitoring procedures.

The Company had $32.0 million commitments to fund new loans and $0.6 million commitments on existing loans to extend credit relating to loans at September 30, 2016. The Company evaluates each customer's creditworthiness on a case-by-case basis.

(9) INVESTMENTS

(A) Investment Gains and Losses

The table below presents realized investment gains and losses, excluding impairment losses, for the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Available for sale debt securities:				
Realized gains on disposal	$1,773	125	2,455	3,323

Realized losses on disposal	(23)	—	(29)	(74)
Held to maturity debt securities:				
Realized gains on disposal	3,278	666	4,764	2,794
Realized losses on disposal	(3)	—	(109)	—
Equity securities realized gains (losses)	401	22	607	113
Real estate gains (losses)	—	—	2,901	—
Totals	$5,426	813	10,589	6,156

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Disposals in the held to maturity category during the periods shown primarily represent calls initiated by the credit issuer of the debt security. It is the Company's policy to initiate disposals of debt securities in the held to maturity category only in instances in which the credit status of the issuer comes into question and the realization of all or a significant portion of the investment principal of the holding is deemed to be in jeopardy.

The Company uses the specific identification method in computing realized gains and losses. For the three and nine months ended September 30, 2016 the percentage of gains on bonds due to the call of securities was 95% and 87%, respectively. For the three and nine months ended September 30, 2015 the percentage of gains on bonds due to the call of securities was 84% and 90%, respectively. This includes calls out of the Company's available for sale portfolio of debt securities.

The table below presents net impairment losses recognized in earnings for the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Total other-than-temporary impairment gains (losses) on debt securities	$27	284	80	549
Portion of loss (gain) recognized in comprehensive income	(27)	(284)	(80)	(549)
Net impairment losses on debt securities recognized in earnings	—	—	—	—
Equity securities impairments	—	—	—	(107)
Totals	$—	—	—	(107)

The table below presents a roll forward of credit losses on securities for which the Company also recorded non-credit other-than-temporary impairments in other comprehensive loss.

	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2016	For the Year Ended December 31, 2015
	(In thousands)		
Beginning balance, cumulative credit losses related to other-than-temporary impairments	$1,649	2,278	2,298
Reductions for securities sold during current period	(209)	(838)	(20)
Additions for credit losses not previously recognized in other-than-temporary impairments	—	—	—

Ending balance, cumulative credit losses related to other-than-temporary impairments	$1,440	1,440	2,278

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(B) Debt and Equity Securities

The table below presents amortized costs and fair values of securities held to maturity at September 30, 2016.

	Securities Held to Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
U.S. agencies	$—	—	—	—
U.S. Treasury	1,932	300	—	2,232
States and political subdivisions	440,027	39,460	(3)	479,484
Public utilities	1,061,021	71,581	—	1,132,602
Corporate	4,189,831	246,973	(3,327)	4,433,477
Residential mortgage-backed	1,402,475	79,474	(174)	1,481,775
Home equity	9,383	1,526	—	10,909
Manufactured housing	1,704	152	—	1,856
Totals	$7,106,373	439,466	(3,504)	7,542,335

The table below presents amortized costs and fair values of securities available for sale at September 30, 2016.

	Securities Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
States and political subdivisions	$581	20	—	601
Foreign governments	9,953	757	—	10,710
Public utilities	127,201	7,834	—	135,035
Corporate	2,743,232	161,263	(5,609)	2,898,886
Residential mortgage-backed	29,265	2,829	(43)	32,051
Home equity	9,682	162	—	9,844
Manufactured housing	674	11	—	685
	2,920,588	172,876	(5,652)	3,087,812
Equity securities	14,021	5,052	(91)	18,982
Totals	$2,934,609	177,928	(5,743)	3,106,794

30

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The table below presents amortized costs and fair values of securities held to maturity at December 31, 2015.

	Securities Held to Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
U.S. agencies	$15,019	275	—	15,294
U.S. Treasury	1,927	317	—	2,244
States and political subdivisions	435,941	29,129	(662)	464,408
Public utilities	1,044,063	42,271	(6,621)	1,079,713
Corporate	4,160,628	114,920	(72,913)	4,202,635
Residential mortgage-backed	1,503,021	59,013	(6,227)	1,555,807
Home equity	11,047	1,701	—	12,748
Manufactured housing	2,321	266	—	2,587
Totals	$7,173,967	247,892	(86,423)	7,335,436

The table below presents amortized costs and fair values of securities available for sale at December 31, 2015.

	Securities Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
States and political subdivisions	$586	—	(34)	552
Foreign governments	9,947	408	—	10,355
Public utilities	129,980	5,354	(775)	134,559
Corporate	2,635,536	73,132	(54,503)	2,654,165
Residential mortgage-backed	36,463	3,103	—	39,566
Home equity	20,123	825	(12)	20,936
Manufactured housing	1,063	26	—	1,089
	2,833,698	82,848	(55,324)	2,861,222
Equity securities	13,716	4,797	(152)	18,361
Totals	$2,847,414	87,645	(55,476)	2,879,583

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The following table shows the gross unrealized losses and fair values of the Company's held to maturity investments by investment category and length of time the individual securities have been in a continuous unrealized loss position at September 30, 2016.

	Securities Held to Maturity					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	$3,032	(3)	—	—	3,032	(3)
Corporate	32,317	(364)	181,928	(2,963)	214,245	(3,327)
Residential mortgage-backed	16,997	(63)	9,308	(111)	26,305	(174)
Total temporarily impaired securities	$52,346	(430)	191,236	(3,074)	243,582	(3,504)

The following table shows the gross unrealized losses and fair values of the Company's available for sale investments by investment category and length of time the individual securities have been in a continuous unrealized loss position at September 30, 2016.

	Securities Available for Sale					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	$—	—	—	—	—	—
Corporate	3,027	(21)	113,560	(5,588)	116,587	(5,609)
Residential mortgage-backed	1,381	(43)	—	—	1,381	(43)
	4,408	(64)	113,560	(5,588)	117,968	(5,652)
Equity securities	462	(45)	336	(46)	798	(91)
Total temporarily impaired securities	$4,870	(109)	113,896	(5,634)	118,766	(5,743)

The Company does not consider securities to be other-than-temporarily impaired when the market decline is attributable to factors such as interest rate movements, market volatility, liquidity, spread widening and credit quality and when recovery of all amounts due under the contractual terms of the security is anticipated. Based on the review and the Company's ability and intent not to sell these securities until maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2016. The Company will monitor the investment portfolio for future changes in issuer facts and circumstances that could result in future impairments beyond those currently identified.

Unrealized losses for securities held to maturity and securities available for sale decreased during the first nine months of 2016 primarily due to the downward movement in market interest rates during this period (which increases the market price of debt securities).

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The following table shows the gross unrealized losses and fair values of the Company's held to maturity investments by investment category and length of time the individual securities have been in a continuous unrealized loss position at December 31, 2015.

	Securities Held to Maturity					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	$16,763	(387)	8,723	(275)	25,486	(662)
Public utilities	298,962	(5,953)	17,840	(668)	316,802	(6,621)
Corporate	1,522,544	(54,295)	323,567	(18,618)	1,846,111	(72,913)
Residential mortgage-backed	148,712	(2,726)	95,443	(3,501)	244,155	(6,227)
Total temporarily impaired securities	$1,986,981	(63,361)	445,573	(23,062)	2,432,554	(86,423)

The following table shows the gross unrealized losses and fair values of the Company's available for sale investments by investment category and length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2015.

	Securities Available for Sale					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	$—	—	552	(34)	552	(34)
Public utilities	42,093	(775)	—	—	42,093	(775)
Corporate	843,679	(32,500)	151,319	(22,003)	994,998	(54,503)
Home equity	—	—	4,823	(12)	4,823	(12)
	885,772	(33,275)	156,694	(22,049)	1,042,466	(55,324)
Equity securities	649	(124)	102	(28)	751	(152)
Total temporarily impaired securities	$886,421	(33,399)	156,796	(22,077)	1,043,217	(55,476)

During the three and nine months ended 2016, the Company recorded no other-than-temporary impairment on debt and equity securities.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Debt securities. The gross unrealized losses for debt securities are made up of 51 individual issues, or 3.8% of the total debt securities held by the Company at September 30, 2016. The market value of these bonds as a percent of amortized cost averages 97.5%. Of the 51 securities, 40, or 78.4%, fall in the 12 months or greater aging category; and 43 were rated investment grade at September 30, 2016.

Equity securities. The gross unrealized losses for equity securities are made up of 20 individual issues at September 30, 2016. These holdings are reviewed quarterly for impairment.

The amortized cost and fair value of investments in debt securities at September 30, 2016, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Debt Securities Available for Sale		Debt Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Due in 1 year or less	$141,741	144,968	198,352	202,724
Due after 1 year through 5 years	953,561	1,032,456	1,791,119	1,942,670
Due after 5 years through 10 years	1,704,850	1,783,821	3,404,124	3,580,986
Due after 10 years	80,815	83,987	299,216	321,415
	2,880,967	3,045,232	5,692,811	6,047,795
Mortgage and asset-backed securities	39,621	42,580	1,413,562	1,494,540
Total	$2,920,588	3,087,812	7,106,373	7,542,335

(C) Transfer of Securities

During the three and nine months ended September 30, 2016 the Company made no transfers from the held to maturity category to securities available for sale.

(D) Mortgage Loans and Real Estate

A financing receivable is a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in a company's statement of financial position. Mortgage, equity, participation and mezzanine loans on real estate are considered financing receivables reported by the Company.

Credit and default risk is minimized through strict underwriting guidelines and diversification of underlying property types and geographic locations. In addition to being secured by the property, mortgage loans with leases on the underlying property are often guaranteed by the lease payments and also by the borrower. This approach has proved to result in quality mortgage loans with few defaults. Mortgage loan interest income is recognized on an accrual basis with any premium or discount amortized over the life of the loan. Prepayment and late fees are recorded on the date of collection.

Loans in foreclosure, loans considered impaired or loans past due 90 days or more are placed on a non-accrual status. If a mortgage loan is determined to be on non-accrual status, the mortgage loan does not accrue any revenue into the Condensed Consolidated Statements of Earnings. The loan is independently monitored and evaluated as to potential impairment or foreclosure. If delinquent payments are made and the loan is brought current, then the Company returns the loan to active status and accrues income accordingly. The Company had no mortgage loans past due 90 days or more at September 30, 2016 or 2015 and as a result all interest income was recognized at September 30, 2016 and 2015.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The following table represents the mortgage loan portfolio by loan-to-value ratio.

	September 30, 2016		December 31, 2015	
	Amount	%	Amount	%
	(In thousands)		(In thousands)	
Mortgage Loans by Loan-to-Value Ratio (1):				
Less than 50%	$49,418	33.5	$64,986	59.7
50% to 60%	8,669	5.9	9,714	8.9
60% to 70%	56,191	38.1	10,134	9.3
70% to 80%	9,543	6.4	4,843	4.4
80% to 90%	23,742	16.1	19,284	17.7
Greater than 90%	—	—	—	—
Gross balance	147,563	100.0	108,961	100.0
Allowance for possible losses	(650)	(0.4)	(650)	(0.6)
Totals	$146,913	99.6	$108,311	99.4

(1) Loan-to-Value Ratio is determined using the most recent appraised value. Appraisals are required at the time of funding and may be updated if a material change occurs from the original loan agreement.

All mortgage loans are analyzed quarterly in order to monitor the financial quality of these assets. Based on ongoing monitoring, mortgage loans with a likelihood of becoming delinquent are identified and placed on an internal “watch list”. Among the criteria that may indicate a potential problem include: major tenant vacancies or bankruptcies, late payments, and loan relief/restructuring requests. The mortgage loan portfolio is analyzed for the need for a valuation allowance on any loan that is on the internal watch list, in the process of foreclosure or that currently has a valuation allowance.

Mortgage loans are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When it is determined that a loan is impaired, a loss is recognized for the difference between the carrying amount of the mortgage loan and the estimated value reduced by the cost to sell. Estimated value is typically based on the loan's observable market price or the fair value of the collateral less cost to sell. Impairments and changes in the valuation allowance are reported in net realized investment gains (losses) in the Condensed Consolidated Statements of Earnings.

The following table represents the mortgage loan allowance.

	September 30, 2016	December 31, 2015
	(In thousands)	
Balance, beginning of period	$ 650	650

Provision	—	—
Releases	—	—
Balance, end of period	$ 650	650

35

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The Company's direct investments in real estate are not a significant portion of its total investment portfolio and totaled approximately $32.0 million and $16.3 million at September 30, 2016 and December 31, 2015, respectively. During the first nine months of 2016 the Company purchased two properties, one located in Cypress, Texas and the other in Tupelo, Mississippi for a total of $16.8 million. The Company recognized operating income on real estate properties of approximately $2.0 million for the first nine months of 2016. In addition, the Company recorded a net realized investment gain on disposed properties located in Brazoria County (Texas), Ruidoso, New Mexico, and Austin, Texas, totaling $2.9 million during the first nine months of 2016.

(10) FAIR VALUES OF FINANCIAL INSTRUMENTS

For financial instruments the FASB provides guidance which defines fair value, establishes a framework for measuring fair value under GAAP, and requires additional disclosures about fair value measurements. In compliance with this GAAP guidance, the Company has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into the required three level hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure fair value fall within different levels of the hierarchy, the category level is based on the lowest priority level input that is significant to the fair value measurement of the instrument.

Financial assets and liabilities recorded at fair value on the Condensed Consolidated Balance Sheets are categorized as follows:

Level 1: Fair value is based on unadjusted quoted prices in active markets that are accessible to the Company for identical assets or liabilities. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. These generally provide the most reliable evidence and are used to measure fair value whenever available. The Company's Level 1 assets are equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets.

Level 2: Fair value is based upon significant inputs other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable for substantially the full term of the asset or liability through corroboration with observable market data as of the reporting date. Level 2 inputs include quoted market prices in active markets for similar assets and liabilities, quoted market prices in markets that are not active for identical or similar assets or liabilities, model-derived valuations whose inputs are observable or whose significant value drivers are observable and other observable inputs. The Company’s Level 2 assets include fixed maturity debt securities (corporate and private bonds, government or agency securities, asset-backed and mortgage-backed securities), and preferred stock. Valuations are generally obtained from third party pricing services for identical or comparable assets or determined through use of valuation methodologies using observable market inputs.

Level 3: Fair value is based on significant unobservable inputs which reflect the entity’s or third party pricing service’s assumptions about the assumptions market participants would use in pricing an asset or liability. The Company’s Level 3 assets are over-the-counter derivative contracts and the Company’s Level 3 liabilities consist of share-based compensation obligations and certain product-related embedded derivatives. Valuations are estimated based on non-binding broker prices or internally developed valuation models or methodologies, discounted cash flow models and other similar techniques.

36

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The following tables set forth the Company's assets and liabilities that are measured at fair value on a recurring basis as of the date indicated:

	September 30, 2016			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale	$3,087,812	—	3,087,812	—
Equity securities, available for sale	18,982	18,889	93	—
Derivatives, index options	90,097	—	—	90,097
Total assets	$3,196,891	18,889	3,087,905	90,097
Policyholder account balances (a)	$96,095	—	—	96,095
Other liabilities (b)	6,434	—	—	6,434
Total liabilities	$102,529	—	—	102,529

During the three and nine months ended September 30, 2016, the Company had no transfers into or out of Levels 1, 2 or 3.

	December 31, 2015			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale	$2,861,222	—	2,861,222	—
Equity securities, available for sale	18,361	17,980	381	—
Derivatives, index options	38,409	—	—	38,409
Total assets	$2,917,992	17,980	2,861,603	38,409
Policyholder account balances (a)	$58,359	—	—	58,359
Other liabilities (b)	7,669	—	—	7,669
Total liabilities	$66,028	—	—	66,028

(a) Represents the fair value of certain product-related embedded derivatives that were recorded at fair value.
(b) Represents the liability for share-based compensation.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The following tables present, by pricing source and fair value hierarchy level, the Company's assets that are measured at fair value on a recurring basis:

	September 30, 2016			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale:				
Priced by third-party vendors	$3,087,812	—	3,087,812	—
Priced internally	—	—	—	—
Subtotal	3,087,812	—	3,087,812	—
Equity securities, available for sale:				
Priced by third-party vendors	18,982	18,889	93	—
Priced internally	—	—	—	—
Subtotal	18,982	18,889	93	—
Derivatives, index options:				
Priced by third-party vendors	90,097	—	—	90,097
Priced internally	—	—	—	—
Subtotal	90,097	—	—	90,097
Total	$3,196,891	18,889	3,087,905	90,097
Percent of total	100.0 %	0.6 %	96.6 %	2.8 %

	December 31, 2015			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale:				
Priced by third-party vendors	$2,861,222	—	2,861,222	—
Priced internally	—	—	—	—
Subtotal	2,861,222	—	2,861,222	—
Equity securities, available for sale:				
Priced by third-party vendors	18,361	17,980	381	—
Priced internally	—	—	—	—
Subtotal	18,361	17,980	381	—
Derivatives, index options:				
Priced by third-party vendors	38,409	—	—	38,409
Priced internally	—	—	—	—
Subtotal	38,409	—	—	38,409

Total	$2,917,992	17,980	2,861,603	38,409
Percent of total	100.0 %	0.6 %	98.1 %	1.3 %

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The following tables provide additional information about fair value measurements for which significant unobservable (Level 3) inputs were utilized to determine fair value.

	For the Three Months Ended September 30, 2016				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Balance at July 1, 2016	$—	—	63,319	63,319	81,056
Total realized and unrealized gains (losses):					
Included in net income	—	—	19,113	19,113	13,492
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	18,848	18,848	18,848
Sales	—	—	—	—	—
Issuances	—	—	—	—	388
Settlements	—	—	(11,183)	(11,183)	(11,255)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	90,097	90,097	102,529
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	23,851	23,851	—
Benefits and expenses	—	—	—	—	25,150
Total	$—	—	23,851	23,851	25,150

39

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

	For the Three Months ended September 30, 2015				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Balance at July 1, 2015	$—	—	72,527	72,527	95,368
Total realized and unrealized gains (losses):					
Included in net income	—	—	(52,816)	(52,816)	(42,887)
Included in other comprehensive income	—	—	—	—	—
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	24,891	24,891	24,891
Sales	—	—	—	—	—
Issuances	—	—	—	—	—
Settlements	—	—	(19,376)	(19,376)	(19,377)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	25,226	25,226	57,995
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	(51,707)	(51,707)	—
Benefits and expenses	—	—	—	—	(1,048)
Total	$—	—	(51,707)	(51,707)	(1,048)

40

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

	Nine Months Ended September 30, 2016				
	Debt Securities, Available for Sale	Equity Securities Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Beginning balance, January 1, 2016	$—	—	38,409	38,409	66,028
Total realized and unrealized gains (losses):					
Included in net income	—	—	8,307	8,307	(7,691)
Included in other comprehensive income	—	—	—	—	—
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	56,387	56,387	56,387
Sales	—	—	—	—	
Issuances	—	—	—	—	921
Settlements	—	—	(13,006)	(13,006)	(13,116)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	90,097	90,097	102,529
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	15,628	15,628	—
Other operating expenses	—	—	—	—	13,582
Total	$—	—	15,628	15,628	13,582

41

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

	Nine Months Ended September 30, 2015				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Beginning balance, January 1, 2015	$—	—	114,287	114,287	142,492
Total realized and unrealized gains (losses):					
Included in net income	—	—	(69,884)	(69,884)	(64,923)
Included in other comprehensive income	—	—	—	—	—
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	64,820	64,820	64,820
Sales	—	—	—	—	—
Issuances	—	—	—	—	—
Settlements	—	—	(83,997)	(83,997)	(84,394)
Transfers into (out of) Level 3	—	—	—	—	
Balance at end of period	$—	—	25,226	25,226	57,995
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	(67,392)	(67,392)	—
Other operating expenses	—	—	—	—	(2,648)
Total	$—	—	(67,392)	(67,392)	(2,648)

The following tables show the quantitative information about the Company's level 3 assets and liabilities.

	September 30, 2016		
	Fair Value (In thousands)	Valuation Technique	Unobservable Input
Derivatives, index options	$90,097	Broker prices	Implied volatility Inputs from broker proprietary models
Total assets	$90,097		
Policyholder account balances	$96,095	Deterministic cash flow model	Projected option cost
Other liabilities	6,434	Black-Scholes model	Expected term Forfeiture assumptions

Total liabilities	$102,529

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

	December 31, 2015		
	Fair Value (In thousands)	Valuation Technique	Unobservable Input
Derivatives, index options	$38,409	Broker prices	Implied volatility Inputs from broker proprietary models
Total assets	$38,409		
Policyholder account balances	$58,359	Deterministic cash flow model	Projected option cost
Other liabilities	7,669	Black-Scholes model	Expected term Forfeiture assumptions
Total liabilities	$66,028		

Realized gains (losses) on debt and equity securities are reported in the Condensed Consolidated Statements of Earnings as net investment gains (losses). Unrealized gains (losses) on available for sale debt and equity securities are reported as other comprehensive income (loss) within the stockholders' equity section of the Condensed Consolidated Balance Sheet.

The fair value hierarchy classifications are reviewed each reporting period. Reclassification of certain financial assets and liabilities may result based on changes in the observability of valuation attributes. Reclassifications are reported as transfers into and out of Level 3 at the beginning fair value for the reporting period in which the changes occur.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The carrying amounts and fair values of the Company's financial instruments are as follows:

	September 30, 2016				
			Fair Value Hierarchy Level		
	Carrying Values	Fair Values	Level 1	Level 2	Level 3
	(In thousands)				
ASSETS					
Investments in debt and equity securities:					
Securities held to maturity	$7,106,373	7,542,335	—	7,542,335	—
Securities available for sale	3,106,794	3,106,794	18,889	3,087,905	—
Cash and cash equivalents	177,288	177,288	177,288	—	—
Mortgage loans	146,913	150,125	—	—	150,125
Policy loans	59,218	113,290	—	—	113,290
Other loans	12,349	11,878	—	—	11,878
Derivatives, index options	90,097	90,097	—	—	90,097
Short-term investments	14,972	14,972	—	14,972	—
Life interest in Trust	7,379	12,775	—	—	12,775
LIABILITIES					
Deferred annuity contracts	$7,693,495	7,314,565	—	—	7,314,565
Immediate annuity and supplemental contracts	443,162	485,702	—	—	485,702

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

	December 31, 2015				
			Fair Value Hierarchy Level		
	Carrying Values	Fair Values	Level 1	Level 2	Level 3
	(In thousands)				
ASSETS					
Investments in debt and equity securities:					
Securities held to maturity	$7,173,967	7,335,436	—	7,335,436	—
Securities available for sale	2,879,583	2,879,583	17,980	2,861,603	—
Cash and cash equivalents	106,007	106,007	106,007	—	—
Mortgage loans	108,311	111,162	—	—	111,162
Policy loans	61,957	108,550	—	—	108,550
Other loans	2,779	2,957	—	—	2,957
Derivatives, index options	38,409	38,409	—	—	38,409
Life interest in Trust	7,379	12,775	—	—	12,775
LIABILITIES					
Deferred annuity contracts	$7,640,951	7,288,108	—		7,288,108
Immediate annuity and supplemental contracts	434,468	461,457	—	—	461,457

Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

(11) DERIVATIVE INVESTMENTS

Fixed-index products provide traditional fixed annuities and universal life contracts with the option to have credited interest rates linked in part to an underlying equity index or a combination of equity indices. The equity return component of such policy contracts is identified separately and accounted for in future policy benefits as embedded derivatives on the Condensed Consolidated Balance Sheets. The remaining portions of these policy contracts are considered the host contracts and are recorded separately as fixed annuity or universal life contracts. The host contracts are accounted for under debt instrument type accounting in which future policy benefits are recorded as discounted debt instruments and accreted, using the effective yield method, to their minimum account values at their projected maturities or termination dates.

The Company purchases over-the-counter index options, which are derivative financial instruments, to hedge the equity return component of its fixed-index annuity and life products. The index options act as hedges to match closely the returns on the underlying index or indices. The amounts which may be credited to policyholders are linked, in part, to the returns of the underlying index or indices. As a result, changes to policyholders' liabilities are substantially offset by changes in the value of the options. Cash is exchanged upon purchase of the index options and no principal or interest payments are made by either party during the option periods. Upon maturity or expiration of the options, cash may be paid to the Company depending on the performance of the underlying index or indices and terms of the contract.

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The Company does not elect hedge accounting relative to these derivative instruments. The index options are reported at fair value in the accompanying condensed consolidated financial statements. The changes in the values of the index options and the changes in the policyholder liabilities are both reflected in the Condensed Consolidated Statements of Earnings. Any changes relative to the embedded derivatives associated with policy contracts are reflected in contract interest in the Condensed Consolidated Statements of Earnings. Any gains or losses from the sale or expiration of the options, as well as period-to-period changes in values, are reflected as net investment income in the Condensed Consolidated Statements of Earnings.

Although there is credit risk in the event of nonperformance by counterparties to the index options, the Company does not expect any of its counterparties to fail to meet their obligations, given their high credit ratings. In addition, credit support agreements are in place with all counterparties which further reduces the Company's credit exposure.

The tables below present the fair value of derivative instruments as of September 30, 2016 and December 31, 2015, respectively.

	September 30, 2016			
	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
		(In thousands)		(In thousands)
Derivatives not designated as hedging instruments				
Equity index options	Derivatives, Index Options	$ 90,097		
Fixed-index products			Universal Life and Annuity Contracts	$ 96,095
Total		$ 90,097		$ 96,095

	December 31, 2015			
	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
		(In thousands)		(In thousands)
Derivatives not designated as hedging instruments				

Equity index options	Derivatives, Index Options	$ 38,409		
Fixed-index products			Universal Life and Annuity Contracts	$ 58,359
Total		$ 38,409		$ 58,359

Table of Contents

NATIONAL WESTERN LIFE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The table below presents the effect of derivative instruments in the Condensed Consolidated Statements of Earnings for the three months ended September 30, 2016 and 2015.

Derivatives Not Designated As Hedging Instruments	Location of Gain or (Loss) Recognized In Income on Derivatives	September 30, 2016	September 30, 2015
		Amount of Gain or (Loss) Recognized in Income on Derivatives (In thousands)	
Equity index options	Net investment income	$19,114	(52,816)
Fixed-index products	Universal life and annuity contract interest	(12,194)	41,839
		$6,920	(10,977)

The table below presents the effect of derivative instruments in the Condensed Consolidated Statements of Earnings for the nine months ended September 30, 2016 and 2015.

Derivatives Not Designated As Hedging Instruments	Location of Gain or (Loss) Recognized In Income on Derivatives	September 30, 2016	September 30, 2015
		Amount of Gain or (Loss) Recognized in Income on Derivatives (In thousands)	
Equity index options	Net investment income	$8,307	(69,884)
Fixed-index products	Universal life and annuity contract interest	5,645	62,275
		$13,952	(7,609)

(12) SUBSEQUENT EVENTS

Subsequent events have been evaluated and no reportable items were identified.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for forward-looking statements. Certain information contained herein or in other written or oral statements made by or on behalf of National Western Life Group, Inc. or its subsidiaries (the "Company") are or may be viewed as forward-looking. Although the Company has taken appropriate care in developing any such information, forward-looking information involves risks and uncertainties that could significantly impact actual results. These risks and uncertainties include, but are not limited to, matters described in the Company's SEC filings such as exposure to market risks, anticipated cash flows or operating performance, future capital needs, and statutory or regulatory related issues. However, as a matter of policy, the Company does not make any specific projections as to future earnings, nor does it endorse any projections regarding future performance that may be made by others. Whether or not actual results differ materially from forward-looking statements may depend on numerous foreseeable and unforeseeable events or developments. Also, the Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future developments, or otherwise.

Management's discussion and analysis of the financial condition and results of operations (“MD&A”) of National Western Life Group, Inc. (formerly National Western Life Insurance Company and subsidiaries) for the three and nine months ended September 30, 2016 follows. Where appropriate, discussion specific to the insurance operations of National Western Life Insurance Company is denoted by "National Western" or "company". This discussion should be read in conjunction with the Company's condensed consolidated financial statements and related notes beginning on page 3 of this report and with the 2015 Annual Report filed on Form 10-K with the SEC.

Overview

National Western provides life insurance products on a global basis for the savings and protection needs of policyholders and annuity contracts for the asset accumulation and retirement needs of contract holders, both domestically and internationally. The company accepts funds from policyholders or contract-holders and establishes a liability representing future obligations to pay the policy or contract-holders and their beneficiaries. To ensure the company will be able to pay these future commitments, the funds received as premium payments and deposits are invested in high quality investments, primarily fixed income securities.

Due to the business of accepting funds to pay future obligations in later years and the underlying economics, the relevant factors affecting the company’s business and profitability include the following:

- the level of sales and premium revenues collected
- persistency of policies and contracts
- returns on investments sufficient to produce acceptable spread margins over interest crediting rates
- investment credit quality which minimizes the risk of default or impairment
- levels of policy benefits and costs to acquire business
- the level of operating expenses
- effect of interest rate changes on revenues and investments including asset and liability matching
- maintaining adequate levels of capital and surplus
- actual levels of surrenders, withdrawals, claims and interest spreads
- changes in assumptions for amortization of deferred policy acquisition expenses and deferred sales inducements
- changes in the fair value of derivative index options and embedded derivatives pertaining to fixed-index life and annuity products
- pricing and availability of adequate reinsurance

- litigation subject to unfavorable judicial development, including the time and expense of litigation

The Company monitors these factors continually as key business indicators. The discussion that follows in this Item 2 includes these indicators and presents information useful to an overall understanding of the Company's business performance for the nine months ended September 30, 2016, incorporating required disclosures in accordance with the rules and regulations of the Securities and Exchange Commission.

Table of Contents

Insurance Operations - Domestic

National Western is currently licensed to do business in all states and the District of Columbia except for New York. Products marketed are annuities, universal life insurance, fixed-index universal life, and traditional life insurance, which include both term and whole life products. The company's domestic sales have historically been more heavily weighted toward annuity products, which include single and flexible premium deferred annuities, single premium immediate annuities, and fixed-index annuities. Most of these annuities can be sold either as tax qualified or nonqualified products. At September 30, 2016, the Company maintained approximately 136,100 annuity contracts in force and 52,900 domestic life insurance policies in force representing $3.0 billion in face amount of coverage.

National Western markets and distributes its domestic products primarily through independent national marketing organizations ("NMOs"). These NMOs assist the company in recruiting, contracting, and managing independent agents. The company's agents are independent contractors who are compensated on a commission basis. The company currently has approximately 24,000 domestic independent agents contracted.

Insurance Operations - International

The company's international clientèle consists mainly of foreign nationals in upper socioeconomic classes. Insurance products are issued currently to residents of countries in South America, the Caribbean, Eastern Europe, and Asia based upon applications received in the Company's home office in Austin, Texas. Issuing policies to residents of countries in these different regions provides diversification that helps to minimize large fluctuations that could arise due to various economic, political, and competitive pressures that may occur from one country to another. Products issued to international residents are almost entirely universal life and traditional life insurance products. However, certain annuity and investment contracts are also available. At September 30, 2016, the company had approximately 65,200 international life insurance policies in force representing approximately $18.0 billion in face amount of coverage.

International applications are submitted by independent contractor consultants and broker-agents. The company has approximately 2,200 independent international consultants and brokers currently contracted.

There are some inherent risks of accepting international applications, which are not present within the domestic market, that are reduced substantially by the company in several ways. As previously described, National Western accepts applications from foreign nationals in upper socioeconomic classes who have substantial financial resources. This targeted customer base coupled with the company's conservative underwriting practices have historically resulted in claims experience, due to natural causes, similar to that in the United States. The company minimizes exposure to foreign currency risks by requiring payment of premiums, claims and other benefits entirely in United States dollars (except for a small block of business in Haiti whose policies are denominated in Haitian gourdes). National Western's fifty plus years of experience with the international products and its longstanding independent consultant and broker-agent relationships further serve to minimize risks.

Table of Contents

SALES

Life Insurance

The following table sets forth information regarding National Western's life insurance sales activity as measured by annualized first year premiums. While the figures shown below are in accordance with industry practice and represent the amount of new business sold during the periods indicated, they are considered a non-GAAP financial measure. The Company believes sales are a measure of distribution productivity and are a leading indicator of future revenue trends. However, revenues are driven by sales in prior periods as well as in the current period and therefore, a reconciliation of sales to revenues is not meaningful or determinable.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
International:				
Universal life	$590	793	1,785	2,220
Traditional life	416	796	1,396	2,289
Equity-index life	2,143	3,483	6,744	10,724
	3,149	5,072	9,925	15,233
Domestic:				
Universal life	22	15	32	49
Traditional life	32	14	89	105
Equity-index life	4,309	4,387	12,287	13,281
	4,363	4,416	12,408	13,435
Totals	$7,512	9,488	22,333	28,668

Life insurance sales, as measured by annualized first year premiums, decreased 21% in the third quarter of 2016 as compared to the third quarter of 2015. By market segment, the domestic life insurance line of business declined 1% while the international life insurance line of business posted a 38% decrease over the comparable results during the third quarter of 2015. For the nine months ended September 30, 2016 total life sales decreased 22% from 2015 levels as domestic life insurance sales declined 8% during this period and international life insurance sales decreased 35%.

The company's domestic operations life insurance product portfolio includes single premium universal life ("SPUL") and equity-index universal life ("EIUL") products as well as hybrids of the EIUL and SPUL products, combining features of these core products. Equity-index universal life products continue to be the predominant product sold in the domestic life market. Most of these sales are single premium mode products (one year, five year, or ten year) designed for transferring accumulated wealth tax efficiently into life insurance policies with limited underwriting due to lesser net insurance amounts at risk (face amount of the insurance policy less cash premium contributed). These products were designed and implemented several years ago targeting the accumulated savings of the Baby Boomer segment of the population entering their retirement years. The wealth transfer life products have been valuable offerings for the Company's distributors as evidenced by comprising 99% of total domestic life sales in the first nine months of 2016. The company also began offering in its domestic line of business graded death benefit whole life and term insurance (traditional) products in 2015.

The company's international life business consists of applications accepted from residents of various regions outside of the United States, the volume of which typically varies based upon changes in the socioeconomic climates of these regions. Historically, the company has experienced a simultaneous combination of rising and declining sales in various countries; however, the appeal of the company's dollar-denominated life insurance products overcomes many of the local and national difficulties.

Table of Contents

Applications submitted from residents of Latin America have historically comprised the majority of the company's international life insurance sales. As noted previously, the company's international sales by geographic market tend to fluctuate with the socio and economic climates in these regions. The company's mix of international sales by geographic region is as follows.

	Nine Months Ended September 30,	
	2016	2015
Percentage of International Sales:		
Latin America	95.9 %	84.6 %
Pacific Rim	—	12.4
Eastern Europe/Asia	4.1	3.0
Totals	100.0%	100.0%

Year-to-date, the company has accepted new business from residents outside of the United States in over thirty different countries with Venezuela (30%), Peru (16%), Chile (12%), and Argentina (10%) comprising the regions with contributions of 10% or more of total international sales.

As previously disclosed in prior SEC filings, the Brazilian Superintendence of Private Insurance ("SUSEP") attempted to serve National Western in 2011 with a subpoena regarding an administrative proceeding initiated by SUSEP in which it alleged the company was operating as an insurance company in Brazil without due authorization. While the company believes that SUSEP has no jurisdiction over the company, the company has been in discussions with SUSEP in an effort to resolve this matter. In light of the pendency of discussions with Brazilian authorities, the company ceased accepting new applications from residents in Brazil in the fourth quarter of 2015. Additionally, after careful consideration of various factors, including segment performance and the volume of application submissions, the company ceased accepting applications from residents in certain other countries, primarily in Central America and the Pacific Rim. Sales of new policies issued to residents in these countries, including Brazil, represented approximately 24% of total international life insurance new business placed during 2015. The actions taken with regard to ceasing the acceptance of applications in the areas mentioned above occurred in the fourth quarter of 2015. Consequently, the international life insurance declines in sales for the quarter and nine months ended September 30, 2016 in comparison to like periods in 2015 reflect the discontinuance of business.

The average new policy face amounts since 2010 are as shown in the following table.

	Average New Policy Face Amount	
	Domestic	International
Year ended December 31, 2010	164,800	338,600
Year ended December 31, 2011	178,500	363,600
Year ended December 31, 2012	254,900	380,200
Year ended December 31, 2013	286,000	384,000
Year ended December 31, 2014	286,600	382,600
Year ended December 31, 2015	274,500	342,500
Nine months ended September 30, 2016	311,300	328,600

The company's efforts are directed toward maintaining its competitive advantages in accepting applications from upper socio-economic residents of international countries and to its wealth transfer strategies for domestic life sales. In both of these strategies the company's portfolio of fixed-index (equity indexed) life insurance products plays an important role. Fixed-index life products accounted for 85% of total life sales in the first nine months of 2016, as compared to 84% for the same period in 2015.

Table of Contents

The table below sets forth information regarding National Western's life insurance in force for each date presented.

	Insurance In Force as of September 30,	
	2016	2015
	($ in thousands)	
Universal life:		
Number of policies	44,940	48,600
Face amounts	$5,064,620	6,042,850
Traditional life:		
Number of policies	34,330	36,140
Face amounts	$3,490,930	3,620,430
Fixed-index life:		
Number of policies	38,850	39,530
Face amounts	$9,462,720	9,856,540
Rider face amounts	$3,046,760	3,102,820
Total life insurance:		
Number of policies	118,120	124,270
Face amounts	$21,065,030	22,622,640

At September 30, 2016, the company’s face amount of life insurance in force was comprised of $18.0 billion from the international line of business and $3.0 billion from the domestic line of business. At September 30, 2015, these amounts were $19.5 billion and $3.1 billion for the international and domestic lines of business, respectively.

Annuities

The following table sets forth information regarding the company's annuity sales activity as measured by single and annualized first year premiums. Similar to life insurance sales, these figures are considered a non-GAAP financial measure but are shown in accordance with industry practice and depict National Western's sales productivity.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Fixed-index annuities	$156,297	174,294	498,186	511,796
Other deferred annuities	4,671	9,787	27,075	39,700
Immediate annuities	807	1,757	3,198	3,774
Totals	$161,775	185,838	528,459	555,270

Table of Contents

Annuity sales in the third quarter of 2016 were 13% below those of the comparable period in 2015. For the nine months ended September 30th, annuity sales were 5% below the amount recorded in the first nine months of 2015. The company's mix of annuity sales has historically shifted with interest rate levels and the relative performance of the equity market. Over the past several years, sales of fixed-index products have accounted for 90% or more of all annuity sales. During the first nine months of 2016, this percentage exceeded 94% reflecting the ongoing bull market run in equities since bottoming out in 2009 and the persisting low level of fixed interest rates. For all fixed-index products, the company purchases over the counter call options to hedge the equity return feature. The options are purchased relative to the issuance of the annuity contracts in such a manner to minimize timing risk. Generally, the index return during the indexing period (if the underlying index increases) becomes a component in a formula (set forth in the annuity), the result of which is credited as interest to contract holders electing the index formula crediting method at the beginning of the indexing period. The formula result can never be less than zero with these products. The company does not deliberately mismatch or under hedge for the equity feature of the products. Fixed-index products also provide the contract holder the alternative to elect a fixed interest rate crediting option.

With the advent of a low interest rate policy engineered by the Federal Reserve in response to the last financial crisis, company management evaluated the potential ramifications of continuing a high level of annuity sales in a depressed interest rate environment. Under the auspices of the company's enterprise risk management (ERM) processes, taking into consideration the Federal Reserve's announced intention to maintain interest rates at historically reduced levels over a prolonged period of time, the decision was made to curtail new sales to desired levels in order to minimize the level of assets added at low yield rates. While National Western does not subsidize its interest crediting rates on new policies in order to obtain market share, the Company's ERM considerations determined that managing to a lower level of annuity sales was prudent given the environment.

The level of annuity business in force requires a focused discipline on asset/liability analysis. The company monitors its asset/liability matching within the self-constraints of desired capital levels and risk tolerance. The company's capital level remains substantially above industry averages and regulatory targets. Management has performed analyses of the capital strain associated with incrementally higher levels of annuity new business and determined that the company's capital position is more than sufficient to handle an increase in sales activity when a more favorable rate environment returns.

The following table sets forth information regarding annuities in force for each date presented.

	Annuities In Force as of September 30,	
	2016	2015
	($ in thousands)	
Fixed-index annuities		
Number of policies	73,930	71,520
GAAP annuity reserves	$5,666,087	5,425,463
Other deferred annuities		
Number of policies	47,780	51,370
GAAP annuity reserves	$1,958,672	2,132,500
Immediate annuities		
Number of policies	14,400	15,120
GAAP annuity reserves	$368,724	363,173

Total annuities		
Number of policies	136,110	138,010
GAAP annuity reserves	$7,993,483	7,921,136

Table of Contents

Impact of Recent Business Environment

The Company's business is generally aided by an economic environment undergoing expansion, whether moderate or vibrant, characterized by metrics which indicate improving employment data and increases in personal income. Approximately 450,000 U.S. jobs were added during the third quarter indicative of moderate economic activity and provided a steady foundation for future growth prospects. The continued recovery in the housing market, low gas prices, and fuel provided by incremental consumer spending all portend economic growth. The ongoing level of low or negative interest rates in many economies across the globe is helping to provide a climate for growth to occur as well. Conversely, uncertainty persists due to the European and U.S. political landscapes, the U.K's exit from the European Union, and the path of interest rates to be set by the Federal Reserve and other major central banks.

Industry analysts and observers generally agree that a sudden jump in interest rate levels, while currently not thought to be a likely scenario, would be harmful to life insurers with interest-sensitive products as it could provide an impetus for abnormal levels of product surrenders and withdrawals at the same time fixed debt securities held by insurers declined in market value. Currently, the solid jobs market and improving economic activity suggest that less monetary stimulus is needed to sustain the recovery of the U.S. economy. The consensus at this time by market prognosticators is for another rate hike of 25 basis points by the Federal Reserve at its December meeting. Future movements beyond this are data-dependent according to central bank policy makers. It is uncertain what direction and at what pace interest rate movements may occur in the future and what impact, if any, such movements would have on the Company's business, results of operations, cash flows or financial condition.

The U.S life insurance sector is encountering an interest rate and regulatory environment causing strategic long-term decision making to be more challenging and suspect to inaccuracies. In an environment such as this, the need for a strong capital position that can cushion against unexpected thumps is critical for stability and ongoing business activity. The Company's operating strategy continues to be to maintain capital levels substantially above regulatory and rating agency requirements in order to maintain its solid independent financial strength insurance ratings. Our business model is predicated upon steady growth in invested assets while managing the block of business within profitability objectives. A key premise of our financial management is maintaining a high quality investment portfolio, well matched in terms of duration with policyholder obligations that continues to outperform the industry with respect to adverse impairment experience. This discipline enables the Company to sustain resources more than adequate to fund future growth and absorb abnormal periods of cash outflows.

RESULTS OF OPERATIONS

The Company's condensed consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). In addition, the Company regularly evaluates operating performance using non-GAAP financial measures which exclude or segregate derivative and realized investment gains and losses from operating revenues. Similar measures are commonly used in the insurance industry in order to assess profitability and results from ongoing operations. The Company believes that the presentation of these non-GAAP financial measures enhances the understanding of the Company's results of operations by highlighting the results from ongoing operations and the underlying profitability factors of the Company's business. The Company excludes or segregates derivative and realized investment gains and losses because such items are often the result of events which may or may not be at the Company's discretion and the fluctuating effects of these items could distort trends in the underlying profitability of the Company's business. Therefore, in the following sections discussing condensed consolidated operations and segment operations, appropriate reconciliations have been included to report information management considers useful in enhancing an understanding of the Company's operations to reportable GAAP balances reflected in the condensed consolidated financial statements.

Table of Contents

Consolidated Operations

Revenues. The following details Company revenues.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Universal life and annuity contract charges	$40,333	39,175	123,791	114,833
Traditional life premiums	4,631	4,840	13,721	14,349
Net investment income (excluding derivatives)	107,867	109,025	327,425	328,275
Other revenues	4,476	5,067	14,050	15,590
Operating revenues	157,307	158,107	478,987	473,047
Derivative gain (loss)	19,114	(52,816)	8,307	(69,884)
Net realized investment gains (losses)	5,426	813	10,589	6,049
Total revenues	$181,847	106,104	497,883	409,212

Universal life and annuity contract charges - Revenues for universal life and annuity contracts were higher for the first nine months in 2016 compared to 2015 primarily due to an increase in surrender charge revenue. Revenues for universal life and annuity products consist of policy charges for the cost of insurance, administration charges, and surrender charges assessed against policyholder account balances, less reinsurance premiums, as shown in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Contract Revenues:				
Cost of insurance and administrative charges	$33,335	33,754	99,624	99,997
Surrender charges	11,348	10,173	34,955	28,898
Other charges	(187)	(735)	1,131	(2,537)
Gross contract revenues	44,496	43,192	135,710	126,358
Reinsurance premiums	(4,163)	(4,017)	(11,919)	(11,525)
Net contract revenues	$40,333	39,175	123,791	114,833

Cost of insurance charges typically trend with the size of the life insurance block in force and the amount of new business issued during the period. Life insurance in force during the nine months ended September 30, 2016 averaged approximately $21.5 billion while for the same period of 2015 averaged $22.9 billion. Countering the decline in insurance in force, the Company implemented higher cost of insurance charges on international life insurance products during the second quarter of 2016. Accordingly, for the three months ended September 30, 2016, cost of insurance charges remained level to the $26.5 million reported in the comparable quarter of 2015. For the nine months ended September 30, 2016, cost of insurance charges increased slightly to $79.2 million from $78.8 million at September 30, 2015. In addition to the increase in international cost of insurance charges, the increase reflects larger domestic face amounts of insurance being added to the in force block of business, which produce higher contract charges per policy, replacing smaller face amounts terminated through death, surrender or lapsation. Administrative charges pertaining to new business issued declined marginally to $20.5 million for the nine months ended September 30, 2016 versus $21.2 million for the nine months ended September 30, 2015 due to a lower amount of life insurance policies issued.

Table of Contents

Surrender charges assessed against policyholder account balances upon withdrawal increased 21% in the first nine months of 2016 versus the comparable prior year period. While the Company earns surrender charge income that is assessed upon policy terminations, the Company's overall profitability is enhanced when policies remain in force and additional contract revenues are realized and the Company continues to make an interest rate spread equivalent to the difference it earns on its investment and the amount that it credits to policyholders. In the first nine months of 2016, lapse rates on domestic life insurance and annuity policies were generally consistent with the prior year. The increase in surrender charge income recognized in the current quarter reflects an increase in the international life insurance lapse rate, most noticeably in the countries from which the Company ceased accepting applications from residents in the fourth quarter of 2015. Surrender charge income recognized is also dependent upon the duration of policies at the time of surrender (i.e. later duration policy surrenders having a lower surrender charge assessed and earlier duration surrenders having a higher surrender charge).

Traditional life premiums - Traditional life premiums were down slightly in the three and nine months ended September 30, 2016 compared to the same periods in 2015. Most of the decline was incurred in renewal life insurance premiums reflecting the increase in international policy lapses noted above. Traditional life insurance premiums for products such as whole life and term life are recognized as revenues over the premium-paying period. The Company's life insurance sales focus has historically been primarily centered around universal life products, although additional term products have been added to the Company's portfolio recently. Universal life products, especially the Company's equity indexed universal life products which offer the opportunity for consumers to acquire life insurance protection and receive credited interest linked in part to an outside market index, have been more popular product offerings in the Company's markets representing in excess of 85% of new life insurance sales for 2016 the periods shown.

Net investment income - To ensure the Company will be able to honor future commitments to policyholders and provide a financial return, the funds received as premium payments and deposits are invested in high quality investments, primarily fixed maturity debt securities. The income from these investments is closely monitored by the Company due to its significant impact on the business. A detail of net investment income (with and without index option gains and losses) is provided below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Gross investment income:				
Debt and equities	$103,650	104,524	312,833	311,911
Mortgage loans	2,070	2,967	5,576	7,823
Policy loans	868	995	2,732	2,945
Short-term investments	252	28	507	183
Other invested assets	1,318	785	6,594	6,241
Total investment income	108,158	109,299	328,242	329,103
Less: investment expenses	291	274	817	828
Net investment income (excluding derivatives)	107,867	109,025	327,425	328,275
Derivative gain (loss)	19,114	(52,816)	8,307	(69,884)
Net investment income	$126,981	56,209	335,732	258,391

For the nine months ended September 30, 2016, debt and equity securities generated approximately 96% of total investment income, excluding derivative gain (loss). The Company's strategy is to invest substantially all of its cash flows in fixed debt securities consistent with its guidelines for credit quality, duration, and diversification. The relatively stable level of investment income from debt and equity securities through the third quarter of 2016 versus 2015, despite higher portfolio balances in the current period, reflects higher yielding debt securities maturing or being called by borrowers and being replaced with lower yielding securities in the current interest rate environment. Investment yields on new bond purchases during the first nine months of 2016 remained below the portfolio's weighted average yield approximating 4.16%.

Table of Contents

Mortgage loan investment income for the nine months ended September 30, 2016 decreased over the comparable period in 2015 reflecting a gradual decline in the portfolio balance over a period of years with the most recent year-end balances dropping from $149.5 million at December 31, 2014 to $108.3 million at December 31, 2015. The Company identified this as an area of investment focus going forward and has increased the mortgage loan portfolio balance to $146.9 million at September 30, 2016. During the nine months ended September 30, 2016 the Company originated new mortgage loans in the amount of $55.8 million compared to $5.0 million in the comparable period of 2015.

In order to evaluate underlying profitability and results from ongoing operations, net investment income performance is analyzed excluding derivative gain (loss), which is a common practice in the insurance industry. Net investment income and average invested assets shown below includes cash and cash equivalents. Net investment income performance is summarized as follows.

	Nine Months Ended September 30,	
	2016	2015
	(In thousands)	
Excluding derivatives:		
Net investment income	$327,425	328,275
Average invested assets, at amortized cost	$10,407,898	10,084,537
Annual yield on average invested assets	4.19 %	4.34 %
Including derivatives:		
Net investment income	$335,732	258,391
Average invested assets, at amortized cost	$10,472,151	10,154,294
Annual yield on average invested assets	4.27 %	3.39 %

The lower yield on average invested assets, excluding derivatives, through the third quarter of 2016 compared to 2015 is due to ongoing lower yields obtained on new fixed maturity debt securities investments. During 2015, the average yield on bond purchases to fund insurance operations was 3.45% representing a 1.31% spread over treasury rates. Insurance operation bond purchases through the third quarter of 2016 had a comparable average yield of 3.43% as spreads increased to 1.68% over treasury rates during this period while treasury rates declined. However, insurance operation bond purchases for the three months ended September 30, 2016 averaged 3.18%.

The bond yield rates during both 2015 and 2016 are below the weighted average bond portfolio rate which was slightly above 4.16% at September 30, 2016. The weighted average quality of new purchases during the first nine months of the current year was "BBB+", which was slightly lower than the "A-" overall quality rating of purchases during 2015. The composite duration of purchases during the first nine months of 2016 was approximately the same as that for 2015 purchases. The Company's general investment strategy is to purchase securities with maturity dates approximating ten years in the future. Accordingly, an appropriate measure for benchmarking the direction of interest rate levels for the Company's debt security purchases is the ten year treasury bond rate. After ending 2015 at a rate of 2.27%, the daily closing yield of the ten year treasury bond ranged from a low of approximately 1.35% to a high of 2.25% during the first nine months of 2016, and ended the third calendar quarter at 1.59%.

The pattern in average invested asset yield, including derivatives, incorporates increases and decreases in the fair value of index options purchased by the Company to support its fixed-index products. Fair values of the purchased call options increased during the 2016 period and decreased in the 2015 period corresponding to the movement in equity market indices in these time frames. Refer to the derivatives discussion below for a more detailed explanation of these instruments.

Other revenues - Other revenues primarily pertain to the Company's two nursing home operations in Reno, Nevada and San Marcos, Texas. Revenues associated with these operations were $13.5 million and $15.5 million for the nine months ended September 30, 2016 and 2015, respectively. Lower nursing home revenues reflect lower census figures at the facilities thus far in 2016 given local competition for residents and a change in mix of payor sources toward lower reimbursement patient types.

Derivative gain (loss) - Index options are derivative financial instruments used to hedge the equity return component of the Company's fixed-index products. Derivative gain or loss includes the amounts realized from the sale or expiration of the options. Since the index options do not meet the requirements for hedge accounting under GAAP, they are marked to fair value on each reporting date and the resulting unrealized gain or loss is also reflected as a component of net investment income.

Table of Contents

Gains and losses from index options are substantially due to changes in equity market conditions. Index options are intended to act as hedges to match the returns on the product's underlying reference index and the rise or decline in the index relative to the index level at the time of the option purchase which causes option values to likewise rise or decline. As income from index options fluctuates with the underlying index, the contract interest expense to policyholder accounts for the Company's fixed-index products also fluctuates in a similar manner and direction. For the three and nine months ended September 30, 2016, the reference indices increased and the Company recorded an overall gain from index options as shown below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Derivatives:				
Unrealized gain (loss)	$32,821	(52,391)	60,121	(100,509)
Realized gain (loss)	(13,707)	(425)	(51,814)	30,625
Total gain (loss) included in net investment income	$19,114	(52,816)	8,307	(69,884)
Total contract interest	$67,776	16,259	179,592	114,729

The economic impact of option performance in the Company's financial statements is not generally determined solely by the option gain or loss included in net investment income as there is a corresponding amount recorded in the contract interest expense line. Rather, the Company's profitability with respect to these options is dependent upon the purchase cost of the option remaining within the financial budget for purchasing options embedded in the product pricing. Option prices vary with interest rates, volatility, and dividend yields among other things. As option prices vary, the Company manages for the variability by making offsetting adjustments to product caps, participation rates, and management fees. For the periods shown, the Company's option costs have been within the product pricing budgets.

Net realized investment gains (losses) - Realized gains on investments in 2016 primarily resulted from bond calls and sales. The net gains reported for the nine months ended September 30, 2016 consisted of gross gains of $10.0 million offset by gross losses of $0.1 million. No other-than-temporary credit impairment losses were recorded during the nine months ended September 30, 2016 while $0.1 million was recorded during the same period for 2015.

The Company records impairment write-downs when a decline in value is considered to be other-than-temporary and full recovery of the investment is not expected. Impairments due to credit factors are recorded in the Company's Condensed Consolidated Statements of Earnings while non-credit (liquidity) impairment losses are included in Condensed Consolidated Statement of Comprehensive Income (Loss). Impairment and valuation write-downs reflected in the Company's Condensed Consolidated Statements of Earnings are summarized in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			

Impairment or valuation write-downs:		
Bonds	$ — —	— —
Equities	— —	—107
Total	$ — —	—107

As shown in the table above, the Company recognized minimal impairments during the first nine months of 2016 and 2015. While the Company frequently impairs equity securities in reporting periods, the level of potential impairments in 2016 thus far did not approach the threshold of materiality. Equity securities (common stocks) represent 0.1% of invested assets and individual common stock holdings have an average cost basis of approximately $40,000.

Table of Contents

Benefits and Expenses. The following table details benefits and expenses.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Life and other policy benefits	$17,430	14,181	48,571	49,567
Amortization of deferred policy acquisition costs	24,395	32,058	88,581	87,780
Universal life and annuity contract interest	67,776	16,259	179,592	114,729
Other operating expenses	23,595	18,482	66,306	57,794
Totals	$133,196	80,980	383,050	309,870

Life and other policy benefits - Death claim benefits, the largest component of policy benefits, decreased to $25.9 million in the first nine months of 2016 compared to $28.3 million for the first nine months of 2015. Death claim amounts are generally subject to variation from period to period. For the three months ended September 30, 2016 and 2015, death claim benefits were $8.0 million and $6.8 million, respectively. The Company's overall mortality experience has generally been consistent with or better than its product pricing assumptions.

Amortization of deferred policy acquisition costs - Life insurance companies are required to defer certain expenses that vary with, and are primarily related to, the cost of acquiring new business. The majority of these acquisition expenses consist of commissions paid to agents, underwriting costs, and certain marketing expenses. Recognition of these deferred policy acquisition costs (“DPAC”) as an expense in the condensed consolidated financial statements occurs over future periods in relation to the expected emergence of profits priced into the products sold. This emergence of profits is based upon assumptions regarding premium payment patterns, mortality, persistency, investment performance, and expense patterns. Companies are required to review universal life and annuity contract assumptions periodically to ascertain whether actual experience has deviated significantly from that assumed. If it is determined that a significant deviation has occurred, the emergence of profits pattern is to be "unlocked" and reset based upon the actual experience. DPAC balances are also adjusted each period to reflect current policy lapse or termination rates, expense levels and credited rates on policies compared to anticipated experience (“true-up”) with the adjustment reflected in current period amortization expense. In accordance with GAAP guidance, the Company must also write-off deferred acquisition costs and unearned revenue liabilities upon internal replacement of certain contracts as well as annuitizations of deferred annuities.

The following table identifies the effects of unlocking and true-up adjustments on DPAC balances recorded through amortization expense three and nine months ended September 30, 2016 and 2015.

Increase (Decrease) in DPAC Balance	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Unlocking	$8,170	—	11,790	1,810
True-up	(2,350)	490	(3,370)	6,010
Totals	$5,820	490	8,420	7,820

Table of Contents

True-up adjustments were recorded in 2016 and 2015 relative to partial surrender rates, mortality rates, credited interest rates and earned rates for the current years' experience. In the third quarter, true-up adjustments resulted in a \$2.4 million increase in amortization expense for 2016 and a \$0.5 million decrease for 2015. These adjustments further produced a \$3.4 million increase in amortization expense for the nine months ended September 30, 2016, and a \$6.0 million decrease for the nine months ended September 30, 2015. The true-up adjustments for the life insurance lines of business were positive (decrease to amortization expense) by \$12.7 million in the first nine months of 2016 whereas the true-up adjustments for the annuity line of business during the same period were negative by \$16.0 million incrementally adding to amortization expense. For the nine months ended September 30, 2015, true-up adjustments for the life insurance lines of business were positive (decrease to amortization expense) by \$14.5 million while true-up adjustments for the annuity line of business during the same period were negative by \$8.5 million incrementally adding to amortization expenses. The annuity true-up adjustments in the 2016 period relative to 2015 were a larger negative amount due to increased spread compression on the block of business.

In the quarter ended September 30, 2016, the Company unlocked the DPAC balance associated with its Domestic Life insurance segment for favorable mortality. The effect the prospective unlocking was to increase DPAC balances by \$8.2 million (and decrease amortization expense). During the second quarter of 2016, the Company unlocked the DPAC balance associated with its International Life insurance segment for favorable mortality, increased cost of insurance charges that had been implemented, and higher lapse assumptions for policies associated with residents in "disengaged countries" (countries which the Company ceased accepting applications from residents during 2015). The effect of the prospective unlocking was to increase DPAC balances by \$7.3 million (and decrease amortization expense). Concurrent with this unlocking, the Company also unlocked the DPAC balance for its Annuity segment for surrender and annuitization rates on its indexed, single tier, and two tier annuities. The effect of this prospective unlocking was to decrease DPAC balances by \$3.7 million (and increase amortization expense).

In the nine months ended September 30, 2015, the Company unlocked the DPAC balance associated with its International Life insurance segment for favorable mortality experience on one of its universal life products. The effect of the prospective unlocking was to increase DPAC balances by \$7.1 million (and decrease amortization expense). In addition, the Company unlocked the DPAC balance associated with its annuity segment for future assumptions pertaining to product development override costs (trailer commissions) which it is obligated to pay to certain contracted National Marketing Organizations. The effect of the prospective unlocking was to decrease DPAC balances by \$5.3 million (and increase amortization expense).

The Company is required to evaluate its emergence of profits continually and management believes that the current amortization patterns of deferred policy acquisition costs, incorporating these unlocking adjustments, are reflective of actual experience.

As the DPAC balance is an asset on the Company's Condensed Consolidated Balance Sheet, generally accepted accounting principles (GAAP) provide for an earned interest return on the unamortized balance each period. The earned interest serves to increase the DPAC balance and reduce amortization expense. The rate at which the DPAC balance earns interest is the average credited interest rate on the Company's universal life and annuity policies in force, including credited interest on equity-index policies. Since the Company's crediting rates have declined, both due to lower fixed interest rates as well as lower equity-index credits, the amount of earned interest on DPAC balances has declined resulting in higher amortization expense.

Universal life and annuity contract interest - The Company closely monitors its credited interest rates on interest sensitive policies, taking into consideration such factors as profitability goals, policyholder benefits, product marketability, and economic market conditions. As long term interest rates change, the Company's credited interest rates are often adjusted accordingly, taking into consideration the factors described above. The difference between yields earned on investments over policy credited rates is often referred to as the "interest spread".

The Company's approximated average credited rates through the first nine months, excluding and including fixed-index (derivative) products, were as follows:

	September 30,		September 30,	
	2016	2015	2016	2015
	(Excluding fixed-index products)		(Including fixed-index products)	
Annuity	2.32%	2.45%	1.94%	1.50%
Interest sensitive life	3.62%	3.72%	3.90%	2.27%

60

Table of Contents

Contract interest including fixed-index products also encompasses the performance of the index options associated with the Company's fixed-index products. As previously noted, the market performance of these derivative features resulted in net realized and unrealized gains/(losses) of $19.1 million and $(52.8) million for the quarters ended September 30, 2016 and 2015, respectively. Generally, the impact of the market value change of index options on asset values aligns closely with the movement of the embedded derivative liability held for the Company's fixed-index products such that the net effect upon pretax earnings is negligible (i.e. net realized and unrealized gains/(losses) included in net investment income approximate the change in contract interest associated with the corresponding embedded derivative liability change). However, during periods of equity market movements (gains or losses), in tandem with Company changes in asset management fees assessed on these products (increases or decreases), deviations can occur between index option asset values and the embedded derivative liability. In the three month periods ending September 30, 2016 and 2015, contract interest was decreased $5.9 million and increased $11.2 million, respectively, for this occurrence.

Similar to deferred policy acquisition costs, the Company defers sales inducements in the form of first year credited interest bonuses on annuity products that are directly related to the production of new business. These bonus interest charges are deferred and amortized using the same methodology and assumptions used to amortize other capitalized acquisition costs and the amortization is included in contract interest. In addition, deferred sales inducement balances are also reviewed periodically to ascertain whether actual experience has deviated significantly from that assumed (unlock) and are adjusted to reflect current policy lapse or termination rates, expense levels and credited rates on policies compared to anticipated experience (true-up). These adjustments, plus or minus, are included in contract interest expense. For the nine months ended September 30, 2016 and 2015, the Company recorded true-up adjustments of its deferred sales inducement balances resulting in decreased balance sheet amounts of $4.8 million and $2.4 million, respectively, which thereby increased contract interest expense by a like amount. For the quarter ended September 30, 2016 and 2015, the true-up adjustments recorded decreased balance sheet amounts by $1.4 million and $1.3 million, respectively.

The Company unlocked its deferred sales inducement balance during the nine months ended September 30, 2016 associated with its annuity segment for surrender and annuitization rate changes as noted in the discussion on deferred policy acquisition costs. The effect of the prospective unlocking was to decrease the deferred sales inducement balance by $1.7 million. In addition, as part of this unlocking, benefit reserves for international universal life and deferred annuities (two tier) were increased by a net amount of $6.0 million. This reserve change increased the contract interest charge for the period.

The Company also unlocked its deferred sales inducement balance in the first nine months of 2015 associated with its annuity segment for future expense assumptions pertaining to product development override costs as previously discussed. The effect of the prospective unlocking was to decrease the deferred sales inducement balance by $1.8 million which increased contract interest expense by the same amount.

Other operating expenses - Other operating expenses consist of general administrative expenses, licenses and fees, commissions not subject to deferral, nursing home expenses and compensation costs. These expenses for the nine months ended September 30, 2016 and 2015 are summarized in the table that follows.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
General insurance expenses	$7,661	5,037	25,447	16,948

Nursing home expenses	4,531	4,902	13,650	14,311
Compensation expenses	6,909	3,929	14,063	13,114
Commission expenses	3,043	3,137	8,480	8,841
Taxes, licenses and fees	1,451	1,477	4,666	4,580
Totals	$23,595	18,482	66,306	57,794

General insurance expenses include expenditures for software and amortization of previously capitalized information technology expenditures. In 2016, the Company began processing new policy applications for certain lines of business on a proprietary policy administration system that had been under development for a number of years. Amortization of the costs capitalized in development of this system therefore commenced in 2016 and increased information technology expense to $6.3 million for the first nine months of 2016 compared to $2.6 million during the comparable period in 2015. This amortization will continue for the next seven years. Given the Company's strategic commitment to upgrading its information technology, consulting expenditures have similarly increased approximating $2.2 million during 2016 year-to-date from $1.6 million in the prior year.

Table of Contents

General insurance expenses include provisions for litigation and other settlement payments made in lieu of litigation. As discussed in the Legal Proceedings section of the footnotes to the condensed consolidated financial statements, the Company charged $2.9 million against earnings in the first quarter of 2016 related to litigation involving an annuity contract matter in Puerto Rico.

Nursing home expenses reflect the operations of the two facilities owned by the Company. Expenses during the first nine months of 2016 were slightly below the previous period reflecting cost containment measures coinciding with lower census figures.

Compensation expenses include share-based compensation costs related to outstanding vested and nonvested stock options and SARs. As further discussed in Note 7 to the condensed consolidated financial statements, the Company awarded 14,643 new SARs to officers of National Western during the first quarter of 2016. No stock options or SARs were awarded in the first nine months of 2015. The related share-based compensation costs move in tandem not only with the number of stock options and SARs outstanding but also with the movement in the market price of the Company's Class A common stock as a result of marking the stock options and SARs to fair value under the liability method of accounting. Consequently, the related expense amount varies positive or negative in any given period. During the third quarter of 2016, the Company's closing stock price increased from $197.27 at June 30, 2016 to $205.37 at September 30, 2016. For the three months ended September 30, 2016 share based compensation expense was $1.7 million while for the comparable period in 2015 share based compensation expense was $(1.0) million. For the nine months ended September 30, 2016 share-based compensation expense was $(1.1) million versus $(2.6) million in the same period for 2015.

Taxes, licenses and fees include premium taxes and licensing fees paid to state insurance departments, guaranty fund assessments, the company portion of social security and Medicare taxes, and other state and municipal taxes. For the nine months ended September 30, 2016, these amounts remained level to the comparable period in 2015.

Federal Income Taxes. Federal income taxes on earnings from operations reflect an effective tax rate of 32.7% for the nine months ended September 30, 2016 compared to 33.2% for the nine months ended September 30, 2015. The Company's effective tax rate is typically lower than the Federal rate of 35% due to tax-exempt investment income related to municipal securities and dividends-received deductions on income from stocks.

Segment Operations

Summary of Segment Earnings

A summary of segment earnings for the three and nine months ended September 30, 2016 and 2015 is provided below. The segment earnings exclude realized gains and losses on investments, net of taxes.

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
	(In thousands)				
Segment earnings (losses):					
Three months ended:					
September 30, 2016	$3,492	9,936	13,661	3,120	30,209
September 30, 2015	$1,896	9,952	1,071	2,773	15,692
Nine months ended:					
September 30, 2016	$3,811	41,548	14,160	10,878	70,397

September 30, 2015	$664	34,136	16,842	10,831	62,473

62

Table of Contents

Domestic Life Insurance Operations

A comparative analysis of results of operations for the Company's domestic life insurance segment is detailed below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Premiums and contract revenues:				
Premiums and contract charges	$8,507	8,259	24,814	22,683
Net investment income	12,294	2,095	28,011	17,265
Other revenues	7	3	37	23
Total revenues	20,808	10,357	52,862	39,971
Benefits and expenses:				
Life and other policy benefits	5,338	3,545	13,629	12,540
Amortization of deferred policy acquisition costs	(4,331)	1,594	989	6,473
Universal life insurance contract interest	9,795	14	20,855	10,413
Other operating expenses	4,847	2,397	11,745	9,554
Total benefits and expenses	15,649	7,550	47,218	38,980
Segment earnings (loss) before Federal income taxes	5,159	2,807	5,644	991
Provision (benefit) for Federal income taxes	1,667	911	1,833	327
Segment earnings (loss)	$3,492	1,896	3,811	664

Revenues from domestic life insurance operations include life insurance premiums on traditional type products and contract revenues from universal life insurance. Revenues from traditional products are simply premiums collected, while revenues from universal life insurance consist of policy charges for the cost of insurance, policy administration fees, and surrender charges assessed during the period. A comparative detail of premiums and contract revenues is provided below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Universal life insurance revenues	$9,384	9,875	26,909	24,279
Traditional life insurance premiums	1,161	201	3,825	3,648
Reinsurance premiums	(2,038)	(1,817)	(5,920)	(5,244)
Totals	$8,507	8,259	24,814	22,683

Table of Contents

The Company's domestic life insurance in force in terms of policy count has been declining for several years. The pace of new policies issued has lagged the number of policies terminated from death or surrender by roughly a two-to-one rate over the past couple of years causing a declining level of insurance in force from which contract charge revenue is received. Consequently, the number of domestic life insurance policies in force has declined from 55,700 at December 31, 2014 to 54,300 at December 31, 2015, and to 52,900 at September 30, 2016. Universal life insurance revenues are also generated with the issuance of new business based upon amounts per application and percentages of the face amount (volume) of insurance issued. Revenues associated with issuing new business are typically greater than that realized in a renewal period for in force policies. The number of domestic life policies issued in the first nine months of 2016 was 20% lower than in the comparable period for 2015 and the volume of insurance issued was 6% less than that in 2015. Universal life insurance revenues also include surrender charge income realized on terminating policies and, in the case of Domestic universal life, amortization into income of the premium load on single premium policies which the Company began deferring in 2013

Premiums collected on universal life products are not reflected as revenues in the Company's Condensed Consolidated Statements of Earnings in accordance with GAAP. Actual domestic universal life premiums collected are detailed below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Universal life insurance:				
First year and single premiums	$30,373	30,534	85,915	91,263
Renewal premiums	5,135	5,423	15,481	15,910
Totals	$35,508	35,957	101,396	107,173

During the past couple of years the Company has achieved some success in growing its domestic life insurance business. Sales have been substantially weighted toward single premium policies which do not have much in the way of recurring premium payments. These products are targeting wealth transfer strategies involving the movement of accumulated wealth in alternative investment vehicles, including annuities, into life insurance products. As a result, renewal premium levels have not been exhibiting a corresponding level of increase.

Net investment income for this segment of business, excluding derivative gain/(losses), has been gradually increasing due to the increased new business activity described above and a higher level of investments needed to support the corresponding growth in policy obligations, especially those for single premium policies. The increase in net investment income has been partially muted by lower investment yields from debt security investment purchases during this time frame. Net investment income also includes the gains and losses on index options purchased to back the index crediting mechanism on fixed-index universal products.

A detail of net investment income for domestic life insurance operations is provided below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			

Net investment income (excluding derivatives)	$8,329	8,368	25,093	23,635
Derivative gain (loss)	3,965	(6,273)	2,918	(6,370)
Net investment income	$12,294	2,095	28,011	17,265

Table of Contents

Life and policy benefits for a smaller block of business are subject to variation from quarter to quarter. Claim activity during the first nine months of 2016 was in line with historical trends and was slightly higher compared to the same period for 2015. The number of incurred claims during the first nine months of 2016 increased 1% compared to the first nine months of 2015 while the average net claim amount increased from $21,000 to $24,000, respectively. The low face amount per claim reflects the older block of domestic life insurance policies sold which were final expense type products (i.e. purchased to cover funeral costs). The increase in the average net claim amount reflects claims from more recent policy sales (single premium wealth transfer products) which have much higher face amounts of insurance coverage per policy. The Company's overall mortality experience for this segment has been better than pricing assumptions.

As noted previously in the discussion of Results of Operations, the Company records true-up adjustments to DPAC balances each period to reflect current policy lapse or termination rates, expense levels and credited rates on policies as compared to anticipated experience with the adjustment reflected in current period amortization expense. To the extent required, the Company may also record unlocking adjustments to DPAC balances. The following table identifies the effects of unlocking and true-up adjustments on domestic life insurance DPAC balances recorded through amortization expense three and nine months ended September 30, 2016 and 2015.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Increase (Decrease) in DPAC Balance				
Unlocking	$8,170	—	8,170	—
True-up	460	2,520	3,260	5,710
Totals	$8,630	2,520	11,430	5,710

As noted in the table above, the true-up adjustments recorded increased the DPAC balance on the Condensed Consolidated Balance Sheets which conversely reduced amortization expense in current earnings by a like amount for the periods shown. As noted in the Consolidated Operations discussion, the Company unlocked the DPAC balance for this segment during the third quarter of 2016 for favorable mortality. The effect of the prospective unlocking was to increase DPAC balances by $8.2 million (and decrease amortization expense).

International Life Insurance Operations

The Company's international life operations have been a significant factor in the Company's overall earnings performance and represents a niche where the Company believes it has had a competitive advantage historically. A stable population of distribution relationships has been developed over decades of operations providing the Company with a consistent foundation for development of the block of business.

Table of Contents

A comparative analysis of results of operations for the Company's international life insurance segment is detailed below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Premiums and other revenues:				
Premiums and contract revenues	$31,066	29,773	95,291	89,470
Net investment income	12,763	448	30,203	17,847
Other revenues	10	5	50	66
Total revenues	43,839	30,226	125,544	107,383
Benefits and expenses:				
Life and other policy benefits	5,038	5,002	14,789	16,794
Amortization of deferred policy acquisition costs	7,296	6,834	11,720	11,347
Universal life insurance and annuity contract interest	11,287	(854)	19,643	13,203
Other operating expenses	6,691	3,929	17,867	15,063
Total benefits and expenses	30,312	14,911	64,019	56,407
Segment earnings (losses) before Federal income taxes	13,527	15,315	61,525	50,976
Provision (benefit) for Federal income taxes	3,591	5,363	19,977	16,840
Segment earnings (loss)	$9,936	9,952	41,548	34,136

As with domestic life operations, revenues from the international life insurance segment include both premiums on traditional type products and contract revenues from universal life insurance. A comparative detail of premiums and contract revenues is provided below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Universal life insurance revenues	$29,687	26,332	91,359	85,056
Traditional life insurance premiums	3,470	5,639	9,896	10,701
Reinsurance premiums	(2,091)	(2,198)	(5,964)	(6,287)
Totals	$31,066	29,773	95,291	89,470

In general, universal life revenues and operating earnings are anticipated to emerge with growth in the amount of international life insurance in force. The volume of insurance in force contracted from $20.0 billion at December 31, 2014 to $19.0 billion at December 31, 2015 and further decreased to $18.0 billion at September 30, 2016. Universal life insurance revenues are also generated with the issuance of new business based upon amounts per application and percentages of the face amount (volume) of insurance issued. The number of international life policies issued in the first nine months of 2016 was 28% lower than in the first nine months of 2015 while the volume of insurance issued was 33% less than that issued in 2015 during the same period as a result of ceasing the acceptance of applications from residents from certain countries in the fourth quarter of 2015.

Table of Contents

A third component of international universal life revenues include surrender charges assessed upon surrender of contracts by policyholders. At the height of the financial crisis in 2008 through 2010 the Company's international policyholders exhibited concern regarding the developments in U.S. financial markets. This evidenced itself in the Company's termination activity in its international life policies in force. The Company incurred higher termination experience than is typical which resulted in recognition of increased surrender charge fee income. This level of termination activity subsequently subsided in 2011 with the termination activity over the following years remaining relatively stable. In 2015, termination activity revisited the levels last seen during the 2008 through 2010 period resulting in additional surrender charge fee revenues, and this activity has continued into 2016. The following table illustrates the Company's recent international life termination experience.

	Amount in $'s (millions)	Annualized Termination Rate	
Volume In Force Terminations			
Year ended December 31, 2011	$ 1,465.1	7.3	%
Year ended December 31, 2012	1,828.4	8.7	%
Year ended December 31, 2013	1,838.5	8.6	%
Year ended December 31, 2014	1,825.5	8.4	%
Year ended December 31, 2015	2,659.1	12.3	%
Nine months ended September 30, 2016	1,819.2	12.0	%

The higher incidence of terminations primarily is occurring with policies to residents of the countries from which the Company discontinued accepting applications in late 2015. As a result of the higher termination incidence, the Company unlocked its DPAC balances for this segment of the business in the second quarter of 2016 to incorporate a greater lapse assumption, among other things.

As noted previously, premiums collected on universal life products are not reflected as revenues in the Company's Condensed Consolidated Statements of Earnings in accordance with GAAP. Actual international universal life premiums collected are detailed below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Universal life insurance:				
First year and single premiums	$ 5,578	7,706	14,679	20,162
Renewal premiums	23,393	24,835	69,903	76,831
Totals	$ 28,971	32,541	84,582	96,993

The Company's most popular international products have been its fixed-index universal life products in which the policyholder can elect to have the interest rate credited to their policy account values linked in part to the performance of an outside equity index. Included in the totals in the above table are collected premiums for fixed-index universal life products of approximately $50.2 million and $63.1 million for the first nine months of 2016 and 2015, respectively. The decline in renewal premiums during 2016 compared to 2015 corresponds with the increased termination activity discussed above.

Table of Contents

As previously noted, net investment income and contract interest include period-to-period changes in fair values pertaining to call options purchased to hedge the interest crediting feature on the fixed-index universal life products. With the growth in the fixed-index universal life block of business, the period-to-period changes in fair values of the underlying options have had an increasingly greater impact on net investment income and universal life contract interest. A detail of net investment income for international life insurance operations is provided below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Net investment income (excluding derivatives)	$9,221	9,233	27,738	28,637
Derivative gain (loss)	3,542	(8,786)	2,465	(10,790)
Net investment income				