

NATIONAL WESTERN LIFE INSURANCE CO  
Form 10-Q  
November 09, 2009

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2009

- 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: 2-17039

NATIONAL WESTERN LIFE INSURANCE COMPANY  
(Exact name of Registrant as specified in its charter)

COLORADO  
(State of Incorporation)

84-0467208  
(I.R.S. Employer Identification Number)

850 EAST ANDERSON LANE  
AUSTIN, TEXAS 78752-1602  
(Address of Principal Executive Offices)

(512) 836-1010  
(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  No

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  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of November 5, 2009, the number of shares of Registrant's common stock outstanding was: Class A – 3,425,966 and Class B - 200,000.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (In thousands)

| ASSETS  | (Unaudited)<br>September<br>30,<br>2009 | December<br>31,<br>2008 |
|---|---|-------------------------|
| Investments:  |   |                         |
| Securities held to maturity, at amortized cost<br>(fair value: \$4,259,696 and \$3,727,353) | \$ 4,082,605                            | 3,831,417               |
| Securities available for sale, at fair value<br>(cost: \$1,963,559 and \$1,904,053)         | 2,033,249                               | 1,745,266               |
| Mortgage loans, net of allowance for possible losses<br>(\$3,577 and \$4,587)               | 88,986                                  | 90,733                  |
| Policy loans  | 75,916                                  | 79,277                  |
| Derivatives, index options  | 66,987                                  | 11,920                  |
| Other long-term investments   | 33,809                                  | 14,168                  |
| <b>Total investments</b>  | <b>6,381,552</b>                        | <b>5,772,781</b>        |
| Cash and short-term investments   | 35,669                                  | 67,796                  |
| Deferred policy acquisition costs   | 624,377                                 | 701,984                 |
| Deferred sales inducements  | 116,883                                 | 120,955                 |
| Accrued investment income   | 72,005                                  | 64,872                  |
| Federal income tax receivable   | -                                       | 1,820                   |
| Other assets  | 63,280                                  | 56,272                  |
|   | <b>\$ 7,293,766</b>                     | <b>6,786,480</b>        |

See accompanying notes to condensed consolidated financial statements.

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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands, except share amounts)

|  | (Unaudited)<br>September<br>30,<br>2009 | December<br>31,<br>2008 |
|--|---|-------------------------|
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |   |                         |
| <b>LIABILITIES:</b>  |   |                         |
| Future policy benefits:  |   |                         |
| Traditional life and annuity contracts   | \$ 135,186                              | 137,530                 |
| Universal life and annuity contracts   | 5,764,603                               | 5,424,968               |
| Other policyholder liabilities   | 129,771                                 | 131,963                 |
| Federal income tax liability:  |   |                         |
| Current  | 14,162                                  | -                       |
| Deferred   | 46,236                                  | 26,506                  |
| Other liabilities  | 105,284                                 | 79,300                  |
| <b>Total liabilities</b>   | <b>6,195,242</b>                        | <b>5,800,267</b>        |
| <b>COMMITMENTS AND CONTINGENCIES (Notes 5 and 8)</b>   |   |                         |
| <b>STOCKHOLDERS' EQUITY:</b>   |   |                         |
| Common stock:  |   |                         |
| Class A - \$1 par value; 7,500,000 shares authorized; 3,425,966<br>and 3,425,966 issued and outstanding in 2009 and 2008 | 3,426                                   | 3,426                   |
| Class B - \$1 par value; 200,000 shares authorized, issued,<br>and outstanding in 2009 and 2008                          | 200                                     | 200                     |
| Additional paid-in capital   | 36,680                                  | 36,680                  |
| Accumulated other comprehensive income (loss)  | 14,959                                  | (65,358)                |
| Retained earnings  | 1,043,259                               | 1,011,265               |
| <b>Total stockholders' equity</b>  | <b>1,098,524</b>                        | <b>986,213</b>          |
|  | <b>\$ 7,293,766</b>                     | <b>6,786,480</b>        |

See accompanying notes to condensed consolidated financial statements.

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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

For the Three Months Ended September 30, 2009 and 2008

(Unaudited)

(In thousands, except per share amounts)

|  | 2009       | 2008     |
|--|------------|----------|
| Premiums and other revenue:  |            |          |
| Traditional life and annuity premiums  | \$ 3,707   | 4,057    |
| Universal life and annuity contract charges                                      | 37,683     | 32,885   |
| Net investment income  | 116,276    | 69,582   |
| Other revenues   | 5,086      | 3,056    |
| Net realized investment gains (losses):  |            |          |
| Total other-than-temporary impairment (“OTTI”) losses                            | (4,666)    | (21,635) |
| Portion of OTTI losses recognized in other comprehensive income                  | 4,572      | -        |
| Net OTTI losses recognized in earnings   | (94)       | (21,635) |
| Other net investment gains   | 151        | 15       |
| Total net realized investment gains (losses)                                     | 57         | (21,620) |
| Total revenues   | 162,809    | 87,960   |
| Benefits and expenses:   |            |          |
| Life and other policy benefits   | 19,965     | 10,794   |
| Amortization of deferred policy acquisition costs and deferred sales inducements | 28,436     | 37,188   |
| Universal life and annuity contract interest                                     | 80,608     | 38,339   |
| Other operating expenses   | 36,426     | 17,905   |
| Total benefits and expenses  | 165,435    | 104,226  |
| Loss before Federal income taxes   | (2,626)    | (16,266) |
| Provision (benefit) for Federal income taxes:                                    |            |          |
| Current  | 18,036     | 3,488    |
| Deferred   | (19,548)   | (9,954)  |
| Total Federal income taxes   | (1,512)    | (6,466)  |
| Net loss   | \$ (1,114) | (9,800)  |
| Basic Loss Per Share:  |            |          |
| Class A  | \$ (0.32)  | (2.78)   |
| Class B  | \$ (0.16)  | (1.39)   |
| Diluted Loss Per Share:  |            |          |
| Class A  | \$ (0.32)  | (2.78)   |

|         |    |        |        |
|---------|----|--------|--------|
| Class B | \$ | (0.16) | (1.39) |
|---------|----|--------|--------|

See accompanying notes to condensed consolidated financial statements.



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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

For the Nine Months Ended September 30, 2009 and 2008

(Unaudited)

(In thousands, except per share amounts)

|  | 2009      | 2008     |
|--|-----------|----------|
| Premiums and other revenues:   |           |          |
| Traditional life and annuity premiums  | \$ 12,227 | 12,575   |
| Universal life and annuity contract charges                                      | 115,116   | 98,696   |
| Net investment income  | 280,625   | 201,290  |
| Other revenues   | 12,187    | 9,348    |
| Net realized investment gains (losses):  |           |          |
| Total other-than-temporary impairment (“OTTI”) losses                            | (11,796)  | (23,085) |
| Portion of OTTI losses recognized in other comprehensive income                  | 6,395     | -        |
| Net OTTI losses recognized in earnings   | (5,401)   | (23,085) |
| Other net investment gains   | 279       | 1,154    |
| Total net realized investment losses   | (5,122)   | (21,931) |
| Total revenues   | 415,033   | 299,978  |
| Benefits and expenses:   |           |          |
| Life and other policy benefits   | 43,241    | 28,905   |
| Amortization of deferred policy acquisition costs and deferred sales inducements | 84,933    | 93,699   |
| Universal life and annuity contract interest                                     | 173,525   | 98,511   |
| Other operating expenses   | 65,770    | 45,962   |
| Total benefits and expenses  | 367,469   | 267,077  |
| Earnings before Federal income taxes   | 47,564    | 32,901   |
| Provision (benefit) for Federal income taxes:                                    |           |          |
| Current  | 39,041    | 15,307   |
| Deferred   | (24,233)  | (5,194)  |
| Total Federal income taxes   | 14,808    | 10,113   |
| Net earnings   | \$ 32,756 | 22,788   |
| Basic Earnings Per Share:  |           |          |
| Class A  | \$ 9.29   | 6.47     |
| Class B  | \$ 4.65   | 3.23     |
| Diluted Earnings Per Share:  |           |          |
| Class A  | \$ 9.28   | 6.42     |

|         |    |      |      |
|---------|----|------|------|
| Class B | \$ | 4.65 | 3.23 |
|---------|----|------|------|

See accompanying notes to condensed consolidated financial statements.

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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
For the Three Months Ended September 30, 2009 and 2008  
(Unaudited)  
(In thousands)

|  | 2009       | 2008     |
|--|------------|----------|
| Net loss   | \$ (1,114) | (9,800)  |
| 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                    | 37,279     | (34,258) |
| Reclassification adjustment for net amounts included in net earnings           | (17)       | 11,707   |
| Amortization of net unrealized gains related to transferred securities         | 6          | 11       |
| Net unrealized gains (losses) on securities                                    | 37,268     | (22,540) |
| Foreign currency translation adjustments                                       | 79         | (8)      |
| Benefit plans:   |            |          |
| Amortization of net prior service cost and net gain                            | 411        | 342      |
| Other comprehensive income (loss)  | 37,758     | (22,206) |
| Comprehensive income (loss)  | \$ 36,644  | (32,006) |

See accompanying notes to condensed consolidated financial statements.

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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
For the Nine Months Ended September 30, 2009 and 2008  
(Unaudited)  
(In thousands)

|  | 2009       | 2008     |
|--|------------|----------|
| Net earnings   | \$ 32,756  | 22,788   |
| 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                    | 76,792     | (49,353) |
| Reclassification adjustment for net amounts included in net earnings           | 2,855      | 11,097   |
| Amortization of net unrealized losses related to transferred securities        | (38)       | (3)      |
| Net unrealized gains (losses) on securities                                    | 79,609     | (38,259) |
| Foreign currency translation adjustments                                       | (19)       | (150)    |
| Benefit plans:   |            |          |
| Amortization of net prior service cost and net gain                            | 1,234      | 1,026    |
| Other comprehensive income (loss)  | 80,824     | (37,383) |
| Comprehensive income (loss)  | \$ 113,580 | (14,595) |

See accompanying notes to condensed consolidated financial statements.

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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
For the Nine Months Ended September 30, 2009 and 2008  
(Unaudited)  
(In thousands)

|  | 2009     | 2008     |
|--|----------|----------|
| Common stock:  |          |          |
| Balance at beginning of period                                   | \$ 3,626 | 3,622    |
| Shares exercised under stock option plan                         | -        | 4        |
| Balance at end of period   | 3,626    | 3,626    |
| Additional paid-in capital:                                      |          |          |
| Balance at beginning of period                                   | 36,680   | 36,236   |
| Shares exercised under the stock option plan                     | -        | 444      |
| Balance at end of period   | 36,680   | 36,680   |
| Accumulated other comprehensive income (loss):                   |          |          |
| Unrealized gains (losses) on non-impaired securities:            |          |          |
| Balance at beginning of period                                   | (53,770) | 1,184    |
| Change in unrealized gains (losses) during period                | 81,514   | (38,259) |
| Balance at end of period   | 27,744   | (37,075) |
| Unrealized losses on impaired held to maturity securities:       |          |          |
| Balance at beginning of period                                   | -        | -        |
| Cumulative effect of change in accounting principle (See Note 3) | (507)    | -        |
| Amortization   | 29       | -        |
| Other-than-temporary impairments                                 | (1,446)  | -        |
| Balance at end of period   | (1,924)  | -        |
| Unrealized losses on impaired available for sale securities:     |          |          |
| Balance at beginning of period                                   | -        | -        |
| Other-than-temporary impairments                                 | (570)    | -        |
| Recoveries   | 82       | -        |
| Balance at end of period   | (488)    | -        |
| Foreign currency translation adjustments:                        |          |          |
| Balance at beginning of period                                   | 2,966    | 3,078    |
| Change in translation adjustments during period                  | (19)     | (150)    |
| Balance at end of period   | 2,947    | 2,928    |

Benefit plan liability adjustment:

|  |          |          |
|--|----------|----------|
| Balance at beginning of period                                 | (14,554) | (11,327) |
| Amortization of net prior service cost and net gain            | 1,234    | 1,026    |
| Balance at end of period                                       | (13,320) | (10,301) |
| Accumulated other comprehensive income (loss) at end of period | 14,959   | (44,448) |

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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY, CONTINUED  
For the Nine Months Ended September 30, 2009 and 2008  
(Unaudited)  
(In thousands)

|   |              |           |
|---|--------------|-----------|
| Retained earnings:  |              |           |
| Balance at beginning of period  | 1,011,265    | 978,892   |
| Cumulative effect of change in accounting principle,<br>net of tax (See Note 3) | 507          | -         |
| Net earnings  | 32,756       | 22,788    |
| Stockholder dividends   | (1,269)      | (1,269)   |
| Balance at end of period  | 1,043,259    | 1,000,411 |
| Total stockholders' equity  | \$ 1,098,524 | 996,269   |

See accompanying notes to condensed consolidated financial statements.

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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine Months Ended September 30, 2009 and 2008

(Unaudited)

(In thousands)

|   | 2009      | 2008      |
|---|-----------|-----------|
| Cash flows from operating activities:   |           |           |
| Net earnings  | \$ 32,756 | 22,788    |
| Adjustments to reconcile net earnings to net cash from operating activities:  |           |           |
| Universal life and annuity contract interest                                  | 173,525   | 98,511    |
| Surrender charges and other policy revenues                                   | (45,205)  | (30,324)  |
| Realized losses on investments  | 5,122     | 21,931    |
| Accrual and amortization of investment income                                 | (3,385)   | (3,715)   |
| Depreciation and amortization   | (335)     | 786       |
| (Increase) decrease in value of derivatives                                   | (61,896)  | 52,824    |
| (Increase) decrease in deferred policy acquisition and sales inducement costs | (20,511)  | 14,508    |
| Increase in accrued investment income   | (7,133)   | (2,496)   |
| (Increase) decrease in other assets   | (8,457)   | 991       |
| Decrease in liabilities for future policy benefits                            | (2,344)   | (694)     |
| Increase in other policyholder liabilities                                    | 28,201    | 8,678     |
| Increase in Federal income tax liability                                      | (7,159)   | (368)     |
| Increase in other liabilities   | 37,213    | 11,116    |
| Other   | 5         | 844       |
| Net cash provided by operating activities                                     | 120,397   | 195,380   |
| Cash flows from investing activities:   |           |           |
| Proceeds from sales of:   |           |           |
| Securities held to maturity   | -         | -         |
| Securities available for sale   | 15,612    | 1,522     |
| Other investments   | 1,118     | 5,382     |
| Proceeds from maturities and redemptions of:                                  |           |           |
| Securities held to maturity   | 757,842   | 417,933   |
| Securities available for sale   | 75,592    | 190,284   |
| Derivatives, index options  | 38,131    | -         |
| Purchases of:   |           |           |
| Securities held to maturity   | (953,502) | (493,363) |
| Securities available for sale   | (220,912) | (190,039) |
| Other investments   | (51,299)  | (47,195)  |
| Principal payments on mortgage loans  | 6,676     | 12,308    |
| Cost of mortgage loans acquired   | (6,049)   | (6,046)   |
| Decrease in policy loans  | 3,361     | 2,835     |
| Other   | -         | (4,316)   |



|                                       |           |           |
|---------------------------------------|-----------|-----------|
| Net cash used in investing activities | (333,430) | (110,695) |
|---------------------------------------|-----------|-----------|

(Continued on next page)

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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED

For the Nine Months Ended September 30, 2009 and 2008

(Unaudited)

(In thousands)

|   | 2009       | 2008      |
|---|------------|-----------|
| Cash flows from financing activities:                                 |            |           |
| Deposits to account balances for universal life and annuity contracts | \$ 611,163 | 346,119   |
| Return of account balances on universal life and annuity contracts    | (430,243)  | (441,195) |
| Issuance of common stock under stock option plan                      | -          | 448       |
| Net cash provided by (used in) financing activities                   | 180,920    | (94,628)  |
| Effect of foreign exchange  | (14)       | (412)     |
| Net decrease in cash and short-term investments                       | (32,127)   | (10,355)  |
| Cash and short-term investments at beginning of period                | 67,796     | 45,206    |
| Cash and short-term investments at end of period                      | \$ 35,669  | 34,851    |

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:**

|   |        |        |
|---|--------|--------|
| Cash paid during the period for:            |        |        |
| Interest                                    | \$ 30  | 30     |
| Income taxes                                | 22,757 | 10,504 |
| Noncash operating activities:               |        |        |
| Net change in deferral of sales inducements | 15,984 | 13,148 |

See accompanying notes to condensed consolidated financial statements.

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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

(1) CONSOLIDATION AND BASIS OF PRESENTATION

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 National Western Life Insurance Company and its subsidiaries ("Company") as of September 30, 2009, and the results of its operations and its cash flows for the three and nine months ended September 30, 2009 and 2008. The results of operations for the nine months ended September 30, 2009 and 2008 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, 2008 accessible free of charge through the Company's internet site at [www.nationalwesternlife.com](http://www.nationalwesternlife.com) or the Securities and Exchange Commission internet site at [www.sec.gov](http://www.sec.gov). The condensed consolidated balance sheet at December 31, 2008, has been derived from the audited consolidated financial statements as of that date. Certain amounts in the prior year condensed consolidated financial statements have been reclassified to conform to the current year presentation.

The accompanying condensed consolidated financial statements include the accounts of National Western Life Insurance Company and its wholly-owned subsidiaries: The Westcap Corporation, NWL Investments, Inc., NWL Services, Inc., NWL Financial, Inc., and Regent Care San Marcos Holdings, LLC. All significant intercorporate transactions and accounts have been eliminated in consolidation.

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) commitments and contingencies, (5) valuation allowances for deferred tax assets, (6) other-than-temporary impairment losses on debt securities, and (7) valuation allowances for mortgage loans and real estate.

(2) NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued new guidance to provide a single definition of fair value, a framework for measuring fair value, and required additional disclosure about the use of fair value to measure assets and liabilities. The Company adopted it for its reporting of financial assets and financial liabilities on January 1, 2008. The effective date for implementation to non financial assets and non financial liabilities was delayed by the FASB until the first reporting period after November 15, 2008. The Company adopted this portion of the guidance effective January 1, 2009. The adoption of fair value measurements did not have a material impact on the Company's consolidated financial statements and results of operations.

In December 2007, the FASB issued new guidance establishing accounting and reporting standards for entities that have equity investments that are not attributable directly to the parent, called noncontrolling interests or minority interests. More specifically, the guidance addresses where and how to report noncontrolling interests in the consolidated statements of financial position and operations, how to account for changes in noncontrolling interests and provides disclosure requirements. The Company adopted it effective January 1, 2009 and it did not have a material impact on the Company's consolidated financial condition and results of operations.

In December 2007, the FASB issued new guidance establishing how an entity accounts for the identifiable assets acquired, liabilities assumed, and any noncontrolling interests acquired, how to account for goodwill acquired and determines what disclosures are required as part of a business combination, and it applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company adopted it effective January 1, 2009 and it did not have an impact on the Company's consolidated financial condition or results of operations.

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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

In March 2008, the FASB issued new guidance to require companies with derivative instruments to disclose information about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. This guidance became effective for financial statements issued for fiscal years beginning after November 15, 2008. The Company adopted it on January 1, 2009 with no material impact on the consolidated financial statements. Please see Note 10 – Fair Value Measurements for additional information pertaining to this guidance.

In September 2008, the FASB issued new guidance establishing disclosure requirements by entities that assume credit risk through the sale of credit derivatives, including credit derivatives embedded in a hybrid instrument, to enable users of financial statements to assess the potential effect on its financial position, financial performance, and cash flows from these credit derivatives, and requires additional disclosure about the current status of the payment/performance risk of a guarantee. The Company adopted the guidance effective January 1, 2009 and it did not have a material effect on the Company's consolidated financial condition and results of operations.

In December 2008, the FASB issued new guidance which requires information to be disclosed on an annual basis pertaining to postretirement benefit plan assets. The Company would be required to separate plan assets into the three fair value hierarchy levels and provide a rollforward of the changes in fair value of plan assets classified as Level 3. The disclosures about plan assets are effective for fiscal years ending after December 15, 2009, but will have no effect on the Company's consolidated financial condition and results of operations.

In January 2009, the FASB issued new guidance to enhance guidance on impairments to remove the exclusive reliance on a "market participant" estimate of future cash flows to a holder's estimate of whether there has been a "probable" adverse change in estimated cash flows. This allows management to apply reasonable judgment in assessing whether an other-than-temporary impairment has occurred. It was effective for the Company as of December 31, 2008 and its adoption did not have a significant impact on the consolidated financial statements of the Company.

In March 2009, the FASB issued new guidance establishing enhanced disclosures regarding an entity's derivative and hedging activity to enable investors to better understand the effects on an entity's financial position, financial performance, and cash flows. The Company adopted the guidance as of January 1, 2009. See Note 12 – Derivative Investments for disclosures regarding derivative instruments and hedging activities.

On April 9, 2009 the FASB issued new guidance for estimating fair value when the volume and level of activity for an asset or liability have significantly decreased and includes guidance on identifying circumstances that indicate a transaction is not orderly. This guidance emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability, and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. This guidance is effective for interim and annual reporting periods ending after June 15, 2009. As further discussed in Note 10 – Fair Value Measurements, the adoption of this guidance did not have a material impact on the Company's consolidated financial condition and results of operations.

On April 9, 2009 the FASB issued new guidance to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. It was effective for

the Company as of June 30, 2009 and did not have a significant impact on the consolidated financial position or results of operations. See Note 10 for additional disclosures.

On April 9, 2009 the FASB issued new guidance which amended the other-than-temporary impairment guidance for debt securities to make the guidance more operational, and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. It did not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. This guidance was effective for the Company as of June 30, 2009. The impact of its adoption is discussed in Note 3, Stockholders' Equity.

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On May 28, 2009 the FASB issued new guidance establishing general standards of accounting for the disclosure of events that occur after the balance sheet date, but before the financial statements are issued or are available to be issued. It was effective for the Company as of June 30, 2009 and did not have a significant impact on the consolidated financial position or results of operations. See Note 13 for additional disclosures.

On June 12, 2009 the FASB issued new guidance that changes the way entities account for securitizations and special purpose entities. The guidance is effective as of the beginning of the Company's first annual reporting period beginning after November 15, 2009 and is not expected to have a significant impact on the consolidated financial position, results of operations or disclosures.

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

The Company is restricted by state insurance laws as to the amount of dividends which may be paid to stockholders without prior approval from the Colorado Division of Insurance. The Company paid no cash dividends on common stock during the nine months ended September 30, 2009 and 2008. The Company did declare a cash dividend on August 28, 2009 payable November 30, 2009 to stockholders on record as of October 30, 2009. The dividends declared were \$0.36 per common share to Class A stockholders and \$0.18 per common share to Class B stockholders. A dividend in the same amounts per share on Class A and Class B shares was declared in August and paid in November of 2008.

Change in Accounting Principles

During the second quarter of 2009, the Company reviewed all previously recorded other-than-temporary impairments of securities in compliance with FASB ASC 320 10 10 guidance and estimated the credit versus the non-credit component consistent with the methodology used in the current period to analyze and bifurcate impairments into credit and non-credit components. As a result, the Company determined that \$0.8 million in previously recorded other-than-temporary impairments had been due to non-credit impairments.

For each security, the Company developed its best estimate of the net present value of the cash flows expected to be received. The credit component of the impairment for these securities was determined to be the difference between the amortized cost of the security and the projected net cash flows. The non-credit component was determined to be the difference between projected net cash flows and fair value. The Company also determined whether management had the intent to sell the security, or if it was more likely than not that it will be required to sell the security, prior to the recovery of the non-credit component.

As a result of the implementation, during the second quarter of 2009, the Company recorded a net of tax opening balance adjustment that increased retained earnings in the amount of \$0.5 million and increased accumulated other comprehensive loss in the amount of \$0.5 million. See Note 9 for further discussion.

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## (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.

|   | Three Months Ended September 30,        |         |          |         |
|---|---|---------|----------|---------|
|   | 2009                                    |         | 2008     |         |
|   | Class A                                 | Class B | Class A  | Class B |
|   | (In thousands except per share amounts) |         |          |         |
| Numerator for Basic and Diluted Earnings Per Share:                                   |   |         |          |         |
| Net loss  | \$ (1,114)                              |         | (9,800)  |         |
| Dividends – Class A shares  | (1,233)                                 |         | (1,233)  |         |
| Dividends – Class B shares  | (36)                                    |         | (36)     |         |
| Undistributed loss  | \$ (2,383)                              |         | (11,069) |         |
| Allocation of net loss:   |   |         |          |         |
| Dividends   | \$ 1,233                                | 36      | 1,233    | 36      |
| Allocation of undistributed loss  | (2,315)                                 | (68)    | (10,755) | (314)   |
| Net loss  | \$ (1,082)                              | (32)    | (9,522)  | (278)   |
| Denominator:  |   |         |          |         |
| Basic earnings per share - weighted-average shares                                    | 3,426                                   | 200     | 3,426    | 200     |
| Effect of dilutive stock options  | -                                       | -       | -        | -       |
| Diluted earnings per share - adjusted weighted-average shares for assumed conversions |   |         |          |         |
|   | 3,426                                   | 200     | 3,426    | 200     |
| Basic Loss Per Share  | \$ (0.32)                               | (0.16)  | (2.78)   | (1.39)  |
| Diluted Loss Per Share  | \$ (0.32)                               | (0.16)  | (2.78)   | (1.39)  |

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## Earnings per Share (continued)

|   | Nine Months Ended September 30,         |         |         |         |
|---|---|---------|---------|---------|
|   | 2009                                    |         | 2008    |         |
|   | Class A                                 | Class B | Class A | Class B |
|   | (In thousands except per share amounts) |         |         |         |
| Numerator for Basic and Diluted Earnings Per Share:                                   |   |         |         |         |
| Net income  | \$ 32,756                               |         | 22,788  |         |
| Dividends – Class A shares  | (1,233)                                 |         | (1,233) |         |
| Dividends – Class B shares  | (36)                                    |         | (36)    |         |
| Undistributed income  | \$ 31,487                               |         | 21,519  |         |
| Allocation of net income:   |   |         |         |         |
| Dividends   | \$ 1,233                                | 36      | 1,233   | 36      |
| Allocation of undistributed income  | 30,594                                  | 893     | 20,909  | 610     |
| Net income  | \$ 31,827                               | 929     | 22,142  | 646     |
| Denominator:  |   |         |         |         |
| Basic earnings per share - weighted-average shares                                    | 3,426                                   | 200     | 3,425   | 200     |
| Effect of dilutive stock options  | 4                                       | -       | 26      | -       |
| Diluted earnings per share - adjusted weighted-average shares for assumed conversions | 3,430                                   | 200     | 3,451   | 200     |
| Basic Earnings Per Share  | \$ 9.29                                 | 4.65    | 6.47    | 3.23    |
| Diluted Earnings Per Share  | \$ 9.28                                 | 4.65    | 6.42    | 3.23    |

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## (5) PENSION AND OTHER POSTRETIREMENT PLANS

## (A) Defined Benefit Pension Plans

The Company sponsors a qualified defined benefit pension plan covering substantially all employees. The plan provides benefits based on the participants' years of service and compensation. The Company makes annual contributions to the plan that comply with the minimum funding provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). On October 19, 2007, the Company'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 summarizes the components of net periodic benefit cost.

|                                    | Three Months Ended September 30, |       | Nine Months Ended September 30, |       |
|------------------------------------|----------------------------------|-------|---------------------------------|-------|
|                                    | 2009                             | 2008  | 2009                            | 2008  |
|                                    | (In thousands)                   |       |                                 |       |
| Service cost                       | \$ -                             | -     | -                               | -     |
| Interest cost                      | 243                              | 259   | 767                             | 777   |
| Expected return on plan assets     | (222)                            | (285) | (667)                           | (855) |
| Amortization of prior service cost | 1                                | 1     | 3                               | 3     |
| Amortization of net loss           | 148                              | 60    | 445                             | 182   |
| Net periodic benefit cost          | \$ 170                           | 35    | 548                             | 107   |

The Company expects to contribute \$2.1 million to the plan in 2009. During the nine months ended September 30, 2009, the Company contributed \$2.0 million to the plan.

The Company also sponsors a non-qualified 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 pension 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 the Company 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 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 for the Chairman and the President of the Company in order to comply with law changes under the American Jobs Creation Act of 2004 ("Act").

Effective July 1, 2005, the Company established a second non-qualified defined benefit plan for the benefit of the Chairman 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 non-qualified plan, while complying with the requirements of the Act.

Effective November 1, 2005, the Company established a third non-qualified defined benefit plan for the benefit of the President of the Company. This plan is intended to provide for post-2004 benefit accruals that supplement the pre-2005 benefit accruals under the first non-qualified plan as previously discussed, while complying with the requirements of the Act.

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The following summarizes the components of net periodic benefit costs for these non-qualified plans.

|                                    | Three Months Ended September 30, |      | Nine Months Ended September 30, |       |
|------------------------------------|----------------------------------|------|---------------------------------|-------|
|                                    | 2009                             | 2008 | 2009                            | 2008  |
|                                    | (In thousands)                   |      |                                 |       |
| Service cost                       | \$ 38                            | 146  | 112                             | 439   |
| Interest cost                      | 308                              | 298  | 925                             | 893   |
| Amortization of prior service cost | 260                              | 260  | 780                             | 780   |
| Amortization of net loss           | 197                              | 177  | 593                             | 530   |
| Net periodic benefit cost          | \$ 803                           | 881  | 2,410                           | 2,642 |

The Company expects to contribute \$2.0 million to these plans in 2009. During the nine months ended September 30, 2009, the Company contributed \$1.3 million to the plans.

**(B) Defined Contribution Pension Plans**

The Company sponsors a qualified 401(k) plan for substantially all employees and a non-qualified deferred compensation plan primarily for senior officers. The Company makes annual contributions to the 401(k) plan of one percent of each employee's compensation in 2009 and 2008. Additional Company matching contributions of up to two percent of each employee's compensation are also made each year based on the employee's personal level of salary deferrals to the plan. All Company contributions are subject to a vesting schedule based on the employee's years of service.

**(C) Defined Benefit Postretirement Plans**

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

|                                    | Three Months Ended September 30, |      | Nine Months Ended September 30, |      |
|------------------------------------|----------------------------------|------|---------------------------------|------|
|                                    | 2009                             | 2008 | 2009                            | 2008 |
|                                    | (In thousands)                   |      |                                 |      |
| Interest cost                      | \$ 33                            | 34   | 98                              | 101  |
| Amortization of prior service cost | 25                               | 25   | 77                              | 77   |
| Amortization of net loss           | -                                | 1    | -                               | 4    |
| Net periodic benefit cost          | \$ 58                            | 60   | 175                             | 182  |

As previously disclosed in its financial statements for the year ended December 31, 2008, the Company expects to contribute minimal amounts to the plan in 2009.

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## (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 as of and for the periods ended September 30, 2009 and 2008 is provided below.

## Selected Segment Information:

|   | Domestic<br>Life<br>Insurance | International<br>Life<br>Insurance | Annuities<br>(In thousands) | All<br>Others | Totals    |
|---|-------------------------------|------------------------------------|-----------------------------|---------------|-----------|
| September 30, 2009:                                     |                               |                                    |                             |               |           |
| Selected Balance Sheet Items:                           |                               |                                    |                             |               |           |
| Deferred policy acquisition costs and sales inducements | \$ 59,722                     | 202,510                            | 479,028                     | -             | 741,260   |
| Total segment assets                                    | 397,154                       | 1,019,901                          | 5,698,414                   | 157,769       | 7,273,238 |
| Future policy benefits                                  | 321,157                       | 626,283                            | 4,952,349                   | -             | 5,899,789 |
| Other policyholder liabilities                          | 12,128                        | 20,424                             | 97,219                      | -             | 129,771   |
| Three Months Ended                                      |                               |                                    |                             |               |           |
| September 30, 2009:                                     |                               |                                    |                             |               |           |
| Condensed Income Statements:                            |                               |                                    |                             |               |           |
| Premiums and contract revenues                          | \$ 8,166                      | 25,706                             | 7,518                       | -             | 41,390    |
| Net investment income (loss)                            | (364)                         | 18,362                             | 91,072                      | 7,206         | 116,276   |
| Other income  | 2                             | 17                                 | 1,647                       | 3,420         | 5,086     |
| Total revenues  | 7,804                         | 44,085                             | 100,237                     | 10,626        | 162,752   |
| Life and other policy benefits                          | 8,233                         | (1,141)                            | 12,873                      | -             | 19,965    |
| Amortization of deferred policy acquisition costs       | 1,136                         | 10,495                             | 16,805                      | -             | 28,436    |
| Universal life and annuity contract interest            | 2,244                         | 17,646                             | 60,718                      | -             | 80,608    |
| Other operating expenses                                | 4,071                         | 5,935                              | 22,391                      | 4,029         | 36,426    |
| Federal income taxes (benefit)                          | (2,555)                       | 3,424                              | (4,411)                     | 2,010         | (1,532)   |
| Total expenses  | 13,129                        | 36,359                             | 108,376                     | 6,039         | 163,903   |
| Segment earnings (loss)                                 | \$ (5,325)                    | 7,726                              | (8,139)                     | 4,587         | (1,151)   |





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## Selected Segment Information (continued):

|  | Domestic<br>Life<br>Insurance | International<br>Life<br>Insurance | Annuities<br>(In thousands) | All<br>Others | Totals         |
|--|-------------------------------|------------------------------------|-----------------------------|---------------|----------------|
| Nine Months Ended                                    |                               |                                    |                             |               |                |
| September 30, 2009:                                  |                               |                                    |                             |               |                |
| Condensed Income Statements:                         |                               |                                    |                             |               |                |
| Premiums and contract                                |                               |                                    |                             |               |                |
| revenues   | \$ 27,123                     | 78,540                             | 21,680                      | -             | 127,343        |
| Net investment income                                | 9,696                         | 32,242                             | 226,189                     | 12,498        | 280,625        |
| Other income   | 22                            | 55                                 | 1,860                       | 10,250        | 12,187         |
| <b>Total revenues</b>                                | <b>36,841</b>                 | <b>110,837</b>                     | <b>249,729</b>              | <b>22,748</b> | <b>420,155</b> |
| Life and other policy benefits                       | 16,388                        | 10,957                             | 15,896                      | -             | 43,241         |
| Amortization of deferred<br>policy acquisition costs | 5,470                         | 35,257                             | 44,206                      | -             | 84,933         |
| Universal life and annuity<br>contract interest      | 6,742                         | 31,846                             | 134,937                     | -             | 173,525        |
| Other operating expenses                             | 10,450                        | 14,615                             | 30,125                      | 10,580        | 65,770         |
| Federal income taxes (benefit)                       | (696)                         | 5,723                              | 7,741                       | 3,832         | 16,600         |
| <b>Total expenses</b>                                | <b>38,354</b>                 | <b>98,398</b>                      | <b>232,905</b>              | <b>14,412</b> | <b>384,069</b> |
| <b>Segment earnings (loss)</b>                       | <b>\$ (1,513)</b>             | <b>12,439</b>                      | <b>16,824</b>               | <b>8,336</b>  | <b>36,086</b>  |

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## Selected Segment Information (continued):

|                                | Domestic<br>Life<br>Insurance | International<br>Life<br>Insurance | Annuities<br><br>(In thousands) | All<br>Others | Totals    |
|--------------------------------|-------------------------------|------------------------------------|---------------------------------|---------------|-----------|
| September 30, 2008:            |                               |                                    |                                 |               |           |
| Selected Balance Sheet Items:  |                               |                                    |                                 |               |           |
| Deferred policy acquisition    |                               |                                    |                                 |               |           |
| costs and sales inducements    | \$ 64,669                     | 219,531                            | 521,950                         | -             | 806,150   |
| Total segment assets           | 398,277                       | 837,859                            | 5,385,733                       | 138,787       | 6,760,656 |
| Future policy benefits         | 318,080                       | 592,887                            | 4,646,293                       | -             | 5,557,260 |
| Other policyholder liabilities | 11,786                        | 12,942                             | 104,350                         | -             | 129,078   |
| Three Months Ended             |                               |                                    |                                 |               |           |
| September 30, 2008:            |                               |                                    |                                 |               |           |
| Condensed Income Statements:   |                               |                                    |                                 |               |           |
| Premiums and contract          |                               |                                    |                                 |               |           |
| revenues                       | \$ 6,798                      | 23,890                             | 6,254                           | -             | 36,942    |
| Net investment income          | 4,912                         | 4,652                              | 58,902                          | 1,116         | 69,582    |
| Other income                   | 3                             | 13                                 | 46                              | 2,994         | 3,056     |
| Total revenues                 | 11,713                        | 28,555                             | 65,202                          | 4,110         | 109,580   |
| Life and other policy benefits | 3,569                         | 5,765                              | 1,460                           | -             | 10,794    |
| Amortization of deferred       |                               |                                    |                                 |               |           |
| policy acquisition costs       | 3,219                         | 8,877                              | 25,092                          | -             | 37,188    |
| Universal life and annuity     |                               |                                    |                                 |               |           |
| contract interest              | 2,249                         | 4,664                              | 31,426                          | -             | 38,339    |
| Other operating expenses       | 3,070                         | 6,597                              | 5,531                           | 2,707         | 17,905    |
| Federal income taxes (benefit) | (147)                         | 694                                | 158                             | 396           | 1,101     |
| Total expenses                 | 11,960                        | 26,597                             | 63,667                          | 3,103         | 105,327   |
| Segment earnings (loss)        | \$ (247)                      | 1,958                              | 1,535                           | 1,007         | 4,253     |

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## Selected Segment Information (continued):

|  | Domestic<br>Life<br>Insurance | International<br>Life<br>Insurance | Annuities<br><br>(In thousands) | All<br>Others | Totals         |
|--|-------------------------------|------------------------------------|---------------------------------|---------------|----------------|
| Nine Months Ended                                    |                               |                                    |                                 |               |                |
| September 30, 2008:                                  |                               |                                    |                                 |               |                |
| Condensed Income Statements:                         |                               |                                    |                                 |               |                |
| Premiums and contract                                |                               |                                    |                                 |               |                |
| revenues   | \$ 20,108                     | 72,116                             | 19,047                          | -             | 111,271        |
| Net investment income                                | 15,103                        | 12,696                             | 168,205                         | 5,286         | 201,290        |
| Other income   | 13                            | 38                                 | 169                             | 9,128         | 9,348          |
| <b>Total revenues</b>                                | <b>35,224</b>                 | <b>84,850</b>                      | <b>187,421</b>                  | <b>14,414</b> | <b>321,909</b> |
| Life and other policy benefits                       | 10,588                        | 15,364                             | 2,953                           | -             | 28,905         |
| Amortization of deferred<br>policy acquisition costs | 7,574                         | 27,278                             | 58,847                          | -             | 93,699         |
| Universal life and annuity<br>contract interest      | 6,892                         | 11,944                             | 79,675                          | -             | 98,511         |
| Other operating expenses                             | 9,093                         | 14,723                             | 13,826                          | 8,320         | 45,962         |
| Federal income taxes                                 | 349                           | 5,042                              | 10,420                          | 1,978         | 17,789         |
| <b>Total expenses</b>                                | <b>34,496</b>                 | <b>74,351</b>                      | <b>165,721</b>                  | <b>10,298</b> | <b>284,866</b> |
| <b>Segment earnings</b>                              | <b>\$ 728</b>                 | <b>10,499</b>                      | <b>21,700</b>                   | <b>4,116</b>  | <b>37,043</b>  |

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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, |          |
|---|----------------------------------|----------|---------------------------------|----------|
|   | 2009                             | 2008     | 2009                            | 2008     |
|   | (In thousands)                   |          |                                 |          |
| Premiums and Other Revenue:                   |                                  |          |                                 |          |
| Premiums and contract revenues                | \$ 41,390                        | 36,942   | 127,343                         | 111,271  |
| Net investment income                         | 116,276                          | 69,582   | 280,625                         | 201,290  |
| Other income                                  | 5,086                            | 3,056    | 12,187                          | 9,348    |
| Realized gains (losses) on investments        | 57                               | (21,620) | (5,122)                         | (21,931) |
| Total consolidated premiums and other revenue | \$ 162,809                       | 87,960   | 415,033                         | 299,978  |

|   | Three Months Ended September 30, |         | Nine Months Ended September 30, |         |
|---|----------------------------------|---------|---------------------------------|---------|
|   | 2009                             | 2008    | 2009                            | 2008    |
|   | (In thousands)                   |         |                                 |         |
| Federal Income Taxes:                           |                                  |         |                                 |         |
| Total segment Federal income taxes              | \$ (1,532)                       | 1,101   | 16,600                          | 17,789  |
| Taxes on realized gains (losses) on investments | 20                               | (7,567) | (1,792)                         | (7,676) |
| Total consolidated Federal income taxes         | \$ (1,512)                       | (6,466) | 14,808                          | 10,113  |

|  | Three Months Ended September 30, |          | Nine Months Ended September 30, |          |
|--|----------------------------------|----------|---------------------------------|----------|
|  | 2009                             | 2008     | 2009                            | 2008     |
|  | (In thousands)                   |          |                                 |          |
| Net Earnings(Loss):                                  |                                  |          |                                 |          |
| Total segment earnings (loss)                        | \$ (1,151)                       | 4,253    | 36,086                          | 37,043   |
| Realized gains (losses) on investments, net of taxes | 37                               | (14,053) | (3,330)                         | (14,255) |
| Total consolidated net earnings (loss)               | \$ (1,114)                       | (9,800)  | 32,756                          | 22,788   |

|                           | September 30,  |           |
|---------------------------|----------------|-----------|
|                           | 2009           | 2008      |
|                           | (In thousands) |           |
| Assets:                   |                |           |
| Total segment assets      | \$ 7,273,238   | 6,760,656 |
| Other unallocated assets  | 20,528         | 40,212    |
| Total consolidated assets | \$ 7,293,766   | 6,800,868 |

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## (7) SHARE-BASED PAYMENTS

The Company has a stock and incentive plan ("1995 Plan") which provides 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; and (4) performance awards. The Company has issued only nonqualified stock options and stock appreciation rights. 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 may be issued under the 1995 Plan, or as to which stock appreciation rights or other awards may be granted, may 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, \$1.00 par value, common stock shares eligible for issue not to exceed 300,000. These shares may be current authorized and unissued shares.

All of the employees of the Company and its subsidiaries are eligible to participate in the two Plans. 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. The directors' grants vest 20% annually following one full year of service to the Company from the date of grant. The employees' grants vest 20% annually following three full years of service to the Company from the date of grant. All grants issued expire after ten years. On February 19, 2009, the Company awarded 29,393 stock appreciation rights to Company officers and 9,000 stock appreciation rights to Company directors at a market value price of \$114.64. During the third quarter of 2008, 2,750 stock appreciation rights were awarded to specified Company officers. Quantities awarded and market value prices on the dates of award are: (1) August 21, 2008, 1,250 awards at \$236.00 (2) September 2, 2008, 1,000 awards at \$251.49; and, (3) September 22, 2008, 500 awards at \$256.00.

Effective during March 2006, the Company adopted and implemented a limited stock buy-back program 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 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.

The Company uses the current fair value method to measure compensation cost. As of September 30, 2009, the liability balance was \$5.8 million versus \$3.8 million as of December 31, 2008. A summary of shares available for grant and stock option activity is detailed below.

| Shares<br>Available<br>For Grant | Options Outstanding<br>Shares | Weighted-<br>Average<br>Exercise<br>Price |
|----------------------------------|-------------------------------|---|
|----------------------------------|-------------------------------|---|

## Stock Options:

|                               |         |         |    |        |
|-------------------------------|---------|---------|----|--------|
| Balance at January 1, 2009    | 291,400 | 105,812 | \$ | 174.33 |
| Exercised                     | -       | -       |    | -      |
| Forfeited                     | 800     | (800)   | \$ | 215.71 |
| Expired                       | 200     | (200)   | \$ | 150.00 |
| Stock options granted         | -       | -       |    | -      |
| Balance at September 30, 2009 | 292,400 | 104,812 | \$ | 174.06 |

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|                                       | Awards |    | Weighted-<br>Average<br>Exercise<br>Price |
|---------------------------------------|--------|----|---|
| Stock Appreciation Rights Outstanding |        |    |   |
| Balance at January 1, 2009            | 2,750  | \$ | 245.70                                    |
| SARs granted February 19, 2009        | 38,393 | \$ | 114.64                                    |
| Balance at September 30, 2009         | 41,143 | \$ | 123.40                                    |

The total intrinsic value of options exercised was zero and \$2.8 million for the nine months ended September 30, 2009 and 2008, respectively. The total share-based liabilities paid were zero and \$2.5 million for the nine months ended September 30, 2009 and 2008, respectively. For the three months ended September 30, 2009 and 2008, the total cash received from the exercise of options under the Plan was zero. The total fair value of shares vested during the nine months ended September 30, 2009 and 2008 was \$0.2 million and \$2.0 million, respectively.

The following table summarizes information about stock options and SARs outstanding at September 30, 2009.

|                           | Options Outstanding   |   |                        |
|---------------------------|-----------------------|---|------------------------|
|                           | Number<br>Outstanding | Weighted-<br>Average<br>Remaining<br>Contractual Life | Options<br>Exercisable |
| Exercise prices:          |                       |   |                        |
| \$ 92.13                  | 10,194                | 1.6 years   | 10,194                 |
| 95.00                     | 6,000                 | 1.7 years   | 6,000                  |
| 150.00                    | 51,850                | 4.6 years   | 32,650                 |
| 255.13                    | 27,768                | 8.6 years   | -                      |
| 208.05                    | 9,000                 | 8.7 years   | 1,800                  |
| 236.00                    | 1,250                 | 8.9 years   | -                      |
| 251.49                    | 1,000                 | 8.9 years   | -                      |
| 256.00                    | 500                   | 9.0 years   | -                      |
| 114.64                    | 38,393                | 9.4 years   | -                      |
| Totals                    | 145,955               |   | 50,644                 |
| Aggregate intrinsic value |                       |   |                        |
| (in thousands)            | \$ 5,043              |   | \$ 2,189               |

The aggregate intrinsic value in the table above is based on the closing stock price of \$175.98 per share on September 30, 2009.

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In estimating the fair value of the options outstanding at September 30, 2009 and December 31, 2008, the Company employed the Black-Scholes option pricing model with assumptions as detailed below.

|                          | September 30,<br>2009 | December 31,<br>2008 |
|--------------------------|-----------------------|----------------------|
| Expected term of options | 2 to 10 years         | 2 to 10 years        |
| Expected volatility:     |                       |                      |
| Range                    | 8.53% to 103.10%      | 24.70% to 77.55%     |
| Weighted-average         | 45.57%                | 37.10%               |
| Expected dividend yield  | 0.21%                 | 0.22%                |
| Risk-free rate:          |                       |                      |
| Range                    | 1.24% to 3.34%        | 1.44% to 2.40%       |
| Weighted-average         | 2.27%                 | 1.94%                |

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.

The pre-tax compensation cost recognized in the financial statements related to the Plan was \$2.0 million and \$2.6 million for the nine months ended September 30, 2009 and 2008, respectively. The related tax benefit recognized was \$0.7 million and \$0.9 million for the nine months ended September 30, 2009 and 2008, respectively.

As of September 30, 2009, the total compensation cost related to nonvested options not yet recognized was \$3.7 million. This amount is expected to be recognized over a weighted-average period of 2.4 years. The Company recognizes compensation cost over the graded vesting periods.

## (8) COMMITMENTS AND CONTINGENCIES

### (A) Legal Proceedings

The Company is a defendant in a class action lawsuit initially filed on September 17, 2004, in the Superior Court of the State of California for the County of Los Angeles. The California state court has certified a class consisting of certain California policyholders age 65 and older alleging violations under California Business and Professions Code section 17200. The court has additionally certified a subclass of 36 policyholders alleging fraud against their agent, and vicariously against the Company. The California Insurance Department has intervened in this case asserting that the Company has violated California insurance laws. The parties to this case are involved in court-ordered mediation which seeks settlement of all issues, but the Company can make no assurances that the parties will reach agreement on a settlement structure.

The Company is a defendant in a second class action lawsuit pending as of June 12, 2006, in the U.S. District Court for the Southern District of California. The case is titled In Re National Western Life Insurance Deferred Annuities Litigation and is in the discovery phase with no class certification motion pending. The complaint asserts claims for RICO violations, Financial Elder Abuse, Violation of Cal. Bus. & Prof. Code 17200, et seq, Violation of Cal. Bus. &

Prof. Code 17500, et seq, Breach of Fiduciary Duty, Aiding and Abetting Breach of Fiduciary Duty, Fraudulent Concealment, Cal. Civ. Code 1710, et seq, Breach of the Duty of Good Faith and Fair Dealing, and Unjust Enrichment and Imposition of Constructive Trust. The Company believes that it has meritorious defenses in this case and intends to vigorously defend itself against the asserted claims.

The Company is involved or may become involved in various other legal actions, in the normal course of its business, in which claims for alleged economic and punitive damages have been or may be asserted, some for substantial amounts. Although there can be no assurances, at the present time, the Company does not anticipate that the ultimate liability arising from such other potential, pending, or threatened legal actions will have a material adverse effect on the financial condition or operating results of the Company.

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The amounts provided in the consolidated financial statements at September 30, 2009 for the foregoing represent estimates made by the Company based upon current information and are subject to change as facts and circumstances change and develop.

In January 2009, the SEC published its newly adopted rule 151A, Indexed Annuities and Certain Other Insurance Contracts. This rule defines “indexed annuities to be securities and thus subject to regulation by the SEC under federal securities laws”. Currently indexed annuities sold by life insurance companies are regulated by the States as insurance products and Section 3(a)(8) of the Securities Act of 1933 provides an exemption for certain “annuity contracts,” “optional annuity contracts,” and other insurance contracts. The new rule is not effective until January 12, 2011. The Company and others have filed suit in the U.S. Court of Appeals for the District of Columbia to overturn this rule. In the event rule 151A is not overturned, it could have a material effect on the Company’s business, results of operations and financial condition.

## (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, |              |
|-------------------------------------|----------------------------------|-----------|---------------------------------|--------------|
|                                     | 2009                             | 2008      | 2009                            | 2008         |
|                                     | (In thousands)                   |           |                                 |              |
| Available for sale debt securities: |                                  |           |                                 |              |
| Realized gains on disposal          | \$ 63                            | 106       | 209                             | 992          |
| Realized losses on disposal         | -                                | -         | (180)                           | -            |
| Held to maturity debt securities:   |                                  |           |                                 |              |
| Realized gains on disposal          | 87                               | 4         | 201                             | 154          |
| Realized losses on disposal         | -                                | -         | (19)                            | -            |
| Equity securities realized gains    | 1                                | 39        | 63                              | 118          |
| Real estate writedown               | -                                | -         | (52)                            | -            |
| Mortgage loans writedowns           | -                                | -         | (12)                            | (4)          |
| Other                               | -                                | (134)     | 69                              | (106)        |
| <b>Totals</b>                       | <b>\$ 151</b>                    | <b>15</b> | <b>279</b>                      | <b>1,154</b> |

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

|  | Three months ended September 30, |      | Nine months ended September 30, |      |
|--|----------------------------------|------|---------------------------------|------|
|  | 2009                             | 2008 | 2009                            | 2008 |

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(In thousands)

|   |    |         |          |          |          |
|---|----|---------|----------|----------|----------|
| Total other-than-temporary impairment losses on debt securities | \$ | (4,666) | (18,200) | (11,380) | (18,200) |
| Portion of loss recognized in comprehensive income              |    | 4,572   | -        | 6,395    | -        |
| Net impairment losses on debt securities recognized in earnings |    |         |          |          |          |
|   |    | (94)    | (18,200) | (4,985)  | (18,200) |
| Equity securities impairments                                   |    | -       | (3,435)  | (416)    | (4,885)  |
| Totals  | \$ | (94)    | (21,635) | (5,401)  | (23,085) |

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For the three months ended September 30, 2009, the Company recognized \$4,637,000 as other-than-temporary impairments on two held to maturity asset-backed securities of which \$65,000 was recognized in earnings as a credit loss and the remaining \$4,572,000 recognized in other comprehensive income as a non-credit loss. Since the adoption of the new FASB guidance issued on April 9, 2009 (see Note 2) which amended the other-than-temporary guidance for debt securities, the Company has recognized \$6,476,000 as other-than-temporary impairments on one available for sale mortgage-backed security and two held to maturity asset-backed securities of which \$81,000 was recognized in earnings as a credit loss and the remaining \$6,395,000 recognized in other comprehensive income as a non-credit loss. The credit component of the impairment was determined to be the difference between amortized cost and the present value of the cash flows expected to be received, discounted at the original yield. The significant inputs used to project cash flows are estimated future prepayment rates, default rates and default loss severity. Prior to adoption of the new guidance, the amount of impairment recognized in earnings was the difference between amortized cost and fair value.

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

|   | Three Months<br>Ended<br>September 30, 2009 | Six Months*<br>Ended<br>September 30, 2009 |
|---|---|--|
|   | (In thousands)                              |  |
| Beginning balance, cumulative credit losses related to other-than-temporary impairments   | \$ 44                                       | 28   |
| Additions for credit losses not previously recognized in other-than-temporary impairments | 94  | 110  |
| Ending balance, cumulative credit losses related to other-than-temporary impairment.      | \$ 138                                      | 138  |

\*Since the adoption date of the new FASB GAAP guidance.

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## (B) Debt and Equity Securities

The table below presents amortized cost and fair values of securities held to maturity at September 30, 2009.

|                                   | Amortized<br>Cost | Securities Held to Maturity<br>Gross<br>Unrealized |        | Fair<br>Value |
|-----------------------------------|-------------------|--|--------|---------------|
|                                   |                   | Gains  | Losses |               |
|                                   |                   | (In thousands)                                     |        |               |
| Debt securities:                  |                   |  |        |               |
| U.S. Agencies                     | \$ 78,182         | 3,268  | -      | 81,450        |
| U.S. Treasury                     | 1,918             | 461  | -      | 2,379         |
| States and political subdivisions | 126,425           | 4,122  | 48     | 130,499       |
| Foreign governments               | 9,961             | 926  | -      | 10,887        |
| Public utilities                  | 600,789           | 40,122   | 870    | 640,041       |
| Corporate                         | 1,490,678         | 77,235   | 32,133 | 1,535,780     |
| Mortgage-backed                   | 1,716,929         | 94,787   | 2,749  | 1,808,967     |
| Home equity                       | 31,735            | -  | 7,221  | 24,514        |
| Manufactured housing              | 25,988            | 440  | 1,249  | 25,179        |
| Totals                            | \$ 4,082,605      | 221,361  | 44,270 | 4,259,696     |

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The table below presents amortized cost and fair values of securities available for sale at September 30, 2009.

|                                   | Amortized<br>Cost | Securities Available for Sale                  |                               | Fair<br>Value |
|-----------------------------------|-------------------|--|-------------------------------|---------------|
|                                   |                   | Gross<br>Unrealized<br>Gains<br>(In thousands) | Gross<br>Unrealized<br>Losses |               |
| Debt securities:                  |                   |  |                               |               |
| U.S. Agencies                     | \$ -              | -  | -                             | -             |
| U.S. Treasury                     | -                 | -  | -                             | -             |
| States and political subdivisions | 20,641            | -  | 965                           | 19,676        |
| Foreign governments               | 10,373            | 1,074  | -                             | 11,447        |
| Public utilities                  | 310,751           | 18,739   | 789                           | 328,701       |
| Corporate                         | 1,353,147         | 66,332   | 24,240                        | 1,395,239     |
| Mortgage-backed                   | 237,060           | 10,180   | 4,175                         | 243,065       |
| Home equity                       | 13,799            | -  | 4,835                         | 8,964         |
| Manufactured housing              | 10,957            | 465  | 1                             | 11,421        |
| Total debt securities             | 1,956,728         | 96,790   | 35,005                        | 2,018,513     |
| Equity securities – private       | 195               | 6,962  | -                             | 7,157         |
| Equity securities – public        | 6,636             | 1,231  | 288                           | 7,579         |
| Totals                            | \$ 1,963,559      | 104,983  | 35,293                        | 2,033,249     |

Included in gross unrealized losses at September 30, 2009 is the non-credit component of an other-than-temporary impairment of a mortgage-backed security of \$1.6 million. This impairment is included in accumulated other comprehensive loss, net of tax and deferred acquisition costs.

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The table below presents amortized cost and fair values of securities held to maturity at December 31, 2008.

|                                   | Amortized<br>Cost | Securities Held to Maturity                    |                               | Fair<br>Value |
|-----------------------------------|-------------------|--|-------------------------------|---------------|
|                                   |                   | Gross<br>Unrealized<br>Gains<br>(In thousands) | Gross<br>Unrealized<br>Losses |               |
| Debt securities:                  |                   |  |                               |               |
| U.S. Agencies                     | \$ 119,674        | 3,975  | -                             | 123,649       |
| U.S. Treasury                     | 1,923             | 592  | -                             | 2,515         |
| States and political subdivisions | 23,123            | 3  | 801                           | 22,325        |
| Foreign governments               | 9,955             | 438  | -                             | 10,393        |
| Public utilities                  | 527,277           | 5,073  | 31,530                        | 500,820       |
| Corporate                         | 1,334,157         | 13,580   | 118,204                       | 1,229,533     |
| Mortgage-backed                   | 1,747,104         | 44,213   | 8,210                         | 1,783,107     |
| Home equity                       | 37,808            | 37   | 9,533                         | 28,312        |
| Manufactured housing              | 30,396            | 93   | 3,790                         | 26,699        |
| Totals                            | \$ 3,831,417      | 68,004   | 172,068                       | 3,727,353     |

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The table below presents amortized cost and fair values of securities available for sale at December 31, 2008.

|                                   | Amortized<br>Cost | Securities Available for Sale                  |                               | Fair<br>Value |
|-----------------------------------|-------------------|--|-------------------------------|---------------|
|                                   |                   | Gross<br>Unrealized<br>Gains<br>(In thousands) | Gross<br>Unrealized<br>Losses |               |
| Debt securities:                  |                   |  |                               |               |
| U.S. Agencies                     | \$ -              | -  | -                             | -             |
| U.S. Treasury                     | -                 | -  | -                             | -             |
| States and political subdivisions | 77,160            | 332  | 13,653                        | 63,839        |
| Foreign governments               | 10,418            | 907  | -                             | 11,325        |
| Public utilities                  | 287,927           | 300  | 25,085                        | 263,142       |
| Corporate                         | 1,239,712         | 6,503  | 126,968                       | 1,119,247     |
| Mortgage-backed                   | 255,910           | 5,739  | 7,693                         | 253,956       |
| Home equity                       | 13,877            | -  | 4,726                         | 9,151         |
| Manufactured housing              | 11,942            | -  | 1,019                         | 10,923        |
| Total debt securities             | 1,896,946         | 13,781   | 179,144                       | 1,731,583     |
| Equity securities - private       | 195               | 6,995  | -                             | 7,190         |
| Equity securities - public        | 6,912             | 486  | 905                           | 6,493         |
| Totals                            | \$ 1,904,053      | 21,262   | 180,049                       | 1,745,266     |

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The table below presents the gross unrealized losses and fair values of the Company's held to maturity securities by the length of time that the individual securities have been in a continuous unrealized loss position at September 30, 2009.

|                                     | Less than 12 Months |                      | Held to Maturity<br>12 Months or Greater |                      | Total         |                      |
|-------------------------------------|---------------------|----------------------|--|----------------------|---------------|----------------------|
|                                     | Fair<br>Value       | Unrealized<br>Losses | Fair<br>Value                            | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
|                                     | (In thousands)      |                      |  |                      |               |                      |
| Debt securities:                    |                     |                      |  |                      |               |                      |
| U.S. Agencies                       | \$ -                | -                    | -  | -                    | -             | -                    |
| U.S. Treasury                       | -                   | -                    | -  | -                    | -             | -                    |
| State and political<br>subdivisions | 5,087               | 22                   | 2,785                                    | 26                   | 7,872         | 48                   |
| Foreign governments                 | -                   | -                    | -  | -                    | -             | -                    |
| Public utilities                    | 6,965               | 50                   | 22,128                                   | 820                  | 29,093        | 870                  |
| Corporate bonds                     | 91,530              | 548                  | 291,240                                  | 31,585               | 382,770       | 32,133               |
| Mortgage-backed                     | -                   | -                    | 59,076                                   | 2,749                | 59,076        | 2,749                |
| Home equity                         | 3,419               | 331                  | 14,466                                   | 6,890                | 17,885        | 7,221                |
| Manufactured housing                | 1,431               | 146                  | 7,340                                    | 1,103                | 8,771         | 1,249                |
| Total                               | \$ 108,432          | 1,097                | 397,035                                  | 43,173               | 505,467       | 44,270               |

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The table below presents the gross unrealized losses and fair values of the Company's available for sale securities by the length of time that the individual securities have been in a continuous unrealized loss position at September 30, 2009.

|                                  | Less than 12 Months |                   | Available For Sale<br>12 Months or Greater |                   | Total      |                   |
|----------------------------------|---------------------|-------------------|--|-------------------|------------|-------------------|
|                                  | Fair Value          | Unrealized Losses | Fair Value                                 | Unrealized Losses | Fair Value | Unrealized Losses |
|                                  | (In thousands)      |                   |  |                   |            |                   |
| Debt securities:                 |                     |                   |  |                   |            |                   |
| U. S. Agencies                   | \$ -                | -                 | -  | -                 | -          | -                 |
| U.S. Treasury                    | -                   | -                 | -  | -                 | -          | -                 |
| State and political subdivisions |                     |                   |  |                   |            |                   |
|                                  | -                   | -                 | 19,676                                     | 965               | 19,676     | 965               |
| Foreign governments              |                     |                   |  |                   |            |                   |
|                                  | -                   | -                 | -  | -                 | -          | -                 |
| Public utilities                 |                     |                   |  |                   |            |                   |
|                                  | -                   | -                 | 23,340                                     | 789               | 23,340     | 789               |
| Corporate bonds                  |                     |                   |  |                   |            |                   |
|                                  | 31,850              | 2,554             | 252,247                                    | 21,686            | 284,097    | 24,240            |
| Mortgage-backed                  |                     |                   |  |                   |            |                   |
|                                  | -                   | -                 | 22,608                                     | 4,175             | 22,608     | 4,175             |
| Home equity                      |                     |                   |  |                   |            |                   |
|                                  | -                   | -                 | 8,964                                      | 4,835             | 8,964      | 4,835             |
| Manufactured housing             |                     |                   |  |                   |            |                   |
|                                  | -                   | -                 | 202  | 1                 | 202        | 1                 |
| Total debt securities            | 31,850              | 2,554             | 327,037                                    | 32,451            | 358,887    | 35,005            |
| Equity securities - public       |                     |                   |  |                   |            |                   |
|                                  | 1,931               | 105               | 743  | 183               | 2,674      | 288               |
| Total                            | \$ 33,781           | 2,659             | 327,780                                    | 32,634            | 361,561    | 35,293            |

Debt securities. The gross unrealized losses for debt securities at September 30, 2009 are made up of 154 individual issues, or 18.4% of the total debt securities held by the Company. The market value of these bonds as a percent of amortized cost averages 91.9%. Of the 154 securities, 127, or approximately 82.5%, fall in the 12 months or greater aging category and 134 were rated investment grade at September 30, 2009. Additional information on debt securities by investment category is summarized below.

State and political subdivisions. The unrealized losses on these investments are the result of holdings in 23 securities. Of these securities, all are rated A or above except two which are rated BBB+ and BB. Based on these facts, the Company's intent not to sell, and the belief that it is not more likely than not to be required to sell prior to a market price recovery, no other-than-temporary loss was recognized as of September 30, 2009.

Public utilities. Of the 12 securities, all are rated BBB or above except one, which is priced at 90.7% of par. At this time, the Company does not consider any of these unrealized losses as other-than-temporary.

Corporate bonds. Corporate securities with unrealized losses are reviewed using monitoring procedures which include: review of the amount of the unrealized loss, the length of time that the issue has been in an unrealized loss position, credit ratings, analyst reports, and recent issuer financial information. A total of 90 securities had unrealized losses with 13 issues rated below investment grade. More extensive analysis was performed on these 13 issues and, based on the work performed, none of the unrealized losses are considered other-than-temporarily impaired at September 30, 2009.

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Mortgage-backed securities. These securities are all rated AAA except for one which is rated CCC. The Company generally purchases these types of investments at a discount relative to their face amount and it is expected that the securities will not be settled at a price less than the stated par. Because the decline in market value is attributable to current illiquidity in the market and not credit quality, and because the Company has the ability and intent to hold these securities until a recovery of fair value, which may be at maturity, and based on the lack of adverse changes in expected cash flows, the Company does not consider these AAA investments to have other-than-temporary impairments at September 30, 2009. The Company recognized an other-than-temporary loss in the third quarter of 2009 on the CCC rated security.

Home equity. Of the 11 securities, 8 are rated AAA and 3 are rated below AA. The Company performs quarterly cash flow analysis on asset-backed securities that are rated below AA. Based on the lack of adverse changes in expected cash flows, the 3 issues rated below AA are not considered other-than-temporarily impaired.

Manufactured housing. Of the 6 securities, 2 are rated AAA, 1 is rated AA and 3 are rated below AA. The Company performs quarterly cash flow analysis on asset-backed securities that are rated below AA. Based on the lack of adverse changes in expected cash flows, the 3 issues rated below AA are not considered other-than-temporarily impaired.

Equity securities - public. The gross unrealized losses for equity securities are made up of 39 individual issues. These holdings are reviewed for impairment quarterly. During the nine months ended September 30, 2009, the Company recorded other-than-temporary impairments on 19 equity securities.

Management believes the unrealized declines in fair values are temporary. Accordingly, realized credit losses have not been recorded by the Company.

The table below presents the gross unrealized losses and fair values of the Company's held to maturity securities by the length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2008.

|                                  | Less than 12 Months |                   | Held to Maturity<br>12 Months or Greater |                   | Total      |                   |
|----------------------------------|---------------------|-------------------|--|-------------------|------------|-------------------|
|                                  | Fair Value          | Unrealized Losses | Fair Value                               | Unrealized Losses | Fair Value | Unrealized Losses |
|                                  | (In thousands)      |                   |  |                   |            |                   |
| Debt securities:                 |                     |                   |  |                   |            |                   |
| U.S. Agencies                    | \$ -                | -                 | -  | -                 | -          | -                 |
| U.S. Treasury                    | -                   | -                 | -  | -                 | -          | -                 |
| State and political subdivisions | 9,687               | 631               | 2,635                                    | 170               | 12,322     | 801               |
| Foreign governments              | -                   | -                 | -  | -                 | -          | -                 |

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|  |            |        |         |        |           |         |
|--|------------|--------|---------|--------|-----------|---------|
| Public utilities                         | 312,575    | 21,485 | 84,474  | 10,045 | 397,049   | 31,530  |
| Corporate bonds                          | 518,841    | 52,581 | 278,975 | 65,623 | 797,816   | 118,204 |
| Mortgage-backed                          | 4,624      | 299    | 54,582  | 7,911  | 59,206    | 8,210   |
| Home equity                              | 5,901      | 559    | 19,657  | 8,974  | 25,558    | 9,533   |
| Manufactured housing                     | 17,507     | 1,404  | 7,024   | 2,386  | 24,531    | 3,790   |
| Total temporarily<br>impaired securities | \$ 869,135 | 76,959 | 447,347 | 95,109 | 1,316,482 | 172,068 |

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The table below presents the gross unrealized losses and fair values of the Company's available for sale securities by the length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2008.

|  | Less than 12 Months |                      | Available For Sale<br>12 Months or Greater |                      | Total         |                      |
|--|---------------------|----------------------|--|----------------------|---------------|----------------------|
|  | Fair<br>Value       | Unrealized<br>Losses | Fair<br>Value                              | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
| (In thousands)                           |                     |                      |  |                      |               |                      |
| Debt securities:                         |                     |                      |  |                      |               |                      |
| U.S. Agencies                            | \$ -                | -                    | -  | -                    | -             | -                    |
| U.S. Treasury                            | -                   | -                    | -  | -                    | -             | -                    |
| State and political<br>subdivisions      | 45,848              | 8,675                | 13,486                                     | 4,978                | 59,334        | 13,653               |
| Foreign governments                      | -                   | -                    | -  | -                    | -             | -                    |
| Public utilities                         | 148,901             | 9,286                | 105,498                                    | 15,799               | 254,399       | 25,085               |
| Corporate bonds                          | 560,028             | 56,214               | 367,933                                    | 70,754               | 927,961       | 126,968              |
| Mortgage-backed                          | -                   | -                    | 48,540                                     | 7,693                | 48,540        | 7,693                |
| Home equity                              | 2,289               | 2,624                | 6,862                                      | 2,102                | 9,151         | 4,726                |
| Manufactured housing                     | 9,456               | 988                  | 1,467                                      | 31                   | 10,923        | 1,019                |
| Total debt securities                    | 766,522             | 77,787               | 543,786                                    | 101,357              | 1,310,308     | 179,144              |
| Equity securities - public               | 2,057               | 577                  | 1,205                                      | 328                  | 3,262         | 905                  |
| Total temporarily<br>impaired securities | \$ 768,579          | 78,364               | 544,991                                    | 101,685              | 1,313,570     | 180,049              |

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(C) Transfer of Securities

During the three and nine months ended September 30, 2009, the Company made transfers totaling \$25.2 million and \$56.0 million, respectively, to the held to maturity category from securities available for sale. Lower holdings of securities available for sale reduce the Company's exposure to market price volatility while still providing securities available for liquidity and asset/liability management purposes. The transfers of securities were recorded at fair value in accordance with GAAP, which requires that the \$0.8 million unrealized holding gain at the date of the transfer continue to be reported in a separate component of stockholders' equity and be amortized over the remaining lives of the securities, as an adjustment of yield, in a manner consistent with the amortization of any premium or discount.

(10) FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the Company adopted FASB 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 FASB ASC 820, the Company has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a 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 include 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), preferred stock, certain equity securities, and over-the-counter derivative contracts. The Company's Level 2 liabilities consist of certain product-related embedded derivatives. 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 assumptions about the assumptions market participants would use in pricing an asset or liability. The Company's Level 3 assets include certain equity securities and certain less liquid or private fixed maturity debt securities where significant valuation inputs cannot be corroborated with observable market data. The Company's Level 3 liabilities consist of share-based compensation obligations. Valuations are estimated based on non-binding broker prices or internally developed valuation models or methodologies, discounted cash flow models and other similar techniques.

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The tables below provide additional information about the Company's assets and liabilities that are measured at fair value on a recurring basis:

| Description                           | Total               | September 30, 2009 |                  |               |
|---------------------------------------|---------------------|--------------------|------------------|---------------|
|                                       |                     | Level 1            | Level 2          | Level 3       |
| (In thousands)                        |                     |                    |                  |               |
| Debt securities, available for sale   | \$ 2,018,513        | -                  | 2,004,397        | 14,116        |
| Equity securities, available for sale | 14,736              | 5,289              | 2,290            | 7,157         |
| Derivatives                           | 66,987              | -                  | 66,987           | -             |
| <b>Total assets</b>                   | <b>\$ 2,100,236</b> | <b>5,289</b>       | <b>2,073,674</b> | <b>21,273</b> |
| Policyholder account balances (a)     | \$ 66,035           | -                  | 66,035           | -             |
| Other liabilities (b)                 | 5,803               | -                  | -                | 5,803         |
| <b>Total liabilities</b>              | <b>\$ 71,838</b>    | <b>-</b>           | <b>66,035</b>    | <b>5,803</b>  |

| Description                           | Total               | December 31, 2008 |                  |               |
|---------------------------------------|---------------------|-------------------|------------------|---------------|
|                                       |                     | Level 1           | Level 2          | Level 3       |
| (In thousands)                        |                     |                   |                  |               |
| Debt securities, available for sale   | \$ 1,731,583        | -                 | 1,721,341        | 10,242        |
| Equity securities, available for sale | 13,683              | 4,558             | 1,935            | 7,190         |
| Derivatives                           | 11,920              | -                 | 11,920           | -             |
| <b>Total assets</b>                   | <b>\$ 1,757,186</b> | <b>4,558</b>      | <b>1,735,196</b> | <b>17,432</b> |
| Policyholder account balances (a)     | \$ 19,377           | -                 | 19,377           | -             |
| Other liabilities (b)                 | 3,787               | -                 | -                | 3,787         |
| <b>Total liabilities</b>              | <b>\$ 23,164</b>    | <b>-</b>          | <b>19,377</b>    | <b>3,787</b>  |

(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.

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The tables below 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, 2009   |  |                 |                      |
|--|--|--|-----------------|----------------------|
|  | Debt<br>Securities,<br>Available<br>For Sale | Equity<br>Securities,<br>Available<br>For Sale | Total<br>Assets | Other<br>Liabilities |
|  | (In thousands)                               |  |                 |                      |
| Beginning balance of period  | \$ 7,545                                     | 7,157  | 14,702          | 2,557                |
| Total realized and unrealized gains (losses):  |  |  |                 |                      |
| Included in net income   | -  | -  | -               | 3,246                |
| Included in other comprehensive income   | 1,973  | -  | 1,973           | -                    |
| Purchases, sales, issuances and settlements, net   | (2)  | -  | (2)             | -                    |
| Transfers into Level 3   | 4,600  | -  | 4,600           | -                    |
| Balance at end of period   | \$ 14,116                                    | 7,157  | 21,273          | 5,803                |
| Amount of total gains for the period included<br>in net income attributable to the change<br>in unrealized gains relating to assets still<br>held at end of period | \$ -   | -  | -               | 3,246                |

|   | For the Three Months Ended September 30, 2008 |  |                 |                      |
|---|---|--|-----------------|----------------------|
|   | Debt<br>Securities,<br>Available<br>For Sale  | Equity<br>Securities,<br>Available<br>For Sale | Total<br>Assets | Other<br>Liabilities |
|   | (In thousands)                                |  |                 |                      |
| Beginning balance of period   | \$ 12,819                                     | 7,190  | 20,009          | 6,303                |
| Total realized and unrealized gains (losses):   |   |  |                 |                      |
| Included in net income  | -   | -  | -               | 2,413                |
| Included in other comprehensive loss  | 151   | -  | 151             | -                    |
| Purchases, sales, issuances and settlements, net  | (1)   | -  | (1)             | (879)                |
| Transfers into Level 3  | -   | -  | -               | -                    |
| Balance at end of period  | \$ 12,969                                     | 7,190  | 20,159          | 7,837                |
| Amount of total gains for the period included<br>in net income attributable to the change<br>in unrealized gains relating to assets still |   |  |                 |                      |

|                       |    |   |   |   |       |
|-----------------------|----|---|---|---|-------|
| held at end of period | \$ | - | - | - | 1,722 |
|-----------------------|----|---|---|---|-------|

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

|  | For the Nine Months Ended September 30, 2009 |  |                 |                      |
|--|--|--|-----------------|----------------------|
|  | Debt<br>Securities,<br>Available<br>For Sale | Equity<br>Securities,<br>Available<br>For Sale | Total<br>Assets | Other<br>Liabilities |
|  | (In thousands)                               |  |                 |                      |
| Beginning balance of period  | \$ 10,242                                    | 7,190  | 17,432          | 3,787                |
| Total realized and unrealized gains (losses):  |  |  |                 |                      |
| Included in net income   | -  | -  | -               | 2,062                |
| Included in other comprehensive loss   | (187)  | (33)   | (220)           | -                    |
| Purchases, sales, issuances and settlements, net   | (539)  | -  | (539)           | (46)                 |
| Transfers into Level 3   | 4,600  | -  | 4,600           | -                    |
| Balance at end of period   | \$ 14,116                                    | 7,157  | 21,273          | 5,803                |
| Amount of total gains for the period included<br>in net income attributable to the change<br>in unrealized gains relating to assets still<br>held at end of period | \$ -   | -  | -               | 1,970                |

|   | For the Nine Months Ended September 30, 2008 |  |                 |                      |
|---|--|--|-----------------|----------------------|
|   | Debt<br>Securities,<br>Available<br>For Sale | Equity<br>Securities,<br>Available<br>For Sale | Total<br>Assets | Other<br>Liabilities |
|   | (In thousands)                               |  |                 |                      |
| Beginning balance of period   | \$ 1,618                                     | 7,147  | 8,765           | 7,712                |
| Total realized and unrealized gains (losses):   |  |  |                 |                      |
| Included in net income  | -  | -  | -               | 2,893                |
| Included in other comprehensive loss  | (48)   | 43   | (5)             | -                    |
| Purchases, sales, issuances and settlements, net  | (525)  | -  | (525)           | (2,768)              |
| Transfers into Level 3  | 11,924                                       | -  | 11,924          | -                    |
| Balance at end of period  | \$ 12,969                                    | 7,190  | 20,159          | 7,837                |
| Amount of total gains for the period included<br>in net income attributable to the change<br>in unrealized gains relating to assets still |  |  |                 |                      |

|                       |    |   |   |   |       |
|-----------------------|----|---|---|---|-------|
| held at end of period | \$ | - | - | - | 2,358 |
|-----------------------|----|---|---|---|-------|

Realized gains (losses) on debt and equity securities are reported in the 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 stockholders' equity.

The fair value hierarchy classifications are reviewed each reporting period. Reclassification of certain financial assets and liabilities may result from 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.

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

|   | September 30, 2009 |                | December 31, 2008  |                |
|---|--------------------|----------------|--------------------|----------------|
|   | Carrying<br>Values | Fair<br>Values | Carrying<br>Values | Fair<br>Values |
| (In thousands)                                  |                    |                |                    |                |
| <b>ASSETS</b>                                   |                    |                |                    |                |
| Investments in debt and equity securities:      |                    |                |                    |                |
| Securities held to maturity                     | \$ 4,082,605       | 4,259,696      | 3,831,417          | 3,727,353      |
| Securities available for sale                   | 2,033,249          | 2,033,249      | 1,745,266          | 1,745,266      |
| Cash and short-term investments                 | 35,669             | 35,669         | 67,796             | 67,796         |
| Mortgage loans                                  | 88,986             | 88,474         | 90,733             | 90,884         |
| Policy loans                                    | 75,916             | 75,916         | 79,277             | 79,277         |
| Other loans                                     | 12,393             | 10,012         | 1,541              | 1,572          |
| Derivatives                                     | 66,987             | 66,987         | 11,920             | 11,920         |
| Life interest in Libbie Shearn<br>Moody Trust   | 1,061              | 12,775         | 1,302              | 12,775         |
| <b>LIABILITIES</b>                              |                    |                |                    |                |
| Deferred annuity contracts                      | \$ 4,569,483       | 4,216,482      | 4,324,702          | 3,997,005      |
| Immediate annuity and<br>supplemental contracts | 451,238            | 448,974        | 388,486            | 409,553        |

Investment securities. Fair values for investments in debt and equity securities are based on quoted market prices, where available. For securities not actively traded, fair values are estimated using values obtained from various independent pricing services. In the cases where prices are unavailable from these sources, values are estimated by discounting expected future cash flows using a current market rate applicable to the yield, credit quality, and maturity of the investments.

Cash and short-term investments. The carrying amounts reported in the balance sheet for these instruments approximate their fair values.

Mortgage and other loans. The fair values of performing mortgage and other loans are estimated by discounting scheduled cash flows through the scheduled maturities of the loans, using interest rates currently being offered for similar loans to borrowers with similar credit ratings. Fair values for significant nonperforming loans are based on recent internal or external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information.

Policy Loans. The carrying value of policy loans approximates fair values.

Derivatives. Fair values for indexed options are based on counterparty market prices.

Life interest in Libbie Shearn Moody Trust. The fair value of the life interest is estimated based on assumptions as to future distributions from the Trust over the life expectancy of Mr. Robert L. Moody. These estimated cash flows were discounted at a rate consistent with uncertainties relating to the amount and timing of future cash distributions. However, the Company has limited the fair value to the maximum amount to be received from insurance proceeds in the event of Mr. Moody's death.

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Annuity and supplemental contracts. Fair values for the Company's insurance contracts other than annuity contracts are not required to be disclosed. This includes the Company's traditional and universal life products. Fair values for immediate annuities without mortality features are based on the discounted future estimated cash flows using current market interest rates for similar maturities. Fair values for deferred annuities, including fixed-indexed annuities, are determined using estimated projected future cash flows discounted at the rate that would be required to transfer the liability in an orderly transaction. The fair values of liabilities under all insurance contracts are taken into consideration in the Company's overall management of interest rate risk, which minimizes exposure to changing interest rates through the matching of investment maturities with amounts due under insurance and annuity contracts.

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) RELATED PARTY TRANSACTIONS

During the third quarter of 2009 the Company established a \$40 million line of credit with Moody National Bank. Robert L. Moody, the Company's Chairman and Chief Executive Officer, also serves as Chairman of the Board and Chief Executive Officer of Moody National Bank. The terms of the line of credit were subject to the appropriate approvals by the Company's Audit Committee and Board of Directors.

(12) DERIVATIVE INVESTMENTS

Fixed-indexed 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 consolidated balance sheet. 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 that are 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-indexed 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 underlying index or indices performance and terms of

the contract.

The Company does not elect hedge accounting relative to these derivative instruments. The index options are reported at fair value in the accompanying 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 statement of earnings. Any changes relative to the embedded derivatives associated with policy contracts are reflected in contract interest in the condensed consolidated statement 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 statement of earnings.

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

The tables below present the fair value of derivative instruments as of September 30, 2009 and December 31, 2008, respectively.

|   | September 30, 2009         |                           |                                      |                           |
|---|----------------------------|---------------------------|--------------------------------------|---------------------------|
|   | Asset Derivatives          |                           | Liability Derivatives                |                           |
|   | Balance Sheet Location     | Fair Value (In thousands) | Balance Sheet Location               | Fair Value (In thousands) |
| Derivatives not designated as hedging instruments |                            |                           |                                      |                           |
| Equity index options                              | Derivatives, Index Options | \$ 66,987                 |                                      |                           |
|   |                            |                           | Universal Life and Annuity Contracts | \$ 66,035                 |
| Fixed-indexed products                            |                            |                           |                                      |                           |
| <b>Total</b>                                      |                            | <b>\$ 66,987</b>          |                                      | <b>\$ 66,035</b>          |

|   | December 31, 2008      |                           |                        |                           |
|---|------------------------|---------------------------|------------------------|---------------------------|
|   | Asset Derivatives      |                           | Liability Derivatives  |                           |
|   | Balance Sheet Location | Fair Value (In thousands) | Balance Sheet Location | Fair Value (In thousands) |
| Derivatives not designated as hedging instruments |                        |                           |                        |                           |
| Equity index options                              | Derivatives,           | \$ 11,920                 |                        |                           |

| Index Options          |           | Universal Life and Annuity Contracts |        |
|------------------------|-----------|--------------------------------------|--------|
| Fixed-indexed products |           | \$                                   | 19,377 |
| Total                  | \$ 11,920 | \$                                   | 19,377 |

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 (UNAUDITED)

The table below presents the effect of derivative instruments in the condensed consolidated statement of earnings for the nine months ended September 30, 2009.

| Derivatives Not Designated as<br>Hedging Instruments Under SFAS No.<br>133 | Location of Gain or (Loss) Recognized<br><br>In Income on Derivatives | Amount of Gain<br>or (Loss)<br>Recognized In<br>Income on<br><br>Derivatives<br>(In thousands) |
|--|---|--|
| Equity index options   | Net investment income   | \$ 23,766  |
| Fixed-indexed products   | Universal life and annuity contract<br>interest                       | (35,762)   |
|  |   | \$ (11,996)  |

## (13) SUBSEQUENT EVENTS

Subsequent events have been evaluated through November 9, 2009, which is the date that the financial statements have been issued and no items were identified.

Table of ContentsITEM 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 Insurance Company (“Company”) or its subsidiaries is 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, the Company, as a matter of policy, 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 financial condition and results of operations (“MD&A”) of National Western Life Insurance Company for the three and nine months ended September 30, 2009 follows. 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.

## Overview

The Company 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 contractholders both domestically and internationally. The Company accepts funds from policyholders or contractholders and establishes a liability representing future obligations to pay the policy or contractholders 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, the underlying economics and relevant factors affecting the life insurance industry include the following:

- level of premium revenues collected
- persistency of policies and contracts
- returns on investments
- investment credit quality
- levels of policy benefits and costs to acquire business
- effect of interest rate changes on revenues and investments including asset and liability matching
- adequate levels of capital and surplus

The Company monitors these factors continually as key business indicators. The discussion that follows in this Item includes these indicators and presents information useful to an overall understanding of the Company’s business performance in 2009, incorporating required disclosures in accordance with the rules and regulations of the Securities and Exchange Commission.

## Insurance Operations - Domestic



The Company is currently licensed to do business in all states except for New York. Products marketed are annuities, universal life insurance, fixed-indexed annuities and fixed-indexed 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-indexed annuities. Most of these annuities can be sold as tax qualified or nonqualified products. At September 30, 2009, the Company maintained approximately 119,000 annuity policies in force.

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The Company 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 currently has approximately 6,500 independent agents contracted. Roughly 29% of these contracted agents have submitted policy applications to the Company in the past twelve months.

## Insurance Operations - International

The Company's international operations focus on foreign nationals in upper socioeconomic classes. Insurance products are issued primarily to residents of countries in Central and South America, the Caribbean, Eastern Europe, Asia and the Pacific Rim. 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, 2009, the Company had approximately 71,900 international life insurance policies in force representing approximately \$15.8 billion in face amount of coverage.

International applications are submitted by independent contractor consultants and broker-agents. The Company has approximately 4,200 independent international consultants and brokers currently contracted, 43% of which have submitted policy applications to the Company in the past twelve months.

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, the Company 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 almost entirely in United States dollars. The Company's over forty years of experience with the international products and its longstanding independent consultant and broker-agents relationships further serve to minimize risks.

## SALES

## Life Insurance

The following table sets forth information regarding the Company'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.

|                     | September 30,<br>Three Months Ended |       | September 30,<br>Nine Months Ended |        |
|---------------------|-------------------------------------|-------|------------------------------------|--------|
|                     | 2009                                | 2008  | 2009                               | 2008   |
|                     | (In thousands)                      |       |                                    |        |
| International:      |                                     |       |                                    |        |
| Universal life      | \$ 3,490                            | 2,346 | 5,316                              | 5,988  |
| Traditional life    | 759                                 | 1,404 | 3,051                              | 4,137  |
| Equity-indexed life | 3,259                               | 5,396 | 12,061                             | 16,829 |

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|                     |          |        |        |        |
|---------------------|----------|--------|--------|--------|
|                     | 7,508    | 9,146  | 20,428 | 26,954 |
| Domestic:           |          |        |        |        |
| Universal life      | 170      | 2,848  | 604    | 5,780  |
| Traditional life    | 39       | 45     | 112    | 116    |
| Equity-indexed life | 383      | 833    | 1,910  | 4,057  |
|                     | 592      | 3,726  | 2,626  | 9,953  |
| Totals              | \$ 8,100 | 12,872 | 23,054 | 36,907 |

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Life insurance sales as measured by annualized first year premiums declined 37% in the third quarter of 2009 as compared to the third quarter of 2008 and declined by the same percentage for the first nine months of 2009 compared to the same period in 2008. Both of the Company's life insurance lines of business, international and domestic, posted decreases over the comparable results in 2008 with international sales 18% and 24% lower for the three and nine month periods ended September 30, 2009, respectively, and domestic life sales down 84% and 74% for the same three and nine month periods.

Management has placed considerable emphasis on building domestic life insurance sales over the past several years as a strategic focus for future growth. This focus was partially in response to comments from outside rating agencies who expressed a preference for a greater proportion of overall Company earnings to derive from the life insurance line of business. The Company's domestic operations have historically been more heavily skewed toward annuity sales than life insurance sales. The Company spent the greater part of 2003 and 2004 revamping its domestic life operations by changing the way it contracts distribution for life business, eliminating products and distribution that had not contributed significantly to earnings, and creating new and competitive products. A single premium universal life ("SPUL") product was launched at the end of 2003 beginning a diversification of the Company's product portfolio away from smaller dollar face amount policies. The Company released its first fixed equity-indexed universal life ("EIUL") product for its domestic markets at the end of 2005 and this product has subsequently accounted annually for 40% to 70% of domestic life insurance sales.

The Company developed hybrids of the initial EIUL and SPUL products, combining features, and discontinued the marketing of smaller premium and volume life insurance policies. As a result, the Company attracted new independent distributors with access to customers purchasing larger face amounts of insurance per policy. During the latter part of 2008, the Company's internal checking and monitoring procedures detected potential instances of rebating in certain domestic geographic markets and instituted commission caps and other preventive procedures to discourage this practice. Although not illegal in these markets, the practice of rebating is particularly prone to large face amount policies not renewing premium payments beyond the initial year of the policy. The Company's actions discouraged sales of larger face amounts resulting in lower sales levels and amounts of insurance per policy as shown below.

|                                      | Average New Policy Face Amount |               |
|--------------------------------------|--------------------------------|---------------|
|                                      | Domestic                       | International |
| Year ended December 31, 2004         | 101,700                        | 234,500       |
| Year ended December 31, 2005         | 137,900                        | 245,900       |
| Year ended December 31, 2006         | 315,800                        | 254,700       |
| Year ended December 31, 2007         | 416,800                        | 251,000       |
| Year ended December 31, 2008         | 455,200                        | 272,000       |
| Nine months ended September 30, 2009 | 191,900                        | 307,000       |

In addition to the action taken above by the Company, the U.S. economic climate has had a significant impact upon life insurance sales industry wide. The financial burdens associated with the current climate evidenced by loss of employment, higher debt levels, a reduction in wealth through home and financial holdings declines in value, and a higher propensity to save versus spending have resulted in dramatically reduced purchases of life insurance in 2009.

The Company's international life business consists of applications submitted from residents in 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 from residents in various countries; however, the appeal of the Company's dollar-denominated life insurance products overcomes many of the local and national difficulties. In the "financial crisis" economic climate of the past 18 to 24 months, individuals in countries outside of the United States have become increasingly leery of the U.S. economy and

the stability of financial institutions and markets. These concerns have manifested in the past several quarters via reduced international sales.

Applications submitted from residents of Latin America and the Pacific Rim perennially have comprised the majority of the Company's international life insurance sales. Over the past few years, new sales efforts were directed toward the sale of a traditional endowment form of life insurance product for residents of Eastern European and the Commonwealth of Independent States (former Soviet Union). While these territories initially demonstrated solid growth potential recent activity has been more muted. 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.

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|                                    | Nine Months Ended September 30, |        |
|------------------------------------|---------------------------------|--------|
|                                    | 2009                            | 2008   |
| Percentage of International Sales: |                                 |        |
| Latin America                      | 74.5%                           | 70.3%  |
| Pacific Rim                        | 18.7                            | 17.9   |
| Eastern Europe                     | 6.8                             | 11.8   |
| Totals                             | 100.0%                          | 100.0% |

Year-to-date, the Company has recorded sales to residents outside of the United States in over thirty different countries with Brazil (22%), Taiwan (18%), and Colombia (10%) making up the largest markets.

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

|                       | Insurance In Force as of September 30, |            |
|-----------------------|--|------------|
|                       | 2009                                   | 2008       |
|                       | (\$ in thousands)                      |            |
| Universal life:       |  |            |
| Number of policies    | 67,220                                 | 71,170     |
| Face amounts          | \$ 7,621,240                           | 7,981,090  |
| Traditional life:     |  |            |
| Number of policies    | 47,630                                 | 49,940     |
| Face amounts          | \$ 2,280,650                           | 2,018,640  |
| Fixed-indexed life:   |  |            |
| Number of policies    | 27,690                                 | 28,040     |
| Face amounts          | \$ 6,425,170                           | 6,449,450  |
| Rider face amounts    | \$ 2,123,380                           | 2,187,710  |
| Total life insurance: |  |            |
| Number of policies    | 142,540                                | 149,150    |
| Face amounts          | \$ 18,450,440                          | 18,636,890 |

## 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 the Company's sales productivity.

|                          | Three Months Ended September 30, |        | Nine Months Ended September 30, |         |
|--------------------------|----------------------------------|--------|---------------------------------|---------|
|                          | 2009                             | 2008   | 2009                            | 2008    |
|                          | (In thousands)                   |        |                                 |         |
| Fixed-indexed annuities  | \$ 134,166                       | 51,069 | 357,505                         | 208,056 |
| Other deferred annuities | 96,961                           | 36,760 | 202,034                         | 81,316  |
| Immediate annuities      | 6,485                            | 1,633  | 15,781                          | 4,239   |

|        |    |         |        |         |         |
|--------|----|---------|--------|---------|---------|
| Totals | \$ | 237,612 | 89,462 | 575,320 | 293,611 |
|--------|----|---------|--------|---------|---------|

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Annuity sales for the third quarter of 2009 were 166% higher than the comparable period in 2008 and increased 96% for the nine months ended September 30, 2009 versus the same period in 2008. Since 2003, when the Company achieved nearly \$1.2 billion in sales, annuity new business had been trending lower due to a combination of declining interest rates, investors returning to alternative investment vehicles, rating agency concerns regarding the percentage of new business derived from the annuity line of business, and the Company managing its targeted levels of risk and statutory capital and surplus. In addition, during a large portion of the past several years the interest rate yield curve has either been inverted (shorter term rates higher than longer term rates) or relatively flat. In such an interest rate environment, consumers tend toward short term investment vehicles such as bank certificates of deposits rather than longer term choices which include fixed rate annuities.

The recessionary contraction and financial market crisis that began in the latter half of 2007 impacted many annuity carriers in the industry. Losses from investment impairments as well as equity exposure through variable annuity product offerings crippled the capital position of numerous insurers and limited their ability to write new business. The Company's substantial capital position achieved through ongoing operating profitability and limited investment loss exposure positioned it to write additional levels of annuity new business. The sales increase in the first nine months of 2009 over the first nine months of 2008 is indicative of the Company's enhanced competitive position in the marketplace. In addition, during the second quarter of 2009 the Company received a rating increase from A.M. Best to "A" (Excellent) further advancing the attractiveness of the Company's product offerings. 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 increased sales activity.

The Company's mix of annuity sales tends to shift with interest rate levels and the relative performance of the equity market. Over the past several years, sales of fixed-indexed products have consistently accounted for more than one-half of all annuity sales and were 62% of annuity activity during the first nine months of 2009. For all fixed-indexed products, the Company purchases over the counter 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-indexed products also provide the contractholder the alternative to elect a fixed interest rate crediting option. With the performance of the equity markets over the past two years, an increasing percentage of fixed-indexed contractholders have elected this crediting option.

The level of annuity sales volume the past several years has required a greater level of asset/liability analysis. The Company monitors its asset/liability matching within the self-constraints of desired capital levels and risk tolerance. Despite the amounts of new business, the Company's capital level remains substantially above industry averages and regulator targets.

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

|                         | Annuities In Force as of September 30, |           |
|-------------------------|--|-----------|
|                         | 2009                                   | 2008      |
|                         | (\$ in thousands)                      |           |
| Fixed-indexed annuities |  |           |
| Number of policies      | 35,540                                 | 32,910    |
| GAAP annuity reserves   | \$ 2,226,450                           | 1,987,660 |



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|                          |              |           |
|--------------------------|--------------|-----------|
| Other deferred annuities |              |           |
| Number of policies       | 67,940       | 70,760    |
| GAAP annuity reserves    | \$ 2,343,040 | 2,353,300 |
| Immediate annuities      |              |           |
| Number of policies       | 15,510       | 14,200    |
| GAAP annuity reserves    | \$ 378,170   | 302,520   |
| Total annuities          |              |           |
| Number of policies       | 118,990      | 117,870   |
| GAAP annuity reserves    | \$ 4,947,660 | 4,643,480 |

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### Critical Accounting Policies

Accounting policies discussed below are those considered critical to an understanding of the Company's financial statements.

**Impairment of Investment Securities.** The Company's accounting policy requires that a decline in the value of a security below its amortized cost basis be evaluated to determine if the decline is other-than-temporary. The primary factors considered in evaluating whether a decline in value for fixed income and equity securities is other-than-temporary include: (a) the length of time and the extent to which the fair value has been less than cost, (b) the reasons for the decline in value (credit event, interest rate related, credit spread widening), (c) the overall financial condition as well as the near-term prospects of the issuer, (d) whether the debtor is current on contractually obligated principal and interest payments, and (e) whether the Company has the intent to sell, or if it is more likely than not that it will be required to sell, the investment prior to a market price recovery. In addition, certain securitized financial assets with contractual cash flows are evaluated periodically by the Company to update the estimated cash flows over the life of the security. If the Company determines that the fair value of the securitized financial asset is less than its carrying amount and there has been a decrease in the present value of the estimated cash flows since the previous purchase or prior impairment, then an other-than-temporary impairment charge is recognized. The Company would recognize impairment of securities due to non credit related events in earnings only if it had the intent to sell or believes that is more likely than not that it will be required to sell the securities prior to market price recovery or maturity. When a security is deemed to be impaired, the portion of the impairment that is deemed to be credit is charged to the income statement and the cost basis of the investment is reduced. The portion of the impairment that is deemed to be non-credit is charged to other comprehensive income (loss). Once an impairment charge has been recorded, the fair value of the impaired investment becomes its new cost basis and the Company continues to review the other-than-temporarily impaired security for appropriate valuation on an ongoing basis. However, the new cost basis of an impaired security is not adjusted for subsequent increases in estimated fair value.

**Deferred Acquisition Costs ("DAC").** The Company is required to defer certain policy acquisition costs and amortize them over future periods. These costs include commissions and certain other expenses that vary with and are primarily associated with acquiring new business. The deferred costs are recorded as an asset commonly referred to as deferred policy acquisition costs. The DAC asset balance is subsequently charged to income over the lives of the underlying contracts in relation to the anticipated emergence of revenue or profits. Actual revenue or profits can vary from Company estimates resulting in increases or decreases in the rate of amortization. The Company does regular evaluations to determine if actual experience or other evidence suggests that earlier estimates should be revised. Assumptions considered significant include surrender and lapse rates, mortality, expense levels, investment performance, and estimated interest spread. Should actual experience dictate that the Company change assumptions regarding the emergence of future revenues or profits (commonly referred to as "unlocking"), the Company would record a charge or credit to bring its DAC balance to the level it would have been if using the new assumptions from the inception date of each policy.

DAC is also subject to periodic recoverability and loss recognition testing. These tests ensure that the present value of future contract-related cash flows will support the capitalized DAC balance to be amortized in the future. The present value of these cash flows, less the benefit reserve, is compared with the unamortized DAC balance and if the DAC balance is greater, the deficiency is charged to expense as a component of amortization and the asset balance is reduced to the recoverable amount.

**Deferred Sales Inducements.** Costs related to sales inducements offered on sales to new customers, principally on investment type contracts and primarily in the form of additional credits to the customer's account value or enhancements to interest credited for a specified period, which are beyond amounts currently being credited to existing contracts, are deferred and recorded as other assets. All other sales inducements are expensed as incurred and

included in interest credited to contract holders' funds. Deferred sales inducements are amortized to income using the same methodology and assumptions as DAC, and are included in interest credited to contract holders' funds. Deferred sales inducements are periodically reviewed for recoverability.

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**Future Policy Benefits.** Because of the long-term nature of insurance contracts, the Company is liable for policy benefit payments many years into the future. The liability for future policy benefits represents estimates of the present value of the Company's expected benefit payments, net of the related present value of future net premium collections. For traditional life insurance contracts, this is determined by standard actuarial procedures, using assumptions as to mortality (life expectancy), morbidity (health expectancy), persistency, and interest rates, which are based on the Company's experience with similar products. The assumptions used are those considered to be appropriate at the time the policies are issued. An additional provision is made on most products to allow for possible adverse deviation from the assumptions assumed. For universal life and annuity products, the Company's liability is the amount of the contract's account balance. Account balances are also subject to minimum liability calculations as a result of minimum guaranteed interest rates in the policies. While management and Company actuaries have used their best judgment in determining the assumptions and in calculating the liability for future policy benefits, there is no assurance that the estimate of the liabilities reflected in the financial statements represents the Company's ultimate obligation. In addition, significantly different assumptions could result in materially different reported amounts.

**Revenue Recognition.** Premium income for the Company's traditional life insurance contracts is generally recognized as the premium becomes due from policyholders. For annuity and universal life contracts, the amounts collected from policyholders are considered deposits and are not included in revenue. For these contracts, fee income consists of policy charges for policy administration, cost of insurance charges and surrender charges assessed against policyholders' account balances which are recognized in the period the services are provided.

Investment activities of the Company are integral to its insurance operations. Since life insurance benefits may not be paid until many years into the future, the accumulation of cash flows from premium receipts are invested with income reported as revenue when earned. Anticipated yields on investments are reflected in premium rates, contract liabilities, and other product contract features. These anticipated yields are implied in the interest required on the Company's net insurance liabilities (future policy benefits less deferred acquisition costs) and contractual interest obligations in its insurance and annuity products. The Company benefits to the extent actual net investment income exceeds the required interest on net insurance liabilities and manages the rates it credits on its products to maintain the targeted excess or "spread" of investment earnings over interest credited. The Company will continue to be required to provide for future contractual obligations in the event of a decline in investment yield. For more information concerning revenue recognition, investment accounting, and interest sensitivity, please refer to Note 1, Summary of Significant Accounting Policies and Note 9, Investments, in the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K.

**Pension Plans and Other Postretirement Benefits.** The Company sponsors a qualified defined benefit pension plan, covering substantially all employees, which was frozen effective December 31, 2007, and three nonqualified defined benefit plans covering certain senior officers. In addition, the Company has postretirement health care benefits for certain senior officers. The freeze of the qualified benefit pension plan 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. In accordance with prescribed accounting standards, the Company annually reviews plan assumptions.

The Company annually reviews its pension benefit plans assumptions which include the discount rate, the expected long-term rate of return on plan assets, and the compensation increase rate. The assumed discount rate is set based on the rates of return on high quality long-term fixed income investments currently available and expected to be available during the period to maturity of the pension benefits. The assumed long-term rate of return on plan assets is generally set at the rate expected to be earned based on the long-term investment policy of the plans, the various classes of the invested funds, based on the input of the plan's investment advisors and consulting actuary, and the plan's historic rate of return. The compensation rate increase assumption is generally set at a rate consistent with current and expected long-term compensation and salary policy, including inflation. These assumptions involve uncertainties and judgment,

and therefore actual performance may not be reflective of the assumptions.

Other postretirement benefit assumptions include future events affecting retirement age, mortality, dependency status, per capita claims costs by age, health care trend rates, and discount rates. Per capita claims cost by age is the current cost of providing postretirement health care benefits for one year at each age from the youngest age to the oldest age at which plan participants are expected to receive benefits under the plan. Health care trend rates involve assumptions about the annual rate(s) of change in the cost of health care benefits currently provided by the plan, due to factors other than changes in the composition of the plan population by age and dependency status. These rates implicitly consider estimates of health care inflation, changes in utilization, technological advances and changes in health status of the participants.

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Share-Based Payments. Liability awards under a share-based payment arrangement have been measured based on the award's fair value at the reporting date. The Black-Scholes valuation method has been used to estimate the fair value of the options. This fair value calculation of the options include assumptions relative to the following:

|  |                            |
|--|----------------------------|
|  | • exercise price           |
| • expected term based on contractual term and perceived future behavior relative to exercise |                            |
|  | • current price            |
|  | • expected volatility      |
|  | • risk-free interest rates |
|  | • expected dividends       |

These assumptions are continually reviewed by the Company and adjustments may be made based upon current facts and circumstances.

Other significant accounting policies, although not involving the same level of measurement uncertainties as those discussed above, but nonetheless important to an understanding of the financial statements, are described in Note 1, Summary of Significant Accounting Policies in Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K.

#### Impact of Recent Business Environment

The financial markets began experiencing stress during the second half of 2007 which significantly increased during 2008 and on into 2009. The volatility and disruption in the financial markets caused the availability and cost of credit to be materially affected. Combined with volatile oil prices, depressed home prices, increasing foreclosures, fluctuating equity market values, declining business and consumer confidence, and higher unemployment, these factors precipitated a severe recession that continued through the first half of 2009. The combination of economic conditions began to negatively impact our sales in 2008, particularly in the international markets, and continued to adversely impact the demand for our life products during the first half of 2009. While financial and economic markets have appeared to stabilize, we may continue to experience a higher incidence of claims, lapses or surrenders of policies.

The fixed income markets, our primary investment source, are experiencing a high level of volatility. Although market liquidity conditions have recently shown signs of improvement in some sectors, credit downgrade events have continued and there is an increased probability of default for many fixed income instruments. These volatile market conditions have also increased the difficulty of valuing certain securities as trading is less frequent and/or market data is less observable. Certain securities that were in active markets with significant observable data became illiquid due to the current financial environment resulting in valuations that require greater estimation and judgment as well as valuation methods which are more complex. Such valuations may not ultimately be realizable in a market transaction and may change very rapidly as market conditions change and valuation assumptions need to be modified.

Credit spreads (difference between bond yields and risk-free interest rates) on fixed maturity securities have narrowed from the abnormally high levels during 2008 and the early part of 2009. While the increase in credit spreads generated higher yields making our products more attractive to consumers, the higher rate levels caused a reduction in the carrying value of our marked-to-market investments in 2008 negatively impacting our financial condition and reported book value per share. The narrowing of credit spreads coincides with early signs that the economy and the financial markets are starting to stabilize. Consequently, during the nine months ended September 30, 2009, the fair value of our mark to market securities showed an increase from their year-end values.

Our operating strategy is to maintain capital levels substantially above regulatory and rating agency requirements. While not significant, our statutory capital levels were impacted during the first half of the year as a result of rating declines on some of our holdings.

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## RESULTS OF OPERATIONS

The Company's 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 derivatives and realized investment gains and losses from operating revenues and earnings. 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 derivatives 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 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 consolidated financial statements.

## Consolidated Operations

Revenues. The following details Company revenues.

|   | Three Months Ended September 30, |          | Nine Months Ended September 30, |          |
|---|----------------------------------|----------|---------------------------------|----------|
|   | 2009                             | 2008     | 2009                            | 2008     |
|   | (In thousands)                   |          |                                 |          |
| Traditional life and annuity premiums         | \$ 3,707                         | 4,057    | 12,227                          | 12,575   |
| Universal life and annuity contract revenues  | 37,683                           | 32,885   | 115,116                         | 98,696   |
| Net investment income (excluding derivatives) | 86,449                           | 84,093   | 256,859                         | 254,114  |
| Other income                                  | 5,086                            | 3,056    | 12,187                          | 9,348    |
| Operating revenues                            | 132,925                          | 124,091  | 396,389                         | 374,733  |
| Derivative income (loss)                      | 29,827                           | (14,511) | 23,766                          | (52,824) |
| Realized gains (losses) on investments        | 57                               | (21,620) | (5,122)                         | (21,931) |
| Total revenues                                | \$ 162,809                       | 87,960   | 415,033                         | 299,978  |

Traditional life and annuity premiums - Traditional life and annuity premiums decreased 8.6% and 2.8% for the three and nine months ended September 30, 2009, respectively, compared to the same periods in 2008. Traditional life insurance premiums for products such as whole life and term life are recognized as revenues over the premium-paying period. These are products that supplement the Company's main core offering of universal life products particularly fixed-indexed universal life products.

Universal life and annuity contract revenues - Revenues for universal life and annuity contract revenues increased 14.6% and 16.6% for the three and nine months ended September 30, 2009 compared to the same periods in 2008, and consist of policy charges for the cost of insurance, administration charges, and surrender charges assessed against policyholder account balances. Revenues in the form of cost of insurance charges were flat versus the prior year at



\$20.7 million and \$62.8 million for the three and nine months ended September 30, 2009 compared to \$21.0 million and \$62.8 million for the three and nine months ended September 30, 2008. Surrender charges assessed against policyholder account balances upon withdrawal increased to \$12.8 million and \$39.9 million for the three and nine months ended September 30, 2009 versus \$9.6 million and \$28.2 million for the three and nine months ended September 30, 2008, indicative of a higher incidence of policy withdrawals and terminations.

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Net investment income - A detail of net investment income is provided below.

|  | Three Months Ended September 30, |               | Nine Months Ended September 30, |                |
|--|----------------------------------|---------------|---------------------------------|----------------|
|  | 2009                             | 2008          | 2009                            | 2008           |
|  | (In thousands)                   |               |                                 |                |
| Gross investment income:                             |                                  |               |                                 |                |
| Debt securities                                      | \$ 83,308                        | 80,963        | 245,960                         | 241,013        |
| Mortgage loans                                       | 1,305                            | 1,827         | 5,144                           | 5,727          |
| Policy loans   | 1,472                            | 1,539         | 4,391                           | 4,593          |
| Short-term investments                               | 17                               | 204           | 107                             | 872            |
| Other invested assets                                | 1,314                            | 311           | 4,176                           | 3,968          |
| <b>Total investment income</b>                       | <b>87,416</b>                    | <b>84,844</b> | <b>259,778</b>                  | <b>256,173</b> |
| Investment expenses                                  | 967                              | 751           | 2,919                           | 2,059          |
| <b>Net investment income (excluding derivatives)</b> | <b>86,449</b>                    | <b>84,093</b> | <b>256,859</b>                  | <b>254,114</b> |
| Derivative gain (loss)                               | 29,827                           | (14,511)      | 23,766                          | (52,824)       |
| <b>Net investment income</b>                         | <b>\$ 116,276</b>                | <b>69,582</b> | <b>280,625</b>                  | <b>201,290</b> |

Income from other invested assets for the nine months ended September 30, 2008 includes a settlement payment of \$0.9 million from a previously impaired and sold security. Derivative income and losses are recorded as a component of investment income but may fluctuate substantially from period to period based on the performance of the underlying indices. See the Derivative income (loss) section for more detailed information relating to index options and derivatives.

To ensure the Company will be able to pay 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. For the nine months ended September 30, 2009, the Company's insurance operations purchased \$647.5 million of debt securities with a weighted average yield to maturity of 6.1% and average Standard and Poor's credit rating of "A".

Net investment income performance is summarized as follows:

|  | Nine Months Ended September 30, |           |
|--|---------------------------------|-----------|
|  | 2009                            | 2008      |
|  | (In thousands)                  |           |
| Excluding derivatives:                     |                                 |           |
| Net investment income                      | \$ 256,859                      | 254,114   |
| Average invested assets, at amortized cost | \$ 6,047,975                    | 5,797,940 |
| Annual yield on average invested assets    | 5.66%                           | 5.84%     |
| Including derivatives:                     |                                 |           |
| Net investment income                      | \$ 280,625                      | 201,290   |
| Average invested assets, at amortized cost | \$ 6,078,578                    | 5,849,156 |

|   |       |       |
|---|-------|-------|
| Annual yield on average invested assets | 6.16% | 4.59% |
|---|-------|-------|

As the Company's invested assets are substantially held in debt securities, the yield on average invested assets tends to move in conjunction with the yield on the debt securities portfolio. Although long-term interest rate levels were lower in the first nine months of 2009 compared to the first nine months of 2008, the relative increase in corporate spreads over treasury rates substantially offset the lower interest rate level such that long-term investment yields remained largely the same. Net investment income performance is analyzed excluding derivative income, which is a common practice in the insurance industry, in order to assess underlying profitability and results from ongoing operations.

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Other income - Other income primarily pertains to the Company's operations involving nursing homes in Reno, Nevada and San Marcos, Texas. Revenues associated with these operations were \$3.9 million and \$3.0 million for the three months ended September 30, 2009 and 2008, respectively, and \$10.7 million and \$9.1 million for the nine months ended September 30, 2009 and 2008, respectively. In addition, the Company received \$1.1 million from a lawsuit settlement during the three months ended September 30, 2009.

Derivative income (loss) - Index options are derivative financial instruments used to partially hedge the equity return component of the Company's fixed-indexed products. Index options are intended to act as economic hedges to match closely the returns on the products' underlying reference indices. With an increase or decline in these indices, the index option values likewise increase or decline. Any increases or decreases in income from these options are substantially offset by corresponding increases or decreases in amounts credited to fixed-indexed annuity and life policyholders. As such, income or loss from the sale or expiration of the options, as well as period-to-period changes in fair values, are reflected as a component of net investment income.

Derivative components included in net investment income and the corresponding contract interest amounts are detailed below.

|   | Three Months Ended September 30, |          | Nine Months Ended September 30, |          |
|---|----------------------------------|----------|---------------------------------|----------|
|   | 2009                             | 2008     | 2009                            | 2008     |
|   | (In thousands)                   |          |                                 |          |
| Derivatives:  |                                  |          |                                 |          |
| Unrealized income (loss)                              | \$ 43,553                        | 1,842    | 61,897                          | (19,447) |
| Realized loss   | (13,726)                         | (16,353) | (38,131)                        | (33,377) |
| Total income (loss) included in net investment income | \$ 29,827                        | (14,511) | 23,766                          | (52,824) |
| Total contract interest                               | \$ 80,609                        | 38,339   | 173,525                         | 98,511   |

Benefits and Expenses. The following details benefits and expenses.

|  | Three Months Ended September 30, |         | Nine Months Ended September 30, |         |
|--|----------------------------------|---------|---------------------------------|---------|
|  | 2009                             | 2008    | 2009                            | 2008    |
|  | (In thousands)                   |         |                                 |         |
| Life and other policy benefits               | \$ 19,965                        | 10,794  | 43,241                          | 28,905  |
| Amortization of deferred acquisition costs   | 28,436                           | 37,188  | 84,933                          | 93,699  |
| Universal life and annuity contract interest | 80,608                           | 38,339  | 173,525                         | 98,511  |
| Other operating expenses                     | 36,426                           | 17,905  | 65,770                          | 45,962  |
| Totals                                       | \$ 165,435                       | 104,226 | 367,469                         | 267,077 |

Life and other policy benefits - Death claims decreased to \$6.4 million for the three months ended September 30, 2009 from \$7.4 million for the corresponding period in 2008. Death claims increased to \$24.0 million during the nine

months ended September 30, 2009 from \$21.6 million for the corresponding period in 2008. While death claim amounts are subject to variation from period to period, the Company's mortality experience generally has been consistent with its product pricing assumptions.

The Company is implementing new actuarial reserving systems that will enhance its ability to provide better estimates used in establishing future policy liabilities, monitor the deferred acquisition cost asset and the deferred sales asset as well as support other actuarial processes within the Company. The implementation of these new reserving systems for specific blocks of business began in the second quarter of 2009 and is expected to be completed in 2010. As the Company applies these new systems to a line of business, current reserving assumptions are reviewed and updated as appropriate. During the three months ended September 30, 2009 Loss Recognition testing was performed on certain products that were converted to the new reserving system. As a result of the Loss Recognition testing, unlocking of historical assumptions resulted in a increase of \$11.6 million in reserves.

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Amortization of deferred acquisition costs - Life insurance companies are required to defer certain expenses associated with acquiring new business. The majority of these acquisition expenses consist of commissions paid to agents, underwriting costs, and certain marketing expenses and sales inducements. The Company defers sales inducements in the form of first year interest bonuses on annuity and universal life products that are directly related to the production of new business. These 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. Recognition of these deferred policy acquisition costs in the financial statements occurs over future periods in relation to the 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 these 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. During the three and nine months ending September 30, 2009 no unlocking was required for these lines of business. During the three and nine months ended September 30, 2008, the Company unlocked its assumptions with respect to certain annuity products where actual activity deviated from that assumed. As a result of unlocking, the unamortized deferred policy acquisition cost balance decreased by \$8.1 million. While the Company is required to evaluate its emergence of profits continually, management believes that the current amortization patterns of deferred policy acquisition costs are reflective of actual experience.

The implementation of the new systems noted above resulted in a benefit to the amortization of deferred acquisition costs for the three and nine months ended September 30, 2009 of \$3.1 million. Total amortization of deferred policy acquisition costs decreased \$8.8 million for the three and nine months ended September 30, 2009 due to this and the 2008 unlocking adjustment referred to above. Amortization reflects the current activity related to partial surrender rates, surrender rates, mortality rates, portfolio yield rates and crediting rates on deferred annuities and universal life products.

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 as described above. The difference between yields earned over policy credited rates is often referred to as the "interest spread".

The Company's approximated average credited rates are as follows:

|                         | September 30,<br>2009              |       | September 30,<br>2008              |       |
|-------------------------|------------------------------------|-------|------------------------------------|-------|
|                         | (Excluding derivative<br>products) |       | (Including derivative<br>products) |       |
| Annuity                 | 3.13%                              | 3.06% | 4.12%                              | 2.28% |
| Interest sensitive life | 2.83%                              | 4.04% | 5.21%                              | 3.30% |

Contract interest also includes the performance of the equity-indexed component of the Company's derivative products which resulted in gains of \$29.8 million and \$23.8 million in the three and nine months ended September 30, 2009 and losses of \$14.5 million and \$52.8 million in the three and nine months ended September 30, 2008. As previously noted, the market performance of these equity-index features is included in contract interest expense while also impacting the Company's investment income given the hedge nature of the options purchased for these products.

Other operating expenses - Other operating expenses consist of general administrative expenses, licenses and fees, commissions not subject to deferral, nursing home expenses and share based compensation costs. Nursing home expenses were \$4.0 million and \$10.6 million for the three and nine months ended September 30, 2009 and \$2.7 million and \$8.3 million for the three and nine months ended September 30, 2008. The increased expenses during 2009 are primarily attributable to the Company's second nursing home which opened during the three months ended September 30, 2009. Share based compensation costs for the Company's stock option plan related to outstanding vested and unvested options for the three and nine months ended September 30, 2009 totaled \$3.2 million and \$2.0 million compared to \$2.0 million and \$2.6 million for the corresponding periods in 2008.

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The Company is currently involved in various legal actions in the normal course of its business including two class action lawsuits. In accordance with generally accepted accounting principles, the Company accrued approximately \$16 million during the quarter ended September 30, 2009 pertaining to these various matters for potential future costs.

**Federal Income Taxes.** Federal income taxes on earnings from continuing operations reflect effective tax rates of 31.1% and 30.7% for the nine months ended September 30, 2009 and 2008, respectively. The effective tax rate is lower than the Federal rate of 35% primarily due to the amount of 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 months and nine months ended September 30, 2009 and 2008 is provided below. The segment earnings exclude realized gains and losses on investments, net of taxes.

|                            | Domestic<br>Life<br>Insurance | International<br>Life<br>Insurance | Annuities<br>(In thousands) | All<br>Others | Totals  |
|----------------------------|-------------------------------|------------------------------------|-----------------------------|---------------|---------|
| Segment earnings (losses): |                               |                                    |                             |               |         |
| Three months ended:        |                               |                                    |                             |               |         |
| September 30, 2009         | \$ (5,325)                    | 7,726                              | (8,139)                     | 4,587         | (1,151) |
| September 30, 2008         | \$ (247)                      | 1,958                              | 1,535                       | 1,007         | 4,253   |
| Nine months ended:         |                               |                                    |                             |               |         |
| September 30, 2009         | \$ (1,513)                    | 12,439                             | 16,824                      | 8,336         | 36,086  |
| September 30, 2008         | \$ 728                        | 10,499                             | 21,700                      | 4,116         | 37,043  |



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## 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, |               |
|---|----------------------------------|---------------|---------------------------------|---------------|
|   | 2009                             | 2008          | 2009                            | 2008          |
|   | (In thousands)                   |               |                                 |               |
| Premiums and other revenue:                       |                                  |               |                                 |               |
| Premiums and contract revenues                    | \$ 8,166                         | 6,798         | 27,123                          | 20,108        |
| Net investment income (loss)                      | (364)                            | 4,912         | 9,696                           | 15,103        |
| Other income                                      | 2                                | 3             | 22                              | 13            |
| <b>Total premiums and other revenue</b>           | <b>7,804</b>                     | <b>11,713</b> | <b>36,841</b>                   | <b>35,224</b> |
| Benefits and expenses:                            |                                  |               |                                 |               |
| Life and other policy benefits                    | 8,233                            | 3,569         | 16,388                          | 10,588        |
| Amortization of deferred policy acquisition costs | 1,136                            | 3,219         | 5,470                           | 7,574         |
| Universal life insurance contract interest        | 2,244                            | 2,249         | 6,742                           | 6,892         |
| Other operating expenses                          | 4,071                            | 3,070         | 10,450                          | 9,093         |
| <b>Total benefits and expenses</b>                | <b>15,684</b>                    | <b>12,107</b> | <b>39,050</b>                   | <b>34,147</b> |
| Segment earnings (loss) before                    |                                  |               |                                 |               |
| Federal income taxes                              | (7,880)                          | (394)         | (2,209)                         | 1,077         |
| Provision (benefit) for Federal income taxes      | (2,555)                          | (147)         | (696)                           | 349           |
| <b>Segment earnings (loss)</b>                    | <b>\$ (5,325)</b>                | <b>(247)</b>  | <b>(1,513)</b>                  | <b>728</b>    |

Revenues from domestic life insurance operations include life insurance premiums on traditional type products and revenues from universal life insurance. Revenues from traditional products are the 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.

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|                | Three Months Ended September 30,<br>2009 | 2008 | Nine Months Ended September 30,<br>2009 | 2008 |
|----------------|--|------|---|------|
| (In thousands) |  |      |   |      |

|                                     |                 |              |               |               |
|-------------------------------------|-----------------|--------------|---------------|---------------|
| Universal life insurance revenues   | \$ 8,195        | 6,901        | 25,561        | 19,279        |
| Traditional life insurance premiums | 1,276           | 1,301        | 5,231         | 4,232         |
| Reinsurance premiums                | (1,305)         | (1,404)      | (3,669)       | (3,403)       |
| <b>Totals</b>                       | <b>\$ 8,166</b> | <b>6,798</b> | <b>27,123</b> | <b>20,108</b> |

The Company's U.S. operations have made efforts over the past several years to attract new independent agents and to promote life products to improve domestic sales.

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Premiums collected on universal life products are not reflected as revenues in the Company's statements of earnings in accordance with GAAP. Actual universal life premiums collected are detailed below.

|                                | Three Months Ended September 30, |       | Nine Months Ended September 30, |        |
|--------------------------------|----------------------------------|-------|---------------------------------|--------|
|                                | 2009                             | 2008  | 2009                            | 2008   |
|                                | (In thousands)                   |       |                                 |        |
| Universal life insurance:      |                                  |       |                                 |        |
| First year and single premiums | \$ 2,224                         | 2,934 | 9,619                           | 10,411 |
| Renewal premiums               | 5,499                            | 4,659 | 16,876                          | 14,238 |
| Totals                         | \$ 7,723                         | 7,593 | 26,495                          | 24,649 |

## International Life Insurance Operations

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, |        |
|---|----------------------------------|--------|---------------------------------|--------|
|   | 2009                             | 2008   | 2009                            | 2008   |
|   | (In thousands)                   |        |                                 |        |
| Premiums and other revenue:                       |                                  |        |                                 |        |
| Premiums and contract revenues                    | \$ 25,706                        | 23,890 | 78,540                          | 72,116 |
| Net investment income                             | 18,362                           | 4,652  | 32,242                          | 12,696 |
| Other income                                      | 17                               | 13     | 55                              | 38     |
| Total premiums and other revenue                  | 44,085                           | 28,555 | 110,837                         | 84,850 |
| Benefits and expenses:                            |                                  |        |                                 |        |
| Life and other policy benefits                    | (1,141)                          | 5,765  | 10,957                          | 15,364 |
| Amortization of deferred policy acquisition costs | 10,495                           | 8,877  | 35,257                          | 27,278 |
| Universal life insurance contract interest        | 17,646                           | 4,664  | 31,846                          | 11,944 |
| Other operating expenses                          | 5,935                            | 6,597  | 14,615                          | 14,723 |
| Total benefits and expenses                       | 32,935                           | 25,903 | 92,675                          | 69,309 |
| Segment earnings before Federal income taxes      | 11,150                           | 2,652  | 18,162                          | 15,541 |

|                                       |          |       |        |        |
|---------------------------------------|----------|-------|--------|--------|
| Provision for Federal<br>income taxes | 3,424    | 694   | 5,723  | 5,042  |
| Segment earnings                      | \$ 7,726 | 1,958 | 12,439 | 10,499 |

International applications are submitted by independent contractor consultants and broker-agents. The Company has approximately 4,200 independent international consultants and brokers currently contracted.

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As with domestic operations, revenues from the international life insurance segment include both premiums on traditional type products and 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, |          |
|-------------------------------------|----------------------------------|---------|---------------------------------|----------|
|                                     | 2009                             | 2008    | 2009                            | 2008     |
|                                     | (In thousands)                   |         |                                 |          |
| Universal life insurance revenues   | \$ 26,653                        | 24,803  | 81,037                          | 72,668   |
| Traditional life insurance premiums | 3,185                            | 3,786   | 9,120                           | 10,840   |
| Reinsurance premiums                | (4,132)                          | (4,699) | (11,617)                        | (11,392) |
| Totals                              | \$ 25,706                        | 23,890  | 78,540                          | 72,116   |

Premiums collected on universal life products are not reflected as revenues in the Company's statements of earnings in accordance with GAAP. Actual universal life premiums collected are detailed below.

|                                | Three Months Ended September 30, |        | Nine Months Ended September 30, |         |
|--------------------------------|----------------------------------|--------|---------------------------------|---------|
|                                | 2009                             | 2008   | 2009                            | 2008    |
|                                | (In thousands)                   |        |                                 |         |
| Universal life insurance:      |                                  |        |                                 |         |
| First year and single premiums | \$ 9,547                         | 10,656 | 24,399                          | 30,607  |
| Renewal premiums               | 27,576                           | 26,465 | 74,247                          | 73,447  |
| Totals                         | \$ 37,123                        | 37,121 | 98,646                          | 104,054 |

The Company reported decreased premiums for fixed-indexed universal life products of \$30.0 million and \$47.5 million versus \$21.7 million and \$59.9 million for the first three and nine months of 2009 and 2008, respectively. Contract revenues have increased as the amount of international life insurance in force has grown from \$15.7 billion at September 30, 2008, to \$15.8 billion at September 30, 2009.

As previously noted, net investment income and contract interest include period-to-period changes in fair values pertaining to options purchased that are tied to the performance of the products underlying reference indices. The largest selling product in the international life insurance segment for the past five years has been an equity-indexed universal life policy with the equity component linked to the underlying indices. With the growth in this block of business, the period-to-period changes in fair values of the underlying options have had an increasingly greater impact on net investment and 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, |        |
|---|----------------------------------|-------|---------------------------------|--------|
|   | 2009                             | 2008  | 2009                            | 2008   |
|   | (In thousands)                   |       |                                 |        |
| Net investment income (excluding derivatives) | \$ 9,841                         | 7,614 | 25,243                          | 22,184 |

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|                          |    |        |         |        |         |
|--------------------------|----|--------|---------|--------|---------|
| Derivative income (loss) |    | 8,521  | (2,962) | 6,999  | (9,488) |
| Net investment income    | \$ | 18,362 | 4,652   | 32,242 | 12,696  |

Amortization of deferred policy acquisition costs increased approximately 29.3% comparing the first nine months of 2009 to the same period in 2008, and increased 18.2% for the three months ended September 30, 2009 versus the same period of 2008 reflecting higher lapse activity due to current economic conditions.

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## Annuity Operations

The Company's annuity operations are almost exclusively in the United States. Although some of the Company's annuity products and investment contracts are available to international residents, current sales are small relative to total annuity sales. A comparative analysis of results of operations for the Company's annuity segment is detailed below.

|   | Three Months Ended September 30, |               | Nine Months Ended September 30, |                |
|---|----------------------------------|---------------|---------------------------------|----------------|
|   | 2009                             | 2008          | 2009                            | 2008           |
|   | (In thousands)                   |               |                                 |                |
| Premiums and other revenue:                         |                                  |               |                                 |                |
| Premiums and contract revenues                      | \$ 7,518                         | 6,254         | 21,680                          | 19,047         |
| Net investment income                               | 91,072                           | 58,902        | 226,189                         | 168,205        |
| Other income  | 1,647                            | 46            | 1,860                           | 169            |
| <b>Total premiums and other revenue</b>             | <b>100,237</b>                   | <b>65,202</b> | <b>249,729</b>                  | <b>187,421</b> |
| Benefits and expenses:                              |                                  |               |                                 |                |
| Life and other benefits                             | 12,873                           | 1,460         | 15,896                          | 2,953          |
| Amortization of deferred policy acquisition costs   | 16,805                           | 25,092        | 44,206                          | 58,847         |
| Annuity contract interest                           | 60,718                           | 31,426        | 134,937                         | 79,675         |
| Other operating expenses                            | 22,391                           | 5,531         | 30,125                          | 13,826         |
| <b>Total benefits and expenses</b>                  | <b>112,787</b>                   | <b>63,509</b> | <b>225,164</b>                  | <b>155,301</b> |
| Segment earnings before Federal income (loss) taxes | (12,550)                         | 1,693         | 24,565                          | 32,120         |
| Provision (benefit) for Federal income taxes        | (4,411)                          | 158           | 7,741                           | 10,420         |
| <b>Segment earnings (loss)</b>                      | <b>\$ (8,139)</b>                | <b>1,535</b>  | <b>16,824</b>                   | <b>21,700</b>  |

Revenues from annuity operations primarily include surrender charges and recognition of deferred revenues relating to immediate or payout annuities. A comparative detail of the components of premiums and annuity contract revenues is provided below.

|  | Three Months Ended September 30, |      | Nine Months Ended September 30, |      |
|--|----------------------------------|------|---------------------------------|------|
|  | 2009                             | 2008 | 2009                            | 2008 |
|  | (In thousands)                   |      |                                 |      |

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|                                   |    |       |       |        |        |
|-----------------------------------|----|-------|-------|--------|--------|
| Surrender charges                 | \$ | 5,884 | 4,917 | 17,008 | 15,342 |
| Payout annuity and other revenues |    | 1,626 | 1,331 | 4,655  | 3,688  |
| Traditional annuity premiums      |    | 8     | 6     | 17     | 17     |
| Totals                            | \$ | 7,518 | 6,254 | 21,680 | 19,047 |

The Company's earnings are dependent upon annuity contracts persisting or remaining in force. While premium and contract revenues increase with an increase in surrender charges, the Company's investment earnings benefit as more policies remain in force.



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Deposits collected on annuity contracts are not reflected as revenues in the Company's statements of earnings in accordance with GAAP. Actual annuity deposits collected for the three and nine months ended September 30, 2009 and 2008 are detailed below.

|                          | Three Months Ended September 30, |        | Nine Months Ended September 30, |         |
|--------------------------|----------------------------------|--------|---------------------------------|---------|
|                          | 2009                             | 2008   | 2009                            | 2008    |
|                          | (In thousands)                   |        |                                 |         |
| Fixed-indexed annuities  | \$ 129,875                       | 60,701 | 347,901                         | 206,007 |
| Other deferred annuities | 94,540                           | 28,010 | 205,374                         | 87,014  |
| Immediate annuities      | 6,049                            | 1,475  | 14,813                          | 3,980   |
| Totals                   | \$ 230,464                       | 90,186 | 568,088                         | 297,001 |

Fixed-indexed product sales typically follow the stock market in that sales increase when confidence is high in the stock market and decline if the stock market is showing poor performance. However, in the current environment the Company's experience has shown a lower proportion of fixed-indexed annuity sales relative to other deferred annuity products which have a fixed interest rate of interest credited to the policy.

Other deferred annuity product sales have increased significantly for the three and nine month periods in 2009. As a selling inducement, many of the deferred products, as well as the fixed-indexed annuity products, include a first year interest bonus in addition to a base interest rate. These bonus rates are deferred in conjunction with other capitalized policy acquisition costs. The amount deferred and amortized over future periods amounted to approximately \$9.6 million and \$26.5 million for the three and nine months ended September 30, 2009, and \$4.0 million and \$14.2 million in the comparable periods of 2008.

A detail of net investment income for annuity operations is provided below.

|   | Three Months Ended September 30, |          | Nine Months Ended September 30, |          |
|---|----------------------------------|----------|---------------------------------|----------|
|   | 2009                             | 2008     | 2009                            | 2008     |
|   | (In thousands)                   |          |                                 |          |
| Net investment income (excluding derivatives) | \$ 70,893                        | 70,452   | 210,141                         | 211,541  |
| Derivative income (loss)                      | 20,179                           | (11,550) | 16,048                          | (43,336) |
| Net investment income                         | \$ 91,072                        | 58,902   | 226,189                         | 168,205  |

As noted previously, derivative income and loss fluctuate from period to period based on the performance of the products' underlying indices.

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Annuity contract interest includes the equity component return associated with the Company's fixed-indexed annuities. The detail of fixed-indexed annuity contract interest compared to contract interest for all other annuities is as follows:

|   | Three Months Ended September 30, |         | Nine Months Ended September 30, |          |
|---|----------------------------------|---------|---------------------------------|----------|
|   | 2009                             | 2008    | 2009                            | 2008     |
|   | (In thousands)                   |         |                                 |          |
| Fixed-indexed annuities                 | \$ 46,978                        | 21,614  | 104,854                         | 25,045   |
| All other annuities                     | 19,624                           | 11,439  | 46,137                          | 59,231   |
| Gross contract interest                 | 66,602                           | 33,053  | 150,991                         | 84,276   |
| Bonus interest deferred and capitalized | (9,608)                          | (4,026) | (26,547)                        | (14,182) |
| Bonus interest amortization             | 3,724                            | 2,399   | 10,493                          | 9,581    |
| Total contract interest                 | \$ 60,718                        | 31,426  | 134,937                         | 79,675   |

Contract interest includes the portion of its return on fixed interest products associated with the performance of the underlying indices.

Amortization of deferred policy acquisition costs decreased approximately 33.0% and 24.9% comparing the three and nine months of 2009 to the same periods in 2008. During 2008, the Company experienced an increased conversion activity of deferred annuities into payout annuities, which resulted in a higher amortization for the three and nine months ended September 30, 2008. Current year amounts should be more reflective of ongoing activity.

The Company is currently involved in various legal actions in the normal course of its business including two class action lawsuits. In accordance with generally accepted accounting principles, the Company accrued approximately \$16 million during the quarter ended September 30, 2009 pertaining to these various matters for potential future costs, which was allocated to the annuity operations segment.

#### Other Operations

National Western's primary business encompasses its domestic and international life insurance operations and its annuity operations. However, as previously noted, National Western also has small real estate, nursing homes, and other investment operations through its wholly-owned subsidiaries. Nursing home operations generated \$0.2 million and \$0.8 million of operating earnings in the first nine months of 2009 and 2008, respectively.

#### INVESTMENTS

##### General

The Company's investment philosophy emphasizes the careful handling of policyowners' and stockholders' funds to achieve security of principal, to obtain the maximum possible yield while maintaining security of principal, and to maintain liquidity in a measure consistent with current and long-term requirements of the Company.



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The Company's overall conservative investment philosophy is reflected in the allocation of its investments, which is detailed below as of September 30, 2009 and December 31, 2008. The Company emphasizes investment grade debt securities, with smaller holdings in mortgage loans and policy loans.

|                            | Composition of Investments       |              |                                  |              |
|----------------------------|----------------------------------|--------------|----------------------------------|--------------|
|                            | September 30, 2009               |              | December 31, 2008                |              |
|                            | Carrying Value<br>(In thousands) | %            | Carrying Value<br>(In thousands) | %            |
| Debt securities            | \$ 6,101,118                     | 95.7         | \$ 5,563,000                     | 96.3         |
| Mortgage loans             | 88,986                           | 1.5          | 90,733                           | 1.6          |
| Policy loans               | 75,916                           | 1.2          | 79,277                           | 1.4          |
| Derivatives; index options | 66,987                           | 1.0          | 11,920                           | 0.2          |
| Equity securities          | 14,736                           | 0.2          | 13,683                           | 0.2          |
| Real estate                | 20,169                           | 0.3          | 10,828                           | 0.2          |
| Other                      | 13,640                           | 0.1          | 3,340                            | 0.1          |
| <b>Totals</b>              | <b>\$ 6,381,552</b>              | <b>100.0</b> | <b>\$ 5,772,781</b>              | <b>100.0</b> |

Derivatives consist of index options purchased to partially hedge the equity return component of the Company's fixed-indexed products. These options are intended to act as economic hedges to match closely the returns on the products underlying reference indices. Derivatives are recorded at the fair value as of the balance sheet date. With the recovery of the equities markets the options have risen in value. Any increases in income from these options are substantially offset by increase in amounts credited to fixed-index annuity and life policy holders. The Company does not participate in more sophisticated derivative instruments such as credit default swaps, interest rate swaps, financial futures or other similar investments.

## Debt and Equity Securities

The Company maintains a diversified portfolio which consists primarily of corporate, mortgage-backed, and public utilities fixed income securities. Investments in mortgage-backed securities include primarily U.S. government agency pass-through securities and collateralized mortgage obligations ("CMOs"). As of September 30, 2009 and December 31, 2008, the Company's debt securities portfolio consisted of the following:

|                            | Composition of Debt Securities   |      |                                  |      |
|----------------------------|----------------------------------|------|----------------------------------|------|
|                            | September 30, 2009               |      | December 31, 2008                |      |
|                            | Carrying Value<br>(In thousands) | %    | Carrying Value<br>(In thousands) | %    |
| Corporate                  | \$ 2,885,917                     | 47.3 | \$ 2,453,404                     | 44.0 |
| Mortgage-backed securities | 1,959,994                        | 32.1 | 2,001,060                        | 36.0 |
| Public utilities           | 929,490                          | 15.2 | 790,419                          | 14.2 |
| U.S. agencies              | 78,182                           | 1.3  | 119,674                          | 2.2  |
| U.S. Treasury              | 1,918                            | -    | 1,923                            | -    |
| Home equity                | 40,699                           | 0.7  | 46,959                           | 0.9  |
| Manufactured housing       | 37,409                           | 0.6  | 41,319                           | 0.7  |
|                            | 146,101                          | 2.4  | 86,962                           | 1.6  |

States & political  
subdivisions

|                     |              |       |              |       |
|---------------------|--------------|-------|--------------|-------|
| Foreign governments | 21,408       | 0.4   | 21,280       | 0.4   |
| Totals              | \$ 6,101,118 | 100.0 | \$ 5,563,000 | 100.0 |

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Because the Company's holdings of mortgage-backed securities are subject to prepayment and extension risk, the Company has substantially reduced these risks by investing primarily in collateralized mortgage obligations, which have more predictable cash flow patterns than pass-through securities. These securities, known as planned amortization class I ("PAC I") and sequential tranches, are designed to amortize in a more predictable manner than other CMO classes or pass-throughs. The Company does not purchase tranches, such as PAC II and support tranches, that subject the portfolio to greater than average prepayment risk. Using this strategy, the Company can more effectively manage and reduce prepayment and extension risks, thereby helping to maintain the appropriate matching of the Company's assets and liabilities.

Due to negative news relative to the mortgage industry, and in particular subprime mortgages, the Company has included detailed information below related to this exposure in the debt securities portfolio. The Company holds approximately \$78.1 million in asset-backed securities at September 30, 2009. This portfolio includes \$37.4 million of manufactured housing bonds and \$40.7 million of home equity loans (also referred to as subprime securities). The Company does not have any holdings in collateralized bond obligations (CBOs), collateralized debt obligations (CDOs), or collateralized loan obligations (CLOs). Principal risks in holding asset-backed securities are structural, credit, and capital market risks. Structural risks include the securities' priority in the issuer's capital structure, the adequacy of and ability to realize proceeds from collateral and the potential for prepayments. Credit risks include corporate credit risks or consumer credit risks for financing such as subprime mortgages. Capital market risks include the general level of interest rates and the liquidity for these securities in the marketplace.

The mortgage-backed portfolio includes one Alt-A security with a carrying value of \$3.7 million. The Alt-A sector is a sub-sector of the jumbo prime MBS sector. The average FICO for an Alt-A borrower is approximately 715 compared to a score of 730 for a jumbo prime borrower. The Company's exposure to the Alt-A and subprime sectors is limited to investments in the senior tranches of structured securities collateralized by Alt-A or subprime residential mortgage loans. The asset-backed portfolio includes thirteen subprime securities, totaling \$40.7 million. The subprime sector is generally categorized under the asset-backed sector. This sector lends to borrowers who do not qualify for prime interest rates due to poor or insufficient credit history. Subprime borrowers generally have FICO scores of 660 or below. The slowing housing market, rising interest rates, and relaxed underwriting standards for loans originated after 2005 resulted in higher delinquency rates and losses in 2007. These events caused illiquidity in the market and volatility in the market prices of subprime securities. All of the loans classified as Alt-A or subprime in the Company's portfolio as of September 30, 2009 were underwritten prior to 2005 as noted in the table below.

| Investment<br>Origination Year | September 30, 2009 |              | December 31, 2008 |              |
|--------------------------------|--------------------|--------------|-------------------|--------------|
|                                | Carrying Value     | Market Value | Carrying Value    | Market Value |
|                                | (In thousands)     |              |                   |              |
| Subprime:                      |                    |              |                   |              |
| 1998                           | \$ 11,191          | 10,064       | 12,125            | 11,157       |
| 2002                           | 1,111              | 464          | 1,123             | 556          |
| 2003                           | 6,345              | 3,857        | 6,894             | 3,779        |
| 2004                           | 22,052             | 19,093       | 26,817            | 21,970       |
| Subtotal subprime              | \$ 40,699          | 33,478       | 46,959            | 37,462       |
| Alt A:                         |                    |              |                   |              |
| 2004                           | \$ 3,660           | 3,660        | 3,821             | 3,821        |

As of September 30, 2009, nine of the subprime securities were rated AAA, one was rated AA, one rated A, one rated BBB and one rated BB.



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In addition to diversification, an important aspect of the Company's investment approach is managing the credit quality of its investments in debt securities. Thorough credit analysis is performed on potential corporate investments including examination of a company's credit and industry outlook, financial ratios and trends, and event risks. This emphasis is reflected in the high average credit rating of the Company's portfolio with 97.7% held in investment grade securities. In the table below, investments in debt securities are classified according to credit ratings by Standard and Poor's ("S&P®"), or other nationally recognized statistical rating organizations if securities were not rated by S&P®.

|                                     | September 30, 2009               |       | December 31, 2008                |       |
|-------------------------------------|----------------------------------|-------|----------------------------------|-------|
|                                     | Carrying Value<br>(In thousands) | %     | Carrying Value<br>(In thousands) | %     |
| AAA and U.S. government             | \$ 2,162,089                     | 35.5  | \$ 2,306,694                     | 41.5  |
| AA                                  | 285,793                          | 4.7   | 205,729                          | 3.7   |
| A                                   | 1,502,143                        | 24.6  | 1,431,703                        | 25.7  |
| BBB                                 | 2,008,107                        | 32.9  | 1,546,720                        | 27.8  |
| BB and other below investment grade | 142,986                          | 2.3   | 72,154                           | 1.3   |
| Totals                              | \$ 6,101,118                     | 100.0 | \$ 5,563,000                     | 100.0 |

The Company does not purchase below investment grade securities. Investments held in debt securities below investment grade are the result of subsequent downgrades of the securities. These holdings are summarized below.

|                    | Below Investment Grade Debt Securities |   |                      |                      |
|--------------------|--|---|----------------------|----------------------|
|                    | Amortized Cost                         | Carrying Value<br>(In thousands except percentages) | Estimated Fair Value | % of Invested Assets |
| September 30, 2009 | \$ 149,366                             | 142,986   | 130,384              | 2.2%                 |
| December 31, 2008  | \$ 84,229                              | 72,154  | 67,375               | 1.2%                 |
| December 31, 2007  | \$ 105,067                             | 100,221   | 97,618               | 1.7%                 |

As of September 30, 2009, the Company's percentage of below investment grade securities compared to total invested assets totaled 2.2%. The increase from December 31, 2008 is primarily due to securities being downgraded during the first nine months of 2009. The Company's holdings of below investment grade securities as a percentage of total invested assets is relatively small compared to industry averages.



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Holdings in below investment grade securities by category as of September 30, 2009 are summarized below, including September 30, 2009 and December 31, 2008 fair values for comparison. The Company is continually monitoring developments in these industries that may affect security valuation issues. Holdings in below investment grade securities by category are summarized below.

|                      | Below Investment Grade Debt Securities     |  |  |                                       |
|----------------------|--|--|--|---------------------------------------|
|                      | Amortized<br>Cost<br>September 30,<br>2009 | Carrying<br>Value<br>September 30,<br>2009 | Fair<br>Value<br>September 30,<br>2009 | Fair<br>Value<br>December 31,<br>2008 |
|                      | (In thousands)                             |  |  |                                       |
| Retail               | \$ 21,701                                  | 19,668                                     | 19,668                                 | 10,502                                |
| Utilities/Energy     | 2,099                                      | 2,124                                      | 2,124                                  | 1,839                                 |
| Telecommunication    | 6,320                                      | 8,400                                      | 8,400                                  | 3,807                                 |
| Home equity          | 1,111                                      | 1,111                                      | 464                                    | 550                                   |
| Manufactured housing | 10,402                                     | 10,819                                     | 9,717                                  | 7,151                                 |
| Mortgage-backed      | 4,894                                      | 3,330                                      | 3,330                                  | 3,641                                 |
| Transportation       | 1,635                                      | 1,538                                      | 1,538                                  | 1,144                                 |
| Manufacturing        | 32,061                                     | 31,211                                     | 30,531                                 | 23,217                                |
| Banking/Finance      | 43,939                                     | 42,302                                     | 32,113                                 | 25,725                                |
| Medical              | 13,000                                     | 13,017                                     | 13,033                                 | 11,050                                |
| Other                | 12,204                                     | 9,466                                      | 9,466                                  | 8,552                                 |
| <b>Totals</b>        | <b>\$ 149,366</b>                          | <b>142,986</b>                             | <b>130,384</b>                         | <b>97,178</b>                         |

The Company closely monitors its below investment grade holdings by reviewing investment performance indicators including information such as issuer operating performance, debt ratings, analyst reports and other economic factors that may affect these specific investments. While additional losses are not currently anticipated based on the existing status and condition of these securities, continued credit deterioration of some securities is possible, which may result in further writedowns.

The Company is required to classify its investments in debt and equity securities into one of three categories: (a) trading securities, (b) securities available for sale, or (c) securities held to maturity. The Company purchases securities with the intent to hold to maturity and accordingly does not maintain a portfolio of trading securities. Of the remaining two categories, available for sale and held to maturity, the Company makes a determination on categorization based on various factors including the type and quality of the particular security and how it will be incorporated into the Company's overall asset/liability management strategy. As shown in the table below, at September 30, 2009, approximately 32% of the Company's total debt and equity securities, based on fair values, were classified as securities available for sale. These holdings provide flexibility to the Company to react to market opportunities and conditions and to practice active management within the portfolio to provide adequate liquidity to meet policyholder obligations and other cash needs.

|                              | September 30, 2009 |                   |                     |
|------------------------------|--------------------|-------------------|---------------------|
|                              | Fair<br>Value      | Amortized<br>Cost | Unrealized<br>Gains |
|                              | (In thousands)     |                   |                     |
| Securities held to maturity: |                    |                   |                     |
| Debt securities              | \$ 4,259,696       | 4,082,605         | 177,091             |

## Securities available for sale:

|                   |              |           |         |
|-------------------|--------------|-----------|---------|
| Debt securities   | 2,018,513    | 1,956,728 | 61,785  |
| Equity securities | 14,736       | 6,831     | 7,905   |
| Totals            | \$ 6,292,945 | 6,046,164 | 246,781 |

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During the nine months ended September 30, 2009 the Company recorded other-than-temporary impairment writedowns on debt securities totaling \$4.9 million and on equity securities totaling \$0.4 million. See Note 9 in the accompanying condensed consolidated financial statements.

As of April 1, 2009, the Company adopted the new FASB ASC 320 10 guidance. See Note 3 in the accompanying condensed consolidated financial statements. For the three months ended September 30, 2009, the Company recognized \$4.7 million of other-than-temporary impairments. Of this amount \$0.1 million was deemed credit related and recognized as realized investment losses in earnings, and \$4.6 million was deemed non-credit related impairments and recognized in other comprehensive income. Year-to-date the Company recognized \$6.5 million of other-than-temporary impairments; of which \$0.1 million was deemed credit related and recognized as realized investment losses in earnings, and \$6.4 million was deemed non credit related impairment and recognized in other comprehensive income.

## Market Risk

Market risk is the risk of change in market values of financial instruments due to changes in interest rates, currency exchange rates, commodity prices, or equity prices. The most significant market risk exposure for National Western is interest rate risk. The fair values of fixed income debt securities correlate to external market interest rate conditions. Because interest rates are fixed on almost all of the Company's debt securities, market values typically increase when market interest rates decline, and decrease when market interest rates rise. However, market values may fluctuate for other reasons, such as changing economic conditions or increasing event-risk concerns.

The correlation between fair values and interest rates for debt securities is reflected in the tables below.

|  | September 30,<br>2009             | June 30,<br>2009 | December 31,<br>2008 |
|--|-----------------------------------|------------------|----------------------|
|  | (In thousands except percentages) |                  |                      |
| Debt securities - fair value   | \$ 6,278,209                      | 5,858,044        | 5,458,936            |
| Debt securities - amortized cost   | \$ 6,039,333                      | 5,877,478        | 5,728,363            |
| Fair value as a percentage of amortized cost                               | 103.96 %                          | 99.67 %          | 95.30 %              |
| Unrealized gain (loss) balance   | \$ 238,876                        | (19,434)         | (269,427)            |
| Ten-year U.S. Treasury bond - increase (decrease) in yield for the quarter | (0.23) %                          | 0.87 %           | (1.81) %             |

## Unrealized Gains (Losses) Balance

|                                    | At<br>September 30,<br>2009 | At<br>June 30,<br>2009 | At<br>December 31,<br>2008 | Quarter<br>Change in<br>Unrealized<br>Balance | YTD<br>Change in<br>Unrealized<br>Balance |
|------------------------------------|-----------------------------|------------------------|----------------------------|---|---|
| Debt securities held to maturity   | \$ 177,091                  | 29,515                 | (104,064)                  | 147,576                                       | 281,155                                   |
| Debt securities available for sale | 61,785                      | (48,949)               | (165,363)                  | 110,734                                       | 227,148                                   |

|        |    |         |          |           |         |         |
|--------|----|---------|----------|-----------|---------|---------|
| Totals | \$ | 238,876 | (19,434) | (269,427) | 258,310 | 508,303 |
|--------|----|---------|----------|-----------|---------|---------|

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Changes in interest rates typically have a sizable effect on the fair values of the Company's debt securities. While the market interest rates of the ten-year U.S. Treasury bond decreased only 23 basis points during the third quarter, the Company experienced a large unrealized gain of \$258.3 million on a portfolio of approximately \$6.0 billion as the fixed income market had a strong recovery during the third quarter. As liquidity improved, the demand for bonds increased causing the spread between corporate bonds and treasuries to narrow and the prices of the bonds to rise. Since the majority of the Company's debt securities are classified as held to maturity, which are recorded at amortized cost, changes in fair values have relatively small effects on the Company's consolidated balance sheet.

The Company manages interest rate risk through on-going cash flow testing required for insurance regulatory purposes. Business models are used to perform cash flow testing under various commonly used stress test interest rate scenarios to determine if existing assets would be sufficient to meet projected liability outflows. Sensitivity analysis allows the Company to measure the potential gain or loss in fair value of its interest-sensitive instruments and to protect its economic value and achieve a predictable spread between what is earned on invested assets and what is paid on liabilities. The Company seeks to minimize the impact of interest risk through surrender charges that are imposed to discourage policy surrenders. Interest rate changes can be anticipated in the business models and the corresponding risk addressed by management actions affecting asset and liability instruments. However, potential changes in the values of financial instruments indicated by hypothetical interest rate changes will likely be different from actual changes experienced, and the differences could be significant.

The Company performed detailed sensitivity analysis as of December 31, 2008, for its interest rate-sensitive assets and liabilities. The changes in market values of the Company's debt securities for the three months ended September 30, 2009 were reasonable given the expected range of results of this analysis.

## LIQUIDITY AND CAPITAL RESOURCES

## Liquidity

Liquidity requirements are met primarily by funds provided from operations. Premium deposits and annuity considerations, investment income, and investment maturities and prepayments are the primary sources of funds while investment purchases, policy benefits in the form of claims, and payments to policyholders and contract holders in connection with surrenders and withdrawals as well as operating expenses are the primary uses of funds. To ensure the Company will be able to pay future commitments, the funds received as premium payments and deposits are invested in high quality investments, primarily fixed income securities. Funds are invested with the intent that the income from investments, plus proceeds from maturities, will meet the ongoing cash flow needs of the Company. The approach of matching asset and liability durations and yields requires an appropriate mix of investments. Although the Company historically has not been put in the position of liquidating invested assets to provide cash flow, its investments consist primarily of marketable debt securities that could be readily converted to cash for liquidity needs. The Company may also borrow up to \$40 million on its bank line of credit for short-term cash needs.

A primary liquidity concern for life insurers is the risk of an extraordinary level of early policyholder withdrawals. The Company includes provisions within its annuity and universal life insurance policies, such as surrender charges, that help limit and discourage early withdrawals.

The actual amounts paid by product line in connection with surrenders and withdrawals for the periods ended September 30 are noted in the table below.

| Three Months Ended September 30, |      | Nine Months Ended September 30, |      |
|----------------------------------|------|---------------------------------|------|
| 2009                             | 2008 | 2009                            | 2008 |
| (In thousands)                   |      |                                 |      |

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|                  |    |         |        |         |
|------------------|----|---------|--------|---------|
| Product Line:    |    |         |        |         |
| Traditional Life | \$ | 976     | 1,372  | 3,430   |
| Universal Life   |    | 14,538  | 10,703 | 44,959  |
| Annuities        |    | 86,141  | 87,553 | 281,286 |
| Total            | \$ | 101,655 | 99,628 | 329,675 |

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The contractual withdrawals, as well as the level of surrenders, experienced were generally consistent with the Company's assumptions in asset/liability management, and the associated cash outflows did not have an adverse impact on overall liquidity. Individual life insurance policies are less susceptible to withdrawal than annuity reserves and deposit liabilities because policyholders may incur surrender charges and undergo a new underwriting process in order to obtain a new insurance policy. However, in the economic climate of the past couple years, the Company has noted a higher incidence of life insurance surrender and withdrawal activity, particularly internationally. Cash flow projections and tests under various market interest rate scenarios are also performed to assist in evaluating liquidity needs and adequacy. The Company currently expects available liquidity sources and future cash flows to be more than adequate to meet the demand for funds.

Cash flows from the Company's insurance operations have been sufficient to meet current needs. Cash flows from operating activities were \$120.4 million and \$195.4 million for the nine months ended September 30, 2009 and 2008, respectively. The Company also has significant cash flows from both scheduled and unscheduled investment security maturities, redemptions, and prepayments. These cash flows totaled \$871.6 million and \$608.2 million for the nine months ended September 30, 2009 and 2008, respectively. Cash flow items could change if interest rates rise. Net cash flows from the Company's universal life and investment annuity deposit product operations totaled \$180.9 million and \$(95.1) million during the nine months ended September 30, 2009 and 2008, respectively.

## Capital Resources

The Company relies on stockholders' equity for its capital resources as there is no long-term debt outstanding and the Company does not anticipate the need for any long-term debt in the near future. As of September 30, 2009, the Company had a remaining maximum commitment of \$0.8 million which was approved by the Company's Board of Directors for the construction of a nursing home facility in Central Texas. The construction of the new facility began in 2007 and commenced operations during the third quarter of 2009.

## OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

It is not Company practice to enter into off-balance sheet arrangements nor is it Company policy to issue guarantees to third parties, other than in the normal course of issuing insurance contracts. Commitments related to insurance products sold are reflected as liabilities for future policy benefits. Insurance contracts guarantee certain performances by the Company.

Insurance reserves are the means by which life insurance companies determine the liabilities that must be established to assure that future policy benefits are provided for and can be paid. These reserves are required by law and based upon standard actuarial methodologies to ensure fulfillment of commitments guaranteed to policyholders and their beneficiaries, even though the obligations may not be due for many years. Refer to Note (1) in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 for a discussion of reserving methods.

The table below summarizes future estimated cash payments under existing contractual obligations as of September 30, 2009.

|                                 | Total  | Payment Due by Period |                |                | More Than<br>5 Years |
|---------------------------------|--------|-----------------------|----------------|----------------|----------------------|
|                                 |        | Less Than<br>1 Year   | 1 - 3<br>Years | 3 - 5<br>Years |                      |
| Operating lease obligations (1) | \$ 131 | 131                   | -              | -              | -                    |

(In thousands)

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|                              |              |         |           |           |           |
|------------------------------|--------------|---------|-----------|-----------|-----------|
| Loan commitments             | 24,571       | 24,571  | -         | -         | -         |
| Construction commitments     | 779          | 779     | -         | -         | -         |
| Life claims payable (2)      | 48,772       | 48,772  | -         | -         | -         |
| Other long-term reserve      |              |         |           |           |           |
| liabilities reflected on the |              |         |           |           |           |
| balance sheet under GAAP (3) | 7,935,490    | 812,282 | 1,474,715 | 1,798,308 | 3,850,185 |
| Total                        | \$ 8,009,743 | 886,535 | 1,474,715 | 1,798,308 | 3,850,185 |

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(1) Refer to Note 9 in the Notes to Consolidated Financial Statements relating to leases in the Company's Annual Report on Form 10-K.

(2) Life claims payable includes benefit and claim liabilities for which the Company believes the amount and timing of the payment is essentially fixed and determinable. Such amounts generally relate to incurred and reported death and critical illness claims including an estimate of claims incurred but not reported.

(3) Other long-term liabilities include estimated life and annuity obligations related to death claims, policy surrenders, policy withdrawals, maturities and annuity payments based on mortality, lapse, annuitization, and withdrawal assumptions consistent with the Company's historical experience. These estimated life and annuity obligations are undiscounted projected cash outflows that assume interest crediting and market growth consistent with assumptions used in amortizing deferred acquisition costs. They do not include any offsets for future premiums or deposits. Other long-term liabilities also include determinable payout patterns related to immediate annuities. In contrast to this table, the majority of the Company's liabilities for future obligations recorded on the consolidated balance sheet do not incorporate future credited interest and market growth. Therefore, the estimated life and annuity obligations presented in this table significantly exceed the life and annuity liabilities recorded in the reserves for future life and annuity obligations. Due to the significance of the assumptions used, the actual cash outflows will differ both in amount and timing, possibly materially, from these estimates.

## CHANGES IN ACCOUNTING PRINCIPLES AND CRITICAL ACCOUNTING POLICIES

### Changes in Accounting Principles

Refer to Notes 2, 3, and 9 of the Notes to Condensed Consolidated Financial Statements.

## REGULATORY AND OTHER ISSUES

### Statutory Accounting Practices

Regulations that affect the Company and the insurance industry are often the result of efforts by the National Association of Insurance Commissioners ("NAIC"). The NAIC routinely publishes new regulations as model acts or laws which states subsequently adopt as part of their insurance regulations. Currently, the Company is not aware of any NAIC regulatory matter material to its operations or reporting of financial results.

### Risk-Based Capital Requirements

The NAIC established risk-based capital ("RBC") requirements to help state regulators monitor the financial strength and stability of life insurers by identifying those companies that may be inadequately capitalized. Under the NAIC's requirements, each insurer must maintain its total capital above a calculated threshold or take corrective measures to achieve the threshold. The threshold of adequate capital is based on a formula that takes into account the amount of risk each company faces on its products and investments. The RBC formula takes into consideration four major areas of risk which are: (i) asset risk which primarily focuses on the quality of investments; (ii) insurance risk which encompasses mortality and morbidity risk; (iii) interest rate risk which involves asset/liability matching issues; and (iv) other business risks. Statutory laws prohibit public dissemination of certain RBC information. However, the Company's current statutory capital and surplus is significantly in excess of the threshold RBC requirements.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

This information is included in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, in the Investments in Debt and Equity Securities section.

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ITEM 4. CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing, and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

There have been no changes in the Company's internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 8 (A) "Legal Proceedings" of the accompanying financial statements included in this Form 10-Q.

ITEM 1A. RISK FACTORS

There have been no changes relative to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Effective August 22, 2008, the Company adopted and implemented a limited stock buy-back program associated with the Company's 2008 Incentive Plan which provides Option Holders the additional alternative of selling shares acquired through the exercise of options directly back to the Company. This program succeeded a similar buy-back program implemented March 10, 2006 associated with the Company's 1995 Stock Option and Incentive Plan. 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.

During the quarter ended September 30, 2009, no shares were purchased from option holders.

ITEM 6. EXHIBITS

(a) Exhibits

|               |  |
|---------------|--|
| Exhibit 31(a) | -Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
|---------------|--|

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Exhibit 31(b) Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32(a) -Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

NATIONAL WESTERN LIFE INSURANCE COMPANY  
(Registrant)

|                           |   |
|---------------------------|---|
| Date: November 9,<br>2009 | /S/ Ross R. Moody   |
|                           | Ross R. Moody<br>President, Chief Operating<br>Officer,<br>and Director<br>(Authorized Officer)                           |
| Date: November 9,<br>2009 | /S/ Brian M. Pribyl   |
|                           | Brian M. Pribyl<br>Senior Vice President,<br>Chief Financial Officer and<br>Treasurer<br>(Principal Financial<br>Officer) |
| Date: November 9,<br>2009 | /S/ Michael G. Kean   |
|                           | Michael G. Kean<br>Vice President,<br>Controller and Assistant<br>Treasurer<br>(Principal Accounting<br>Officer)          |



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