NATIONAL WESTERN LIFE INSURANCE CO
Form 10-K
March 16, 2010

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

FORM 10-K

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

For the Fiscal Year Ended December 31, 2009

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

For the transition period from to

Commission File Number: 2-17039

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

COLORADO	84-0467208
(State of Incorporation)	(I.R.S. Employer Identification Number)

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

(512) 836-1010
(Telephone Number)

Securities registered pursuant to Section 12 (b) of the Act:

Title of each class to be so registered:	Name of each exchange on which each class is to be registered:
Class A Common Stock, $1.00 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12 (g) of the Act:
None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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. (Check One)

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

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

The aggregate market value of the common stock (based upon the closing price) held by non-affiliates of the Registrant on June 30, 2009 was $399,981,531.

As of March 11, 2010, the number of shares of Registrant's common stock outstanding was: Class A - 3,425,966 and Class B - 200,000.

DOCUMENTS INCORPORATED BY REFERENCE

Documents incorporated by reference: Portions of the registrant's definitive proxy statement for the annual meeting of shareholders to be held June 29, 2010, which will be filed within 120 days after December 31, 2009 are incorporated by reference into Part III of this report.

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PART I

ITEM 1. BUSINESS

General

National Western Life Insurance Company (hereinafter referred to as "National Western", "Company", or "Registrant") is a stock life insurance company, chartered in the State of Colorado in 1956, and doing business in forty-nine states, the District of Columbia, and four U.S. territories or possessions. National Western is also licensed in Haiti, and although not otherwise licensed, accepts applications from and issues policies to residents of various countries in Central and South America, the Caribbean, the Pacific Rim, Eastern Europe and Asia. Such policies are underwritten, accepted, and issued in the United States upon applications submitted by independent contractors. The Company provides life insurance products for the savings and protection needs of approximately 142,000 policyholders and for the asset accumulation and retirement needs of 121,000 annuity contract holders.

In 2009, the Company's total assets increased to $7.5 billion at December 31, 2009, from $6.8 billion at December 31, 2008. The Company generated revenues of $568.4 million, $411.1 million and $474.5 million in 2009, 2008 and 2007, respectively. In addition, National Western generated net income of $45.5 million, $33.6 million and $85.4 million in 2009, 2008 and 2007, respectively.

The Company's financial information, including information in this report filed on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to the above reports, are accessible free of charge through the Company's Internet site at www.nationalwesternlife.com or may be viewed at the United States Securities and Exchange Commission ("SEC") Public Reference Room in Washington, D.C. or at the SEC's Internet site at www.sec.gov.

Products

National Western offers a broad portfolio of individual whole life, universal life and term insurance plans, and annuities, including supplementary riders.

Life Products. The Company's life products provide protection for the life of the insured and, in some cases, allow for cash value accumulation on a tax-deferred basis. These product offerings include universal life insurance ("UL"), interest-sensitive whole life, and traditional products such as term insurance coverage. Interest sensitive products such as UL accept premiums that are applied to an account value. Deducted from the account value are costs of insurance charges which vary by age, gender, plan, and class of insurance, as well as various expense charges. Interest is credited to account values at a fixed interest rate generally determined in advance and guaranteed for a policy year at a time, subject to minimum guaranteed rates specified in the policy contract. A slight variation to this general interest crediting practice involves equity-indexed universal life ("EIUL") policies whose credited interest may be linked in part to an outside index such as the S&P 500® Composite Stock Price Index ("S&P 500 Index®") at the election of the policyholder. These products offer both flexible and fixed premium modes and provide policyholders with flexibility in the available coverage, the timing and amount of premium payments and the amount of the death benefit, provided there are sufficient policy funds to cover all policy charges for the coming year. Traditional products generally provide for a fixed death benefit payable in exchange for regular premium payments.

Annuity Products. Annuity products sold include flexible premium and single premium deferred annuities, fixed-indexed annuities, and single premium immediate annuities. These products can be tax qualified or nonqualified annuities. A fixed single premium deferred annuity ("SPDA") provides for a single premium payment at the time of issue, an accumulation period, and an annuity payout period commencing at some future date. A flexible premium deferred annuity ("FPDA") provides the same features but allows, generally with some conditions, additional payments into the contract. Interest is credited to the account value of the annuity initially at a current rate of interest which is guaranteed for a period of time, typically the first year. After this period, the interest credited is subject to change based upon market rates and product profitability subject to a minimum guaranteed rate specified in the contract. Interest accrues during the accumulation period generally on a tax-deferred basis to the contract holder. After a number of years specified in the annuity contract, the owner may elect to have the proceeds paid as a single payment or as a series of payments over a period of time. The owner is permitted at any time during the accumulation period to withdraw all or part of the annuity account balance subject to contract provisions such as surrender charges and market value adjustments. A fixed-indexed deferred annuity performs essentially in the same manner as SPDAs and FPDAs with the exception that, in addition to a fixed interest crediting option, the contract holder has the ability to elect an interest crediting mechanism that is linked, in part, to an outside index such as the S&P 500 Index®. A single premium immediate annuity ("SPIA") foregoes the accumulation period and immediately commences an annuity payout period.

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Distributions of the Company's direct premium revenues and deposits by product type are provided below.

	Years Ended December 31,		
	2009	2008	2007
	(In thousands)		
Annuities:			
Single premium deferred	$ 15,707	4,417	3,808
Flexible premium deferred	309,424	116,902	112,472
Fixed-indexed deferred	489,180	281,649	316,848
Single premium immediate	23,266	7,165	4,637
Total annuities	837,577	410,133	437,765
Universal life insurance	173,167	170,933	168,279
Traditional life and other	19,580	20,698	22,310
Total direct premiums and deposits collected	$ 1,030,324	601,764	628,354

Operating Segments

The Company manages its business between Domestic Insurance Operations and International Insurance Operations. For segment reporting purposes, the Company's annuity business, which is predominantly domestic, is separately identified. The Company also has a Corporate segment, which consists of the assets and activities that have not been allocated to any other operating segment.

Domestic Insurance Operations. The Company is currently licensed to do business in all states and the District of Columbia, except for New York. Products marketed are annuities, universal life insurance, and traditional life insurance, which include both term and whole life products. The majority of domestic sales are the Company's annuities. National Western markets and distributes its domestic products primarily through independent national marketing organizations ("NMO"). These NMOs assist the Company in recruiting, contracting, and managing independent agents. The Company's agents are independent contractors who are compensated on a commission basis. At December 31, 2009, the Company's NMO relationships had contracted approximately 7,300 independent agents with the Company. Nearly 31% of these contracted agents submitted policy applications to the Company in the past twelve months. At December 31, 2009, the Company had nearly 70,000 domestic life insurance policies in force representing over $2.5 billion in face amount of coverage and 121,000 annuity contracts representing account balances of $5.2 billion.

International Insurance Operations. National Western's international operations generally focus on foreign nationals in upper socioeconomic classes. Insurance products are issued primarily to residents of countries in Central and South America, the Caribbean, the Pacific Rim, Eastern Europe, and Asia. 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 December 31, 2009, the Company had 72,000 international life insurance policies in force representing nearly $16.2 billion in face amount of coverage.

International applications are submitted by independent contractors, consultants and broker-agents, many of whom have been submitting policy applications to National Western for 20 or more years. The Company had relationships with approximately 4,000 independent international individuals at December 31, 2009, over 41% of which 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 National Western'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 and claims in United States dollars. In addition, experience with the international products for over forty years and the Company's longstanding business relationships further serve to minimize risks.

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Geographical Distribution of Business. The following table depicts the distribution of the Company's premium revenues and deposits.

	Years Ended December 31,		
	2009	2008	2007
	(In thousands)		
United States domestic products:			
Annuities	$821,361	398,312	421,497
Life insurance	58,825	59,412	57,770
Total domestic products	880,186	457,724	479,267
International products:			
Annuities	16,215	11,821	16,268
Life insurance	133,923	132,219	132,819
Total international products	150,138	144,040	149,087
Total direct premiums and deposits collected	$1,030,324	601,764	628,354

Although many agents sell National Western's products, the Company's annuity sales in any year typically reflect several NMOs whose contracted independent agents sold 10% or more of the Company’s total annuity sales. In 2009, there were three NMOs that accounted for more than 10% of the Company’s annuity sales with 16.8%, 11.6%, and 10.8% of the total annuity sales, respectively. Similarly, domestic life insurance sales in any year may include several NMOs who accounted for 10% or more of total domestic life insurance sales. In 2009, there were three NMOs who generated 24.4%, 12.3% and 11.0%, respectively, of total domestic life insurance sales. The NMO accounting for 24.4% of domestic life sales was also the same NMO who produced 10.8% of total annuity sales while the NMO contributing 12.3% of domestic life sales also contributed 16.8% of total annuity sales. With the independent distribution model the Company employs, the concentration of sales within a particular NMO is not as an acute concern as with other distribution channels given that the underlying agents are free to contract with the Company through any NMO the Company has a relationship with.

International life insurance sales are much more diversified by independent consultants and contractors and in 2009 were geographically attributed to Latin America (77%), the Pacific Rim (18%), and Eastern Europe (5%). In terms of international countries, Brazil and Taiwan were the only two countries exceeding 10% of total international sales with shares of 32.4% and 15.7%, respectively.

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Segment Financial Information. A summary of financial information for the Company's segments is as follows:

	Domestic Life Insurance	International Life Insurance	Annuities (In thousands)	All Others	Totals
Revenues, excluding realized gains (losses):					
2009	$53,937	148,624	343,502	27,510	573,573
2008	48,193	115,073	252,511	21,530	437,307
2007	44,783	113,598	292,402	20,227	471,010
Segment earnings: (A)					
2009	$426	14,663	25,460	8,294	48,843
2008	717	15,350	27,842	6,781	50,690
2007	342	20,179	56,299	6,278	83,098
Segment assets: (B)					
2009	$383,844	1,056,087	5,955,734	107,581	7,503,246
2008	397,413	842,119	5,369,920	127,189	6,736,641
2007	399,097	796,012	5,500,226	106,039	6,801,374

Notes to Table:

(A) Amounts exclude realized gains and losses on investments, net of taxes.
(B) Amounts exclude other unallocated assets.

Additional information concerning these industry segments is included in Note 13, Segment and Other Operating Information, of the accompanying consolidated financial statements.

Competition and Ratings

National Western competes with hundreds of life and health insurance company groups in the United States as well as other financial intermediaries such as banks and securities firms who market insurance products. Competitors in our international markets include Pan-American Life Insurance, American Fidelity Life Insurance, Manhattan Life Insurance Company and Best Meridian Insurance while domestic market competitors include, among others, American Equity Investment Life, Sammons Financial Group (Midland, NACOLAH), AVIVA, Allstate (Lincoln Benefit), Lincoln National Life, Equitrust Life Insurance Company and Old Mutual Financial Network (F&G). Competitive factors are primarily the breadth and quality of products offered, established positions in niche markets, pricing, relationships with distribution, commission structures, the perceived stability of the insurer, quality of underwriting and customer service, scale and cost efficiency. Operating results of life insurers are subject to fluctuations not only from this competitive environment but also due to economic conditions, interest rate levels and changes, performance of investments, and the maintenance of strong insurance ratings from independent rating agencies.

In order to compete successfully, life insurers have turned their attention toward distribution, technology, defined end market targets, speed to the market in terms of product development, and customer relationship management as ways of gaining a competitive edge. The Company's management believes that it competes primarily on the basis of its longstanding reputation for commitment in serving international markets, its financial strength and stability, and its ability to attract and retain distribution based upon product and compensation. With respect to international markets, the Company is of the opinion that the home office infrastructure to support languages other than English, and the knowledge needed to effectively underwrite risks outside of the United States is a significant barrier to entry for potential competitors.

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Ratings with respect to financial strength are an important factor in establishing the competitive position of insurance companies. Financial strength ratings are generally defined as a rating agency's opinion as to a company's financial strength and ability to meet ongoing obligations to policyholders. Accordingly, ratings are important to maintaining public confidence and impact the ability to market products. The following summarizes the Company's financial strength ratings.

Rating Agency	Rating	Outlook
A.M. Best	A (Excellent)	Stable
Standard & Poor's	A (Strong)	Negative

A.M. Best and Standard & Poor's ratings are a consideration of the Company's claims paying ability and are not a rating of the Company's investment worthiness. The rating agencies formally review the Company and its rating on an annual basis with interim analysis performed as necessary. In June 2009, A.M. Best upgraded the Company's rating to "A" from "A-". This is particularly noteworthy given the financial crisis backdrop that has framed the past two years and the number of companies that were negatively impacted, often significantly, in this environment. The negative outlook from Standard & Poor's signifies the rating agency's bias toward a rating downgrade sometime in the future. Both A.M. Best and Standard & Poor's maintain a "negative outlook" on the life insurance industry overall which means that the rating of many U.S. life insurance companies may be downgraded due to the impact of negative market conditions. Generally speaking, there is no assurance that the Company's ratings will continue for a certain period of time. In the event the Company's ratings are subsequently downgraded, the Company's business may be negatively impacted.

Risk Management

Similar to other insurers, the Company is exposed to a wide spectrum of financial, operational, and other risks as described in Item 1A "Risk Factors". Effective enterprise risk management is a key concern for identifying, monitoring, measuring, communicating, and managing risks within limits and risk tolerances. The Company's Board of Directors and senior management are knowledgeable of and accountable for key risks. The Board meets at least every other month and regularly hears reports from the President and Chief Operating Officer, the Chief Financial Officer, the Chief Actuary, the Chief Investment Officer, and the Chief Compliance Officer. In addition, the Board has several committees which include the Audit Committee, the Investment Committee, and the Compensation and Stock Option Committee that regularly convene to address various aspects of risk.

Enterprise Risk Management (ERM) Governance Framework

Board of Directors and Sub-Committees of the Board

Company Senior Management

ERM Committees

Disclosure Committee	Asset/Liability Matching	Product Pricing/ Development	Compliance/Fraud Unit	Underwriting/ Claims

Corporate Risk Function

Insurance Risk Market Risk Credit Risk Operational Risk Strategy Risk

Lines of Business / Functional Areas

The Company maintains several management groups and committees that meet regularly to monitor, discuss and manage a variety of issues and risks associated with the business. These groups and committees include numerous areas such as regulatory compliance, financial reporting process and controls, fraud unit investigations, product spread management, and business strategy. Key members of senior management are involved with these groups and committees providing direction and oversight and serve as a reporting liaison with the Company's Board of Directors and sub-committees.

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The Company maintains a system of disclosure controls and procedures, including internal controls designed to provide reasonable assurance that assets are safeguarded and transactions are properly authorized, executed and recorded. The Company recognizes the importance of full and open presentation of its financial position and operating results and to this end maintains a Disclosure Controls and Procedures Committee comprised of senior executives who possess comprehensive knowledge of the Company's business and operations. This Committee is responsible for evaluating disclosure controls and procedures and for the gathering, analyzing, and disclosing of information as required to be disclosed under the securities laws. It assists the Chief Executive Officer and Chief Financial Officer in their responsibilities for making the certifications required under the securities laws regarding the Company's disclosure controls and procedures. It ensures that material financial information is properly communicated up the Company's hierarchy to the appropriate person or persons and that all disclosures are made in a timely fashion. This Committee reports directly to the Audit Committee of the Company.

The Company's product designs, underwriting standards and risk management techniques are utilized to protect against disintermediation risk and greater than expected mortality and morbidity risk. Disintermediation risk is limited through the use of surrender charges, certain provisions not allowing discretionary withdrawals, and market value adjustment features. Investment guidelines including duration targets, asset allocation tolerances and return objectives help to ensure that disintermediation risk is managed within the constraints of profitability criteria. Prudent underwriting is applied to select and price insurance risks and the Company regularly monitors mortality experience relative to its product pricing assumptions. Enforcement of disciplined claims management serves to further protect against greater than expected mortality.

A significant aspect of the Company’s business is managing the linkage of its asset characteristics with the anticipated behavior of its policy obligations and liabilities, a process commonly referred to as asset-liability matching. The Company maintains an Asset-Liability Committee (“ALCO”) consisting of senior level members of the Company who assist and advise the Company’s Board of Directors in monitoring the level of risk the Company is exposed to in managing its assets and liabilities in order to attain the risk-return profile desired. Certain members of the ALCO meet as frequently as necessary, to review and recommend for board of director ratification, current period interest crediting rates to policyholders based upon existing and anticipated investment opportunities. These rates apply to new sales and to products after an initial guaranteed period, if applicable. Rates are established after the initial guaranteed period based upon asset portfolio yields and each product’s required interest spread, taking into consideration current competitive market conditions.

Substantially all international products contain a currency clause stating that premium and claim "dollars" refer to lawful currency of the United States. Policy applications submitted by international insurance brokers are generally associated with individuals in upper socioeconomic classes who desire the stability and inflationary hedge of dollar denominated insurance products issued by the Company. The favorable demographics of this group typically results in a higher average policy size, and persistency and claims experience (from natural causes) similar to that in the United States. By accepting applications submitted on residents outside the United States, the Company is able to further diversify its revenue, earnings and insurance risk.

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Reinsurance

The Company follows the industry practice of reinsuring (ceding) portions of its insurance risks with a variety of reinsurance companies. We do not use financial or surplus relief reinsurance. The use of reinsurance allows the Company to underwrite policies larger than the risk it is willing to retain on any single life and to continue writing a larger volume of new business. The maximum amount of life insurance the Company normally retains is $250,000 on any one life subject to a minimum reinsurance cession of $50,000. However, the use of reinsurance does not relieve the Company of its primary liability to pay the full amount of the insurance benefit in the event of the failure of a reinsurer to honor its contractual obligation. Consequently, the Company avoids concentrating reinsurance risk with any one reinsurer and only participates in reinsurance treaties with reputable carriers. No reinsurer of business ceded by the Company has failed to pay policy claims (individually or in the aggregate) with respect to our ceded business. The Company continuously monitors the financial strength of our reinsurers and has been able to obtain replacement coverages from financially responsible reinsurers when making changes. The Company's primary reinsurers as of December 31, 2009 were as follows.

Reinsurer	A.M. Best Rating		Amount of In Force Ceded ($000's)
Hannover Life Reassurance Company	A	$	1,684,048
Transamerica Life Insurance Company	A+		1,220,040
SCOR Rueckversicherung (Cologne)	A-		1,033,417
SCOR Global Life (Paris)	A-		779,960
Mapfre Re (Madrid)	A+		462,236
All others			729,687
		$	5,909,388

Regulatory and Other Issues

Regulation. The Company's insurance business is subject to comprehensive state regulation in each of the states it is licensed to conduct business. The laws enforced by the various state insurance departments provide broad administrative powers with respect to licensing to transact business, licensing and appointing agents, approving policy forms, regulating unfair trade and claims practices, establishing solvency standards, fixing minimum interest rates for the accumulation of surrender values, and regulating the type, amounts, and valuations of permitted investments, among other things. The Company is required to file detailed annual statements with each of the state insurance supervisory departments in which it does business. Annually, our board-appointed qualified actuary must submit an opinion to state insurance regulators where the Company is licensed to do business on whether the statutory assets held backing the statutory reserves are sufficient to meet contractual obligations and related expenses of the insurer. If an opinion cannot be rendered noting the sufficiency of assets, the Company is required to establish additional statutory reserves which draw from available statutory surplus until the time such an opinion can be furnished.

The Company's operations and financial records are subject to examination by these departments at regular intervals. Statutory financial statements are prepared in accordance with accounting practices prescribed or permitted by the Colorado Division of Insurance, the Company's principal insurance regulator. Prescribed statutory accounting practices are largely dictated by the Statutory Accounting Principles adopted by the National Association of Insurance Commissioners ("NAIC"). The NAIC, as well as state regulators, continually evaluates existing laws and regulations pertaining to the operations of life insurers. To the extent that initiatives result as a part of this process, they may be adopted in the various states in which the Company is licensed to do business. It is not possible to predict the ultimate content and timing of new statutes and regulations adopted by state insurance departments and the related impact upon the Company's operations although it is conceivable that they may be more restrictive.

Each state has insurance guaranty association laws under which insurers doing business in a state can be assessed contributions, up to prescribed limits, in order to cover contractual benefit obligations of insolvent insurance companies. The state guaranty associations levy assessments on each insurer on the basis of their proportionate share of the premiums written in the lines of business in which the insolvent insurer had been engaged. Some states permit the member insurers to recover the assessments paid through full or partial premium tax offsets.

The Company’s business is also affected by U.S. federal, state and local tax laws. Although the federal government does not directly regulate the life insurance industry, federal measures previously considered or enacted by Congress, if revisited, could affect the insurance industry and the Company's business. These measures include the tax treatment of life insurance companies and life insurance products, as well as changes in individual income tax structures and rates. Even though the ultimate impact of any of these changes, if implemented, is uncertain, the persistency of the Company's existing products and the ability to sell products could be materially affected.

Risk-Based Capital Requirements. In order to enhance the regulation of insurer solvency, 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. For each category, the RBC requirements are determined by applying specified factors to various assets, premiums, reserves, and other items, with the factor being higher for items with greater underlying risk and lower for items with less risk. The standards require life insurers to submit a report to state regulators on an annual basis regarding their risk-based capital. The Company's statutory capital and surplus at December 31, 2009, was significantly in excess of the threshold RBC requirements.

Effects of Inflation. The rate of inflation as measured by the change in the average consumer price index has not had a material effect on the revenues or operating results of the Company during the three most recent fiscal years.

Employees. The Company had 294 employees as of December 31, 2009 substantially all of which worked in the Company’s home office in Austin, Texas. None of the employees are subject to collective bargaining agreements governing their employment with the Company.

ITEM 1A. RISK FACTORS

Company performance is subject to varying risk factors. This section provides an overview of possible risk exposures at this point in time that could impact Company performance in the future. While these scenarios do not represent expectations of future experience, they are intended to illustrate the potential impacts if any of the following risks were to manifest into actual occurrences.

Current difficult conditions globally and in the U.S. economy may materially adversely affect our business and results of operations.

The Company’s results from operations are materially affected by economic conditions both in the U.S. and elsewhere around the world. The stress experienced by financial markets beginning in the second half of 2007 continued throughout 2008 and into 2009. Consumer confidence declined as home values and the stock market decreased and unemployment and energy costs increased. The volatility and disruption in the financial markets reached unfamiliar levels such that the availability and cost of credit was materially impacted. The market for fixed income securities experienced decreased liquidity, increased price volatility, credit downgrades, and an increasing probability of default. Consequently, these securities became less liquid, more difficult to value, and potentially harder to dispose of if situations dictate. Although there is evidence that market conditions may have stopped their decline and begun to improve, these events have had an adverse effect on the value of our investment portfolio and may continue to do so in the event of prolonged economic challenges such as a global credit crisis.

Demand for our products and ultimately the profitability of our business may be adversely affected by such factors as lower consumer spending, negative investor sentiment, higher unemployment, lower corporate earnings and business investment, lackluster consumer confidence, and ongoing volatility in capital markets. We may also experience a higher incidence of claims, lapses or surrenders of policies. Our policyholders may opt to defer or stop paying insurance premiums. Adverse changes as detailed above could negatively affect our net income and have a material effect on our business, results of operations and financial condition.

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Our investment portfolio is subject to several risks which may lessen the value of invested assets and the amounts credited to policyholders.

The Company substantially invests monies received in investment grade, fixed income investment securities in order to meet its obligations to policyholders and provide a return on its deployed capital. Consequently, we are subject to the risk that issuers of these securities may default on principal and interest payments, particularly in the event of an ongoing downturn in the economic and/or business climate. At December 31, 2009, approximately 3% of the Company's $6.2 billion fixed income securities portfolio was comprised of issuers who were investment grade at the time the Company acquired them but were subsequently downgraded for various reasons. A substantial increase in defaults from these or other issuers could negatively impact the Company's financial position and results.

For the Company's fixed-indexed products, over the counter derivative instruments are purchased from a number of highly rated counterparties to fund the index credit to policyholders. In the event that any of these counterparties fails to meet their contractual obligations under these derivative instruments, the Company would be financially at risk for providing the credits due that the counterparty reneged on. The failure of the counterparty to perform could negatively impact the Company's financial strength and reduce the Company's profitability.

The determination of valuation and impairments of fixed income securities include estimations and assumptions that are subjective and prone to differing interpretations and could materially impact our results of operations or financial condition.

The determination of whether to impair an investment is based upon our evaluation of known and inherent risks which we revise as conditions change and new information becomes available. During periods of market disruption and volatility, it becomes more difficult to evaluate securities particularly if trading becomes less frequent or market data becomes less observable. As a result, valuations may include inputs and assumptions that are less observable or require greater estimation and judgment as well as valuation methods which are more complex. We also consider a wide range of factors about security issuers in evaluating the cause of a decline in the estimated fair value of a security and in assessing the prospects for recovery. The decision on whether to record an other-than-temporary impairment is determined by our assessment of the financial condition and prospects of a particular issuer, projections of future cash flows and recoverability as well as our ability and intent to hold the securities to recovery or maturity. Our conclusions concerning the recoverability of any particular security's market price could ultimately prove to be invalid as facts and circumstances change. Consequently, there can be no assurance that we have accurately assessed the level of impairments in our financial statements or that additional impairments may not need to be taken in the future.

We are subject to changing interest rates and credit spreads, market volatility, and general economic conditions which may affect the risk and returns on both our investment portfolio and our products.

We are exposed to significant capital market risk related to changes in interest rates. Substantial and sustained changes, up or down, in market interest rate levels can materially affect the profitability of our products, the market value of our investments, and ultimately the reported amount of stockholders' equity.

A rise in interest rates will increase the net unrealized loss position of our investment portfolio and may subject the Company to disintermediation risk. Disintermediation risk is the risk that policyholders may surrender their contracts in a rising interest rate environment, requiring the Company to liquidate investments in an unrealized loss position (i.e. the market value less than the carrying value of the investments). With respect to fixed income security investments the Company maintains in an "Available for Sale" category, rising interest rates will cause declines in the market value of these securities. These declines are reported in our financial statements as an unrealized investment loss and a reduction of stockholders' equity.

There may be occasions, especially in the current climate, where the Company could encounter difficulty selling some of its investments due to a lack of liquidity in the marketplace. If the Company required significant amounts of cash on short notice during such a period, it may have difficulty selling investments at attractive prices, in a timely manner or both.

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A decline in interest rates could expose the Company to reduced profitability due to minimum interest rate guarantees that are required in our products by regulation. A key component of profitability is investment spread, or the difference between the yield on our investments and the rates we credit to policyholders on our products. A narrowing of investment spreads ("spread compression") could negatively affect operating results. Although the Company has the ability to adjust the rates credited on products in order to maintain our required investment spread, a significant decline in interest rate levels could affect investment yields to the point where the investment spread is compromised due to minimum interest rate guarantees. In addition, the potential for increased policy surrenders and cash withdrawals, competitor activities, and other factors could further limit the Company's ability to maintain crediting rates on its products at levels necessary to avoid sacrificing investment spread.

The profitability of the Company's fixed-indexed products linked in part to market indices is significantly affected by the cost of underlying call options purchased to fund the credits owed to contract holders selecting this form of interest crediting. If there are little or no gains on the call options purchased over the expected life of these fixed-indexed products, the Company would incur expenses for credited interest over and above the option costs. In addition, if the Company does not successfully match the terms of the underlying call options purchased with the terms of the fixed-indexed products, the index credits could exceed call option proceeds. This would serve to reduce the Company's spread on the products and decrease profits.

We are subject to incurring difficulties in marketing and distributing our products through our current and future distribution channels.

The Company distributes its life and annuity products through independent broker-agents. There is substantial competition, particularly in the Company's domestic market, for independent broker-agents with the demonstrated ability to market and sell insurance products. Competition for these individuals or organizations typically centers on company reputation, products, compensation, home office support and the insurer's financial strength ratings. The Company's future sales and financial condition are dependent upon avoiding significant interruptions in attracting and retaining independent broker-agents.

We are subject to a downgrade in our financial strength ratings which may negatively affect our ability to attract and retain independent distributors, make our products less attractive to consumers, and may have an adverse effect on our operations.

Financial strength ratings are an important criteria in establishing the competitive position of insurers. Ratings generally reflect the rating agencies' view of a particular company's financial strength, operating performance, and ability to meet its obligations to policyholders. However, some of the rating factors often relate to the particular views of the rating agency, their independent economic modeling, the general economic climate, and other circumstances outside of the insurer's control. Accordingly, we cannot predict with any certainty what actions rating agencies may take. A downgrade in our financial strength rating, or an announced potential downgrade, could affect our competitive position and make it more difficult to market our products vis-à-vis competitors with higher financial strength ratings. In extreme situations, a significant downgrade action by one or more rating agency could induce existing policyholders to cancel their policies and withdraw funds from the Company. Currently, the major rating agencies, including A.M. Best and Standard & Poor's, maintain negative outlooks on the U.S. life insurance industry primarily based upon expectations for larger than normal investment credit losses and reduced financial flexibility. Accordingly, these rating agencies could revise their benchmarks regarding levels of capital, earnings, and other metrics that align with particular rating levels and impact their rating assessments of U.S. life insurance companies. These events could have a material adverse effect on our financial position and liquidity.

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We are subject to competition from new sources as well as companies having substantially greater financial resources, higher ratings, and more expansive product offerings which could have an adverse impact upon our business levels and profitability.

Our ability to compete is based upon a variety of factors including financial strength ratings, competitive products, service, scale, and distribution capacity. In recent years, there has been considerable consolidation among companies in the insurance and financial sectors resulting in large, well-capitalized entities that offer products comparable to the Company. Frequently, these larger organizations are not domiciled in the United States or are financial services entities attempting to establish a position in the insurance industry. These larger competitors often enjoy economies of scale which produce lower operating costs and the wherewithal to absorb greater risk allowing them to price products more competitively and, in turn, attract independent distributors. Consequently, the Company may encounter additional product pricing pressures and be challenged to maintain profit margin targets and profitability criteria. Because of these competitive presences, the Company may not be able to effectively compete without negative affects on our financial position and results.

We are subject to regulation and changes to existing laws that may affect our profitability or means of operations.

The Company is subject to extensive laws and regulations which are complex and subject to change. In addition, these laws and regulations are enforced by a number of different authorities including, but not limited to, state insurance regulators, the Securities and Exchange Commission (SEC), state attorney generals, and the U.S. Department of Justice. Compliance with these laws and regulations is time consuming and any changes may materially increase our compliance costs and other expenses of doing business. The regulatory framework at the state and, increasingly, federal level pertaining to insurance products and practices is advancing and could affect not only the design of our products but our ability to continue to sell certain products.

Life insurer products generally offer tax advantages to policyholders via the deferral of income tax on policy earnings during the accumulation phase of the product, be it an annuity or a life insurance product. Taxes, if any, are payable on income attributable to a distribution under a policy/contract for the year in which the distribution is made. Periodically, Congress has considered legislation that would reduce or eliminate this tax deferral advantage inherent to the life insurance industry and subject the industry's products to treatment more equivalent with other investments. In the event that the tax-deferred status of life insurance products is revised or reduced by Congress all life insurers would be adversely impacted.

Insurance companies that do business in a particular state are subject to assessment up to certain prescribed limits by that state's insurance guaranty association to provide funds to help pay for policyholder losses or liabilities of insolvent insurance companies. As the amount and timing of assessments by state insurance guaranty associations is outside of the Company's control, the liabilities provided for these potential assessments in our financial statements may differ from the amounts ultimately assessed.

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 and 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 was not effective until January 12, 2011, but is currently subject to legal challenges by National Western and other companies regarding the validity. The SEC, in briefing regarding appropriate remedies, has "determined to consent to" a two year stay of Rule 151A's effective date to run from the date of publication of a reissued or retained Rule 151A in the Federal Register. In the event rule 151A is not overturned, it could have a material effect on our business, results of operations and financial condition.

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We may be subject to unfavorable judicial developments, including the time and expense of litigation, which potentially could affect our financial position and results.

In the ordinary course of business, we are involved in various legal actions common to the life insurance industry, some of which may occasionally assert claims for large amounts. Companies in the life insurance and annuity lines of business have encountered litigation, including class action lawsuits, pertaining to allegations of improper sales practices in connection with the sale of life insurance, improper design of products, bad faith in the handling of insurance claims, and other similar pleas. In addition, life insurance companies are subject to risk of errors and misconduct of the agents selling their products for fraud, non-compliance with policies and recommending products or transactions that are not suitable in a particular situation. Given the inherent unpredictability of litigation, there can be no assurance that such litigation, current or in the future, will not have such a material adverse effect on the Company's results of operation or cash flows in any particular reporting period.

We could be liable with respect to liabilities ceded to reinsurers if the reinsurers fail to meet the obligations assumed by them.

The Company cedes material amounts of insurance to other unaffiliated insurance companies through reinsurance. However, these reinsurance arrangements do not fully discharge the Company's obligation to pay benefits on the reinsured business. If a reinsurer fails to meet its obligations, the Company would be forced to cover these claims. In addition, if a reinsurer becomes insolvent, it may cause the Company to lose its reserve credits on the ceded business which require the establishment of additional reserves. To mitigate the risks associated with the use of reinsurance, the Company carefully monitors the ratings and financial condition of its reinsurers on a regular basis and attempts to avoid concentration of credit risks by spreading its business among several reinsurers in order to diversify its risk exposure.

We are subject to policy claims experience which can fluctuate from period to period and vary from past results or expectations.

The Company's earnings are significantly influenced by policy claims received and will vary from period to period depending upon the amount of claims incurred. In any given quarter or year, there is very limited predictability of claims experience. The liability established for future policy benefits is based upon a number of different factors. Our mortality experience could be adversely impacted by a catastrophic event such as a natural disaster, terrorist attack or pandemic event. In the event our future claim experience does not match our past results or pricing assumptions, our operating results could be materially and adversely affected.

We are subject to assumption inaccuracies regarding future mortality, persistency, and interest rates used in determining deferred policy acquisition costs which may require us to accelerate our amortization.

Deferred policy acquisition costs (and deferred sales inducement amounts) are calculated using a number of assumptions related to policy persistency, mortality and interest rates. They represent costs that vary with and are primarily related to the acquisition of new insurance and annuity contracts. Amortization of deferred policy acquisition expenses is dependent upon actual and expected profits generated by the lines of business that incurred the related expenses and are amortized over the expected lives of the corresponding contracts. The deferred policy acquisition costs recorded on the balance sheet are tested to determine if they are recoverable under current assumptions. The estimates and assumptions used to amortize deferred policy acquisition costs proportional to expected gross profits are also regularly reviewed. Due to the uncertainty associated with establishing these assumptions, the Company cannot, with precision, determine the exact pattern of profit emergence. Increases in actual or future withdrawals or surrenders or investment losses, often associated with severe economic recessions, could result in an acceleration of amortization. Accordingly, actual results could differ from the related assumptions which could have a material and adverse impact on the Company’s operating results.

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We are dependent upon effective information technology systems and on development and implementation of new technologies.

The Company's business operations are technology dependent for maintaining accurate records, administering complex contract provisions, and complying with increasingly demanding regulation. While systems developments can streamline many processes and in the long term reduce the cost of doing business, these initiatives can present short-term cost and implementation risks. Projections of expenses, implementation time frames and the ultimate enhancement values may be different from expectations and escalate over time. The Company also faces rising costs and time constraints in meeting data security compliance requirements of new and proposed regulations. These increased risks and expanding requirements expose the Company to potential data loss and damages and significant increases in compliance and litigation costs.

The Company relies on its computer systems to conduct business and produce financial statements. While policies, procedures and back-up plans designed to prevent or minimize the effect of incapacity or failure are maintained, the Company's computer systems may be vulnerable to disruptions or breaches as a result of natural disasters, man-made disasters, criminal activity or other events beyond the Company's control. The failure or incapacity of any of the Company's computer systems could disrupt operations and adversely impact our profitability.

The Company retains confidential information on its systems, including customer information and proprietary business information. The increasing volume and sophistication of computer viruses, hackers and other external threats may increase the vulnerability of the Company's systems to data breaches. Any compromise of the security of the Company's technology systems that results in the disclosure of personally identifiable customer information could damage the Company's reputation, expose it to litigation, and result in significant technical, legal and other expenses.

Some of the Company's information technology systems are older legacy-type systems and require an ongoing commitment of resources to maintain current standards. These legacy systems are written in older programming languages with which fewer and fewer individuals are knowledgeable of and trained in. The Company's success is in large part dependent on maintaining and enhancing the effectiveness of existing legacy systems and failure of these systems for any reason could disrupt our operations, result in the loss of business and adversely impact our profitability.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Westcap Corporation, a wholly owned subsidiary, owns the Company's principal office location in Austin, Texas and two buildings adjacent to it, totaling approximately 93,000 square feet that are leased and utilized by the Company. The Company's affiliate, Regent Care Building, LP, owns a 65,000 square foot building in Reno, Nevada, which is leased and utilized by another of the Company's affiliates, Regent Care Operations, LP, for use in its nursing home operations. The Company's subsidiary, Regent Care San Marcos Holdings, LLC, completed construction of a 74,000 square foot building in San Marcos, Texas in 2009 used in nursing home operations. Lease costs and related operating expenses for facilities of the Company's subsidiaries are currently not significant in relation to the Company's consolidated financial statements. The intercompany lease costs related to The Westcap Corporation and the nursing homes have been eliminated for consolidated reporting purposes.

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ITEM 3. LEGAL PROCEEDINGS

The Company was 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 certified a class consisting of certain California policyholders age 65 and older alleging violations under California Business and Professions Code section 17200. The court additionally certified a subclass of 36 policyholders alleging fraud against their agent, and vicariously against the Company. The California Insurance Department had intervened in this case asserting that the Company has violated California insurance laws. The parties to this case had been involved in court-ordered mediation and ongoing negotiations. On February 22, 2010, the Company reported in a Form 8-K filing a settlement agreement with the plaintiffs and plaintiff in intervention providing a settlement benefit of approximately $17 million. The settlement agreement is subject to final court approval.

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. 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 the named Defendant in the case of Sheila Newman vs. National Western Life Insurance Company which alleged mishandling of policyholder funds by an agent. On February 3, 2010, the 415th Judicial District Court of Parker County in Weatherford, Texas, entered a Final Judgment against the Company of approximately $208,000 for actual damages, attorney's fees for preparation of trial, and prejudgment interest on the actual damages. In addition, the Final Judgment included $150 million for exemplary damages. The Company will continue to vigorously defend this case by filing an appeal of the Final Judgment with the proper Court of Appeals in Texas. The Company believes the Final Judgment is inconsistent with current state and federal laws and intends to establish on appeal that it is not liable for the Plaintiff's actual or exemplary damages.

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.

The amounts provided in the financial statements at December 31, 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 Company and others subsequently filed suit in the U.S. Court of Appeals for the District of Columbia to overturn this rule. As a result, the court requested the SEC to make additional findings and to resubmit the rule. The new rule was scheduled to be effective January 12, 2011, but is currently subject to legal challenges by National Western and other companies regarding its validity. The SEC, in briefing regarding appropriate remedies, has "determined to consent to" a two year stay of Rule 151A's effective date to run from the date of publication of a reissued or retained Rule 151A in the Federal Register. In the event rule 151A is not overturned, it could have a material effect on our business, results of operations and financial condition.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the Company's security holders during the fourth quarter of 2009.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

The principal market on which the Class A common stock of the Company trades is The NASDAQ - Stock Market® under the symbol "NWLI". The high and low sales prices for the Class A common stock for each quarter during the last two years are shown in the following table.

			High	Low
2009:	First Quarter	$	161.80	58.30
	Second Quarter		138.25	108.00
	Third Quarter		181.25	115.45
	Fourth Quarter		195.98	165.29
2008:	First Quarter	$	221.67	173.55
	Second Quarter		259.97	199.00
	Third Quarter		258.46	193.20
	Fourth Quarter		275.00	111.06

Equity Security Holders

The number of stockholders of record on March 11, 2010 was as follows:

Class A Common Stock	4,317
Class B Common Stock	2

Dividends

During 2009, the Company paid cash dividends on its Class A and Class B common stock in the amounts of $1,233,348 and $36,000, respectively. During 2008, the Company also paid cash dividends on its Class A and Class B common stock in the amounts of $1,233,348 and $36,000, respectively. Payment of dividends is within the discretion of the Company's Board of Directors. The Company's general policy is to reinvest earnings internally to finance the development of new business.

Securities Authorized For Issuance Under Equity Compensation Plans

The Company has two equity compensation plans that were approved by security holders. Under the two plans, a total of 104,577 shares of the Company's Class A common stock may be issued upon exercise of the outstanding options at December 31, 2009. The weighted average exercise price of the outstanding options is $174.24 per option. Excluding the outstanding options, 292,400 shares of the common stock remain available for future issuance under the plans at December 31, 2009.

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Performance Graph

The following graph compares the change in the Company's cumulative total stockholder return on its common stock with the NASDAQ - U.S. Companies Index and the NASDAQ - Insurance Stock Index. The graph assumes that the value of the Company's common stock and each index was $100 at December 31, 2004, and that all dividends were reinvested.

Issuer Purchases of Equity Securities

Effective March 10, 2006, the Company adopted and implemented a limited stock buy-back program associated with the Company's 1995 Stock Option and Incentive Plan ("Plan") which provides Option Holders the additional alternative of selling shares acquired through the exercise of options directly back to the Company. Option Holders may elect to sell such acquired shares back to the Company at any time within ninety (90) days after the exercise of options at the prevailing market price as of the date of notice of election.

Effective August 22, 2008 the Company adopted and implemented another limited stock buy-back program substantially similar to the 2006 program for shares issued under the 2008 Incentive Plan.

During November 2009, 235 shares were purchased from Option Holders at an average price of $92.13. Purchased shares are reported in the Company's consolidated financial statements as authorized and unissued.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following five-year financial summary includes comparative amounts derived from the audited consolidated financial statements.

	Years Ended December 31,				
	2009	2008	2007	2006	2005
	(In thousands except per share amounts)				
Earnings Information:					
Revenues:					
Life and annuity premiums	$17,043	17,752	19,513	15,805	14,602
Universal life and annuity contract revenues	145,651	133,424	119,677	106,320	96,765
Net investment income	393,531	273,362	318,137	379,768	310,213
Other income	17,348	12,769	13,683	17,304	9,579
Realized gains (losses) on investments	(5,167)	(26,228)	3,497	2,662	9,884
Total revenues	568,406	411,079	474,507	521,859	441,043
Benefits and expenses:					
Life and other policy benefits	48,997	39,759	41,326	35,241	39,162
Amortization of deferred policy acquisition costs	115,163	127,161	88,413	90,358	87,955
Universal life and investment annuity contract interest	242,816	138,960	164,391	213,736	150,692
Other operating expenses	92,192	55,630	55,130	65,709	46,349
Total expenses	499,168	361,510	349,260	405,044	324,158
Earnings before Federal income taxes	69,238	49,569	125,247	116,815	116,885
Federal income taxes	23,754	15,927	39,876	40,472	39,618
Net earnings	$45,484	33,642	85,371	76,343	77,267
Basic Earnings Per Share:					
Class A	$12.90	9.54	24.24	21.69	22.06
Class B	$6.45	4.77	12.12	10.84	11.00
Diluted Earnings Per Share:					
Class A	$12.87	9.48	23.95	21.46	21.83
Class B	$6.45	4.77	12.12	10.84	11.00
Balance Sheet Information:					
Total assets	$7,518,735	6,786,480	6,835,326	6,693,443	6,369,008
Total liabilities	$6,404,682	5,800,267	5,823,641	5,760,459	5,495,000
Stockholders’ equity	$1,114,053	986,213	1,011,685	932,984	874,008

Book value per common share	$307.24	271.99	279.29	257.67	241.89

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ITEM 7. 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 or its subsidiaries are or may be viewed as forward-looking. Although the Company has taken appropriate care in developing any such information, forward-looking information involves risks and uncertainties that could significantly impact actual results. These risks and uncertainties include, but are not limited to, matters described in the Company's SEC filings such as exposure to market risks, anticipated cash flows or operating performance, future capital needs, and statutory or regulatory related issues. However, National Western, 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 years ended December 31, 2009 follows. This discussion should be read in conjunction with the Company's consolidated financial statements and related notes beginning on page 60 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 contract holders both domestically and internationally. The Company accepts funds from policyholders or contract holders and establishes a liability representing future obligations to pay the policy or contract holders and their beneficiaries. To ensure the Company will be able to pay these future commitments, the funds received as premium payments and deposits are invested in high quality investments, primarily fixed income securities.

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

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

The Company monitors these factors continually as key business indicators. The discussion that follows in this Item 7 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.

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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) the Company does not intend to sell the investment prior to 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 changing interest rates or market dislocations only if the Company intended to sell the securities prior to recovery. When a security is deemed to be impaired a charge is recorded equal to the difference between the fair value and amortized cost basis of the security. In compliance with GAAP guidance the estimated credit versus the non-credit components are bifurcated, and the non-credit component reclassified as unrealized losses in other comprehensive income. 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 Policy Acquisition Costs ("DPAC"). 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 DPAC 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 of its universal life and annuity contracts 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 its 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 DPAC balance to the level it would have been if using the new assumptions from the inception date of each policy.

DPAC 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 DPAC balance to be amortized in the future. The present value of these cash flows, less the benefit reserve, is compared with the unamortized DPAC balance and if the DPAC balance is greater, the deficiency is charged to expense as a component of amortization and the asset balance is reduced to the recoverable amount. For more information about accounting for DPAC see Note 1, Summary of Significant Accounting Policies, of the consolidated financial statements.

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 DPAC, and are included in interest credited to contract holders' funds. Deferred sales inducements are periodically reviewed for recoverability. For more information about accounting for DPAC see Note 1, Summary of Significant Accounting Policies, of the consolidated financial statements.

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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. A discussion of the assumptions used to calculate the liability for future policy benefits is reported in Note 1, Summary of Significant Accounting Policies, in the Notes to Consolidated Financial Statements.

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, Note 3, Investments, in the Notes to Consolidated Financial Statements, and the discussions under Investments in Item 7 of this report.

Pension Plans and Other Postretirement Benefits. The Company sponsors a qualified defined benefit pension plan, which was frozen effective December 31, 2007, covering substantially all employees, 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, 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.

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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.

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

Ÿ exercise price

Ÿ expected term based on contractual term and perceived future behavior relative to exercise

Ÿ current price

Ÿ expected volatility

Ÿ risk-free interest rates

Ÿ 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 the Notes to Consolidated Financial Statements.

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 the first half of 2009. Volatility and disruption in the financial markets caused the availability and cost of credit to be materially affected. Consumer confidence declined in the face of depressed home prices, increasing foreclosures, and higher unemployment. Eventually, these factors precipitated a severe recession in many ways akin to the Great Depression.

This combination of economic conditions began to negatively impact our sales in 2008, particularly in the domestic life and international life segments. Although the financial markets and the economy began to show improvement in the latter half of 2009, international life insurance sales, as measured by placed annualized target premium, declined 15% from 2008 levels and domestic life insurance sales dropped 74%. Economic indicators are currently pointing toward the economy as having emerged from the trough of the recession and possibly toward a line of growth in the immediate future. However, high unemployment, massive Federal government budget deficits, instability in the European economic markets, and the threat of looming inflation make the prospects of future economic stability and prosperity anything but certain. Consequently, demand for our life insurance products may continue to be adversely impacted during this period of economic uncertainty. It is also uncertain what impact, if any, the current environment may have upon the incidence of claims, policy lapses, or surrenders of policies.

The economic backdrop did not have a similar influence on our annuity product sales. Annuity sales in 2009 increased 106% over the levels attained in 2008. Several factors may explain this outcome including: (1) during uncertain economic periods, consumers follow a flight to safety toward lower risk assets such as annuity products; (2) the

Company's strong financial position, upgrade in financial strength rating from A.M. Best during the year and ample capital resources enhanced our presence in the annuity marketplace with independent distributors and end market consumers; and (3) many of the Company's competitors incurred reductions in their capital base due to a deterioration in the quality of their investment portfolios, including investment impairments and losses, which caused them to curtail sales activity and recruitment of independent distribution. Despite the growth in annuity sales, it is unclear what effect ongoing economic challenges may have upon future business levels.

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The fixed income markets, our primary investment source, have experienced a high level of turmoil and constrained market liquidity conditions. Recently, there have been some improvements in this market although the low interest rate environment and tightening of interest spreads over U.S. treasury investment rates present a different set of tests. Credit downgrades of fixed income instruments by rating agencies were fairly prevalent during the first nine months of calendar 2009 with the fourth quarter producing much less activity in this regard. Market analysts generally anticipate events of default to continue into 2010 with moderation occurring during the second half of the year. The Company has experienced minimal impairment and degradation of quality in its fixed income holdings thus far although future events may not produce the same success in this regard.

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. Some market sectors remain dislocated with market valuations not indicative of true economic value.

Credit spreads (difference between bond yields and risk-free interest rates) on fixed maturity securities increased markedly during 2008 given the market conditions but tightened throughout 2009 and on into 2010. While the increase in credit spreads in 2008 and early in 2009 generated higher yields making our products more attractive to consumers, the subsequent spread tightening caused investment yields to fall dramatically. The lower investment yields not only cause the Company’s products to appear less appealing to consumers but also require skillful management of the Company’s earnings margin relative to minimum interest guarantee levels. It also caused us to hold a higher amount of cash and short-term investments at very low interest rates while portfolio managers searched for investment securities meeting the Company’s criteria for quality, diversification, duration and yield.

Our operating strategy is to maintain capital levels substantially above regulatory and rating agency requirements. While not significant, our capital levels incurred declinations for impairment losses on investments during 2008 and 2009. Despite these modest reductions in capital, the Company maintains resources more than adequate to fund future growth and absorb abnormal periods of cash outflows.

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 derivative and realized investment gains and losses from operating revenues. Similar measures are commonly used in the insurance industry in order to assess profitability and results from ongoing operations. The Company believes that the presentation of these non-GAAP financial measures enhances the understanding of the Company’s results of operations by highlighting the results from ongoing operations and the underlying profitability factors of the Company’s business. The Company excludes or segregates derivative and realized investment gains and losses because such items are often the result of events which may or may not be at the Company’s discretion and the fluctuating effects of these items could distort trends in the underlying profitability of the Company’s business. Therefore, in the following sections discussing 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.

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Consolidated Operations

Revenues. The following details Company revenues:

	Years Ended December 31,		
	2009	2008	2007
		(In thousands)	
Universal life and annuity contract charges	$ 145,651	133,424	119,677
Traditional life and annuity premiums	17,043	17,752	19,513
Net investment income (excluding derivatives)	348,186	339,038	334,799
Other revenues	17,348	12,769	13,683
Operating revenues	528,228	502,983	487,672
Derivative income (loss)	45,345	(65,676)	(16,662)
Net realized investment (losses) gains	(5,167)	(26,228)	3,497
Total revenues	$ 568,406	411,079	474,507

Universal life and annuity contract revenues - Revenues for universal life and annuity contract revenues increased 9.2% in 2009 compared to 2008. Revenues for these products consist of policy charges for the cost of insurance, administration charges, and surrender charges assessed against policyholder account balances, less reinsurance premiums. Cost of insurance charges were $83.6 million in 2009 compared to $82.9 million in 2008 and $74.3 million in 2007. Administrative charges were $25.4 million, $25.0 million and $20.9 million for the years ended December 31, 2009, 2008 and 2007, respectively. Surrender charges assessed against policyholder account balances upon withdrawal were $50.0 million in 2009 compared to $39.1 million in 2008 and $33.4 million in 2007.

Traditional life and annuity premiums - Traditional life and annuity premiums decreased 4.0% in 2009 compared to 2008. Traditional life insurance premiums for products such as whole life and term life are recognized as revenues over the premium-paying period. The Company's life insurance sales focus has been primarily centered around universal life products. Universal life products, especially the Company's equity indexed universal life products, offer the opportunity for consumers to acquire life insurance protection and receive credited interest linked in part to an outside market index such as the S&P 500 Index®.

Net investment income (with and without derivatives) - A detail of net investment income is provided below.

	Years Ended December 31,		
	2009	2008	2007
		(In thousands)	
Gross investment income:			
Debt securities	$ 332,207	321,234	315,271
Mortgage loans	6,346	7,223	8,513
Policy loans	5,901	6,096	6,302
Short-term investments	116	956	1,496
Other investments	6,982	5,934	6,087
Total investment income	351,552	341,443	337,669
Less: investment expenses	3,366	2,405	2,870

Net investment income (excluding derivatives)	348,186	339,038	334,799
Derivative income (loss)	45,345	(65,676)	(16,662)
Net investment income	$393,531	273,362	318,137

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Investment grade debt securities generated approximately 95.4% of net investment income, excluding derivatives, in 2009. The decrease in short-term investment income in 2009 is attributable to the very low interest rates available on money market funds during all of 2009. Interest income earned on other investments increased due to new investments in collateralized loans made during the second half of 2009.

Net investment income performance is analyzed excluding derivative income (loss), which is a common practice in the insurance industry, in order to assess underlying profitability and results from ongoing operations. Net investment income performance is summarized as follows:

	Years Ended December 31,		
	2009	2008	2007
	(In thousands except percentages)		
Excluding derivatives:			
Net investment income	$348,186	339,038	334,799
Average invested assets, at amortized cost	$6,056,042	5,762,688	5,732,212
Yield on average invested assets	5.75 %	5.88 %	5.84 %
Including derivatives:			
Net investment income	$393,531	273,362	318,137
Average invested assets, at amortized cost	$6,083,722	5,814,439	5,789,502
Yield on average invested assets	6.47 %	4.70 %	5.50 %

The average invested asset yield, excluding derivatives, decreased in 2009 due to the Company obtaining lower yields on newly invested cash inflows. The Company invests substantially most of its net cash flows in debt securities whose yields fell during 2009 with the decline in U.S. Treasury yields. Although the Company's average credit spread on debt securities purchased for insurance operations widened to approximately 270 basis points during 2009 from 240 basis points in 2008, the overall drop in interest rate levels more than offset the incremental spread on new investments. The average invested asset yield, including derivatives, increased due to the recovery in the equity markets during 2009. Refer to the derivatives discussion following this section for a more detailed explanation.

Other revenues - Other revenues consists primarily of gross income associated with nursing home operations of $15.7 million, $12.5 million and $12.6 million in 2009, 2008 and 2007, respectively. In addition, the Company received $0.5 million related to lawsuit settlements during 2007.

Derivative income (loss) - Index options are derivative financial instruments used to fully hedge the equity return component of the Company's fixed-indexed products, which were first introduced for sale in 1997. In 2002, the Company began selling a fixed-indexed universal life product in addition to its fixed-indexed annuities. Any 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.

Income and losses from index options are due to market conditions. Index options are intended to act as hedges to match the returns on the product's underlying reference index and the rise or decline in the index causes option values to likewise rise or decline. The Company does not elect hedge accounting relative to these derivative instruments. While income from index options fluctuates with the underlying index, the contract interest expense to policyholder accounts for the Company's fixed-indexed products also fluctuates in a similar manner and direction. In 2009, the reference indices increased and the Company recorded income from index options and likewise increased contract interest expenses. In 2008 and 2007, the reference indices decreased resulting in index option losses and a reduction in contract interest expenses.

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The table below summarized the derivate income (loss) amounts and total contract interest by year.

	Years Ended December 31,		
	2009	2008	2007
		(In thousands)	
Derivatives:			
Unrealized income (loss)	$93,085	(17,480)	(56,204)
Realized income (loss)	(47,740)	(48,196)	39,542
Total income (loss) included in net investment income	$45,345	(65,676)	(16,662)
Total contract interest	$242,816	138,960	164,391

Net realized investment (losses) gains - Realized losses on investments have primarily resulted from impairment write-downs on investments in debt securities and valuation allowances recorded on mortgage loans. The net losses reported in 2009 of $5.2 million consisted of gross gains of $2.2 million primarily from calls and sales of debt securities, offset by gross losses of $7.4 million, which includes other-than-temporary impairment losses.

The Company records impairment write-downs when a decline in value is considered to be other-than-temporary and full recovery of the investment is not expected. Impairment write-downs are summarized in the following table.

	Years Ended December 31,		
	2009	2008	2007
		(In thousands)	
Impairment or valuation write-downs:			
Bonds	$5,105	21,803	67
Equities	416	5,412	-
Mortgage loans	1,461	1,020	1,467
	$6,982	28,235	1,534

Due to events providing evidence of a significant deterioration in the issuers' credit worthiness, one security was transferred from the held to maturity to the available for sale classification, and was ultimately sold.

The equity impairments represent mark-to-market write-downs on various equity holdings. In addition, the 2008 amount includes Fannie Mae and Freddie Mac preferred stock impairments of $4.6 million.

The mortgage loan valuation writedown in 2009 relates to a property located in Steubenville, Ohio. The writedown in 2008 principally involves a property located in Ft. Smith, Arkansas. The 2007 mortgage loan valuation writedown involves a New Orleans, Louisiana property whose value was negatively impacted by Hurricane Katrina.

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Benefits and Expenses. The following details benefits and expenses.

	Years Ended December 31,		
	2009	2008	2007
		(In thousands)	
Life and other policy benefits	$48,997	39,759	41,326
Amortization of deferred policy acquisition costs	115,163	127,161	88,413
Universal life and annuity contract interest	242,816	138,960	164,391
Other operating expenses	92,192	55,630	55,130
Totals	$499,168	361,510	349,260

Life and other policy benefits - Life and other policy benefits include death claims of $30.2 million, $29.6 million and $28.5 million for 2009, 2008 and 2007, respectively.

The Company is implementing new actuarial reserving systems that will enhance its ability to provide estimates used in establishing future policy liabilities, monitor the deferred acquisition cost asset and the deferred sales inducement 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 year ended December 31, 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 an increase of $11.6 million in reserves and policy benefit expenses.

Amortization of deferred policy 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 consolidated financial statements occurs over future periods in relation to the expected emergence of profits priced into the products sold. This emergence of profits is based upon assumptions regarding premium payment patterns, mortality, persistency, investment performance, and expense patterns. Companies are required to review universal life and annuity contract assumptions periodically to ascertain whether actual experience has deviated significantly from that assumed. If it is determined that a significant deviation has occurred, the emergence of profit patterns is to be "unlocked" and reset based upon the actual experience.

An unlocking adjustment was recorded in 2009 which resulted in an increase of amortization of $5.2 million. This unlocking adjustment was based upon changes to future mortality assumptions reflecting current experience studies and assumption changes regarding the level of future policy maintenance expenses. An unlocking adjustment was also recorded in 2008 which resulted in an increase of amortization by $8.1 million. This unlocking adjustment was based upon assumption changes to future annuitizations and full surrenders reflecting current experience studies. An unlocking adjustment was recorded in 2007 which resulted in a decrease in amortization of $10.4 million. This unlocking adjustment was based upon changes to future mortality assumptions reflecting current experience studies and assumption changes to future cost of insurance rates. 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.

In accordance with GAAP guidance the Company writes off deferred acquisition costs, unearned revenue liabilities, and deferred sales inducement assets upon internal replacement of certain contracts as well as annuitizations of deferred annuities.

The Company is required to periodically adjust for actual experience that varies from that assumed. True-up adjustments were recorded in 2009, 2008 and 2007 relative to partial surrender rates, mortality rates, credited interest rates and earned rates for the current year's experience resulting in $8.4 million, $16.2 million, and $1.0 million increases in amortization, respectively.

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Universal life and annuity contract interest - The Company closely monitors credited interest rates on interest sensitive policies, taking into consideration such factors as profitability goals, policyholder benefits, product marketability, and economic market conditions. As long-term interest rates change, the Company's credited interest rates are often adjusted accordingly, taking into consideration the factors described above. The difference between yields earned on investments over policy credited rates is often referred to as the "interest spread". Raising policy credited rates can typically have an impact sooner than higher market rates on the Company's investment portfolio yield, making it more difficult to maintain the current interest spread.

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

	December 31,			December 31,		
	2009	2008	2007	2009	2008	2007
	(Excluding equity-indexed products)			(Including equity-indexed products)		
Annuity	2.83 %	3.01 %	3.41 %	4.11 %	2.42 %	2.84 %
Interest sensitive life	3.80 %	3.92 %	3.23 %	6.83 %	3.39 %	4.28 %

Contract interest includes the performance of the derivative component of the Company's equity-indexed products. As previously noted, the recent market performance of these derivative features increased contract interest expense in 2009 and 2007, and decreased contract interest expense in 2008, with corresponding offsetting effects in the Company's investment income given the hedge nature of the options. With these credited rates, the Company generally realized its targeted interest spread on its products.

Other operating expenses - Other operating expenses consist of general administrative expenses, legal costs, licenses and fees, commissions not subject to deferral, and expenses of nursing home operations. As discussed previously in Item 3. Legal Proceedings, and in reports on Form 8-K which the Company issued on February 9, 2010 and February 22, 2010, the Company is currently involved in various legal actions in the normal course of its business. In accordance with generally accepted accounting principles, the Company accrued $23.0 million during the year ended December 31, 2009 for potential future costs pertaining to these various matters.

During 2009, the Company started or accelerated major information system initiatives to enhance actuarial, accounting, policy acquisition, and policy administration processes. Non-capitalizable expenses associated with these various system development efforts were approximately $1.5 million higher than amounts incurred in 2008. Deprecation expense increased $0.9 million in association with new system implementations.

Guaranty fund assessment expenses increased to $0.5 million in 2009 from $0.3 million and $(0.2) million in 2008 and 2007, respectively.

Nursing home expenses amounted to $14.9 million, $11.4 million and $11.0 million in 2009, 2008 and 2007, respectively. The higher level of expenses during 2009 is primarily related to the start-up of operations of the Company’s second nursing home during 2009.

Compensation costs related to stock options totaled $1.6 million in 2009, $(1.4) million in 2008 and $(1.1) million in 2007 as a result of marking the options to fair value under the liability method of accounting.

Federal income taxes - Federal income taxes on earnings from continuing operations for 2009, 2008 and 2007 reflect effective tax rates of 34.3%, 32.1% and 31.8%, respectively, which are lower than the expected Federal rate of 35% primarily due to tax-exempt investment income related to investments in municipal securities and dividends-received deductions on income from stock investments.

During 2008, the Company was notified that its 2005 tax return amendment, which was filed September 2007, was being audited by the IRS. The audit is currently in progress. Adjustments to the amended return, if any, are not expected to have a material effect on the financial condition or operating results of the Company.

During the second quarter of 2007, upon the completion of a detailed review of deferred tax items, the Company identified a $2.3 million error in the net deferred tax liability. The error, which occurred during various periods prior to 2005, was corrected in the second quarter of 2007 and resulted in a decrease in the net deferred tax liability and deferred tax expense. The adjustment was not material to 2007 or any prior period financial statements.

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Segment Operations

Summary of Segment Earnings

A summary of segment earnings from continuing operations for the years ended December 31, 2009, 2008 and 2007 is provided below. The segment earnings exclude realized gains and losses on investments, net of taxes.

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Segment earnings:					
2009	$426	14,663	25,460	8,294	48,843
2008	717	15,350	27,842	6,781	50,690
2007	342	20,179	56,299	6,278	83,098

Domestic Life Insurance Operations

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

	Years Ended December 31, 2009	2008	2007
		(In thousands)	
Premiums and other revenue:			
Premiums and contract charges	$34,414	27,919	25,879
Net investment income	19,498	20,254	18,863
Other revenues	25	20	41
Total premiums and other revenue	53,937	48,193	44,783
Benefits and expenses:			
Life and other policy benefits	13,884	14,478	14,922
Amortization of deferred policy acquisition costs and deferred sales inducements	16,423	12,416	7,998
Universal life insurance contract interest	9,014	9,171	9,463
Other operating expenses	13,968	11,057	11,898
Total benefits and expenses	53,289	47,122	44,281
Segment earnings before Federal income taxes	648	1,071	502
Federal income taxes	222	354	160
Segment earnings	$426	717	342

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

	Years Ended December 31,		
	2009	2008	2007
		(In thousands)	
Universal life insurance revenues	$32,993	26,978	23,028
Traditional life insurance premiums	6,378	5,849	6,629
Reinsurance premiums	(4,957)	(4,908)	(3,778)
Totals	$34,414	27,919	25,879

The Company’s premiums and contract revenues increased 23% from 2008 coinciding with sales growth in recent years of domestic life products. It is the Company's marketing plan to increase domestic life product sales through increased recruiting, new distribution and the development of new life insurance products. The Company had approximately 7,300 contracted agents as of December 31, 2009, an increase of 3,000 contracted agents from December 31, 2008.

In accordance with generally accepted accounting principles, premiums collected on universal life products are not reflected as revenues in the Company's consolidated statements of earnings. Actual domestic universal life premiums are detailed below.

	Years Ended December 31,		
	2009	2008	2007
		(In thousands)	
Universal life insurance:			
First year and single premiums	$13,640	15,272	15,592
Renewal premiums	21,978	19,948	16,639
Totals	$35,618	35,220	32,231

Net investment income decreased slightly to $19.5 million in 2009 as compared to $20.3 million in 2008 and $18.9 million in 2007, due to lower investment yields from debt security investment purchases backing the obligations of the line of business.

Policy benefits in 2009, 2008 and 2007 were consistent with Company expectations. Other operating expenses were $2.9 million higher in 2009 reflecting the factors discussed in the other operating expense section of consolidated operations above.

During the current year, unlocking of the projected universal life per policy maintenance expense and projected mortality assumptions decreased the DPAC asset balance and increased life DPAC amortization by $2.7 million. Current year true-up adjustments increased amortization expense by $1.9 million. No unlocking adjustments were recorded in 2008. True-up adjustments increased DPAC amortization $1.4 million for the year. During 2007, the Company recorded an unlocking adjustment for changes in mortality assumptions which reduced the DPAC asset and increased DPAC amortization expense by $2.2 million. True-up adjustments increased DPAC amortization expense by $0.6 million.

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International Life Insurance Operations

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

	Years Ended December 31,		
	2009	2008	2007
	(In thousands)		
Premiums and other revenue:			
Premiums and contract charges	$ 104,016	97,661	88,782
Net investment income	44,540	17,350	24,690
Other revenues	68	62	126
Total premiums and other revenue	148,624	115,073	113,598
Benefits and expenses:			
Life and other policy benefits	19,522	21,292	22,810
Amortization of deferred policy acquisition costs and deferred sales inducements	41,849	37,525	24,959
Universal life insurance contract interest	45,868	16,803	20,993
Other operating expenses	19,048	16,502	15,271
Total benefits and expenses	126,287	92,122	84,033
Segment earnings before Federal income taxes	22,337	22,951	29,565
Federal income taxes	7,674	7,601	9,386
Segment earnings	$ 14,663	15,350	20,179

In general, as the amount of international life insurance in force grows, the Company anticipates operating earnings to increase as well. The amount of international life insurance in force grew from $14.8 billion at December 31, 2007 to $15.9 billion at December 31, 2008. However, international life insurance in force declined slightly to $15.7 billion at December 31, 2009, in reaction to the U.S. financial market crisis.

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.

	Years Ended December 31,		
	2009	2008	2007
	(In thousands)		
Universal life insurance revenues	$ 106,601	98,458	85,633
Traditional life insurance premiums	13,113	14,727	15,692
Reinsurance premiums	(15,698)	(15,524)	(12,543)
Totals	$ 104,016	97,661	88,782

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International operations have emphasized universal life policies over traditional life insurance products. In accordance with generally accepted accounting principles, premiums collected on universal life products are not reflected as revenues in the Company's consolidated statements of earnings. Actual international universal life premiums collected are detailed below.

	Years Ended December 31,		
	2009	2008	2007
		(In thousands)	
Universal life insurance			
First year and single premiums	$35,147	39,257	44,426
Renewal premiums	102,403	96,456	91,621
Totals	$137,550	135,713	136,047

The Company's international life operations historically have been a significant factor in the Company's overall earnings performance and represent a market niche where the Company believes it has a competitive advantage. A productive agency force has been developed given the Company's longstanding reputation for supporting its international life products coupled with the instability of competing companies in international markets. In particular, the Company has experienced growth with its fixed-indexed universal life products and has collected related premiums of $81.9 million, $78.5 million and $76.8 million for the years ended 2009, 2008 and 2007, respectively.

The appealing feature to a consumer purchasing a fixed-indexed universal life policy is the interest crediting component linked in part to an equity index. With the growth in this block of business, the period-to-period changes in fair values of the underlying options used to hedge this interest crediting feature 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.

	Years Ended December 31,		
	2009	2008	2007
		(In thousands)	
Net investment income (excluding derivatives)	$34,130	28,687	26,519
Derivative income (loss)	10,410	(11,337)	(1,829)
Net investment income	$44,540	17,350	24,690

In 2009, the Company recorded an unlocking adjustment of $2.5 million relative to changes in projected universal life per policy maintenance expenses, and projected mortality assumptions, that reduced the DPAC asset and increased amortization expense. True-up adjustments of $1.5 million were also recorded that increased amortization expense. Amortization of deferred policy acquisition costs in 2008, were impacted as the Company recorded true-up adjustments that reduced the DPAC asset and increased amortization by $3.7 million. The Company recorded an unlocking adjustment benefit in 2007 totaling $9.0 million relative to improved mortality assumptions that resulted in an increase to the DPAC asset balance and a decrease in amortization expense. In addition, a true-up adjustment of $1.7 million was also recorded in 2007 resulting in a decrease to amortization. Offsetting the decrease to 2007 amortization for the unlocking and true-up adjustments was an increase in amortization due primarily to the application of new GAAP guidance in 2007 which required the write-off of deferred balances on contracts considered substantially changed. These balances were previously carried and amortized over the projected life of the contract.

Contract interest expense includes fluctuations that are the result of underlying equity indices performance relative to the equity-indexed universal life products. The associated stock market gains (losses) increase (decrease) the amounts the Company credits to policyholders. With the recovery in the equity markets during 2009, the segment reported significant increases in net investment income and contract interest expense. For more details about the Company's use of index options to hedge equity indices performance refer to the derivative income (loss) discussion in the Consolidated Operations section of Item 7.

Other operating expenses reported in 2009 were 15.4% higher compared to 2008, reflecting the factors discussed in the other operating expense section of Consolidated Operations previously.

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Annuity Operations

The Company's annuity operations are almost exclusively in the United States. Although some of the Company's 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.

	Years Ended December 31,		
	2009	2008	2007
	(In thousands)		
Premiums and other revenue:			
Premiums and contract charges	$24,264	25,596	24,529
Net investment income	317,703	226,683	266,953
Other revenues	1,535	232	920
Total premiums and other revenue	343,502	252,511	292,402
Benefits and expenses:			
Life and other policy benefits	15,666	3,990	3,594
Amortization of deferred policy acquisition costs and deferred sales inducements	56,891	77,219	55,456
Annuity contract interest	187,934	112,986	133,935
Other operating expenses	44,227	16,685	16,931
Total benefits and expenses	304,718	210,880	209,916
Segment earnings before Federal income taxes	38,784	41,631	82,486
Federal income taxes	13,324	13,789	26,187
Segment earnings	$25,460	27,842	56,299

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.

Years Ended December 31,

2009