

NATIONAL WESTERN LIFE INSURANCE CO
Form 10-Q
August 08, 2014

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

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2014

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
(State of Incorporation)

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

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

(512) 836-1010
(Telephone Number)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated file" in Rule 12b-2 of the Exchange Act.

Large accelerated filer £ Accelerated filer R Non-accelerated filer £

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

As of August 7, 2014, the number of shares of Registrant's common stock outstanding was: Class A – 3,436,166 and Class B - 200,000.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

ASSETS	(Unaudited) June 30, 2014	December 31, 2013
Investments:		
Securities held to maturity, at amortized cost (fair value: \$6,979,345 and \$6,656,144)	\$6,641,083	6,510,320
Securities available for sale, at fair value (cost: \$2,625,676 and \$2,535,264)	2,799,450	2,651,544
Mortgage loans, net of allowance for possible losses (\$650 and \$650)	152,208	132,765
Policy loans	64,988	65,969
Derivatives, index options	146,514	169,314
Other long-term investments	30,421	30,991
Total investments	9,834,664	9,560,903
Cash and short-term investments	133,506	120,859
Deferred policy acquisition costs	774,530	785,706
Deferred sales inducements	159,143	169,570
Accrued investment income	95,816	95,367
Federal income tax receivable	3,434	—
Other assets	94,988	98,011
Total assets	\$11,096,081	10,830,416

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

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CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	(Unaudited) June 30, 2014	December 31, 2013
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Future policy benefits:		
Universal life and annuity contracts	\$9,155,686	8,987,062
Traditional life reserves	137,099	138,072
Other policyholder liabilities	149,714	142,587
Deferred Federal income tax liability	30,256	7,199
Federal income tax payable	—	10,067
Other liabilities	107,429	97,481
Total liabilities	9,580,184	9,382,468
COMMITMENTS AND CONTINGENCIES (Note 8)		
STOCKHOLDERS' EQUITY:		
Common stock:		
Class A - \$1 par value; 7,500,000 shares authorized; 3,436,165 issued and outstanding in 2014 and 3,434,765 in 2013	3,436	3,435
Class B - \$1 par value; 200,000 shares authorized, issued, and outstanding in 2014 and 2013	200	200
Additional paid-in capital	38,116	37,767
Accumulated other comprehensive income	56,670	38,080
Retained earnings	1,417,475	1,368,466
Total stockholders' equity	1,515,897	1,447,948
Total liabilities and stockholders' equity	\$11,096,081	10,830,416

Note: The Condensed Consolidated Balance Sheet at December 31, 2013 has been derived from the audited Consolidated Financial Statements as of that date.

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

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CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

For the Three Months Ended June 30, 2014 and 2013

(Unaudited)

(In thousands, except per share amounts)

	2014	2013
Premiums and other revenues:		
Universal life and annuity contract charges	\$38,217	40,363
Traditional life premiums	5,169	5,218
Net investment income	155,179	129,687
Other revenues	5,211	5,990
Net realized investment gains (losses):		
Total other-than-temporary impairment (“OTTI”) gains (losses)	—	(72)
Portion of OTTI (gains) losses recognized in other comprehensive income	—	(106)
Net OTTI losses recognized in earnings	—	(178)
Other net investment gains (losses)	3,065	1,779
Total net realized investment gains (losses)	3,065	1,601
 Total revenues	 206,841	 182,859
Benefits and expenses:		
Life and other policy benefits	14,796	18,450
Amortization of deferred policy acquisition costs	27,258	28,852
Universal life and annuity contract interest	102,429	71,438
Other operating expenses	19,500	24,843
 Total benefits and expenses	 163,983	 143,583
 Earnings before Federal income taxes	 42,858	 39,276
 Federal income taxes	 13,675	 12,285
 Net earnings	 \$29,183	 26,991
Basic earnings per share:		
Class A	\$8.26	\$7.64
Class B	\$4.13	\$3.82
Diluted earnings per share:		
Class A	\$8.25	\$7.62
Class B	\$4.13	\$3.82

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

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CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

For the Six Months Ended June 30, 2014 and 2013

(Unaudited)

(In thousands, except per share amounts)

	2014	2013
Premiums and other revenues:		
Universal life and annuity contract charges	\$76,222	78,262
Traditional life premiums	9,440	9,082
Net investment income	263,630	310,501
Other revenues	10,974	12,132
Net realized investment gains (losses):		
Total other-than-temporary impairment (“OTTI”) gains (losses)	(32	) 310
Portion of OTTI (gains) losses recognized in other comprehensive income	(3	) (549
Net OTTI losses recognized in earnings	(35	) (239
Other net investment gains (losses)	4,613	4,153
Total net realized investment gains (losses)	4,578	3,914
 Total revenues	 364,844	 413,891
Benefits and expenses:		
Life and other policy benefits	27,759	31,140
Amortization of deferred policy acquisition costs	55,837	59,656
Universal life and annuity contract interest	165,365	211,738
Other operating expenses	42,963	46,767
 Total benefits and expenses	 291,924	 349,301
 Earnings before Federal income taxes	 72,920	 64,590
 Federal income taxes	 23,911	 20,967
 Net earnings	 \$49,009	 43,623
Basic earnings per share:		
Class A	\$13.86	\$12.34
Class B	\$6.93	\$6.17
Diluted earnings per share:		
Class A	\$13.86	\$12.32
Class B	\$6.93	\$6.17

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

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

For the Three Months Ended June 30, 2014 and 2013

(Unaudited)

(In thousands)

	2014	2013	
Net earnings	\$29,183	26,991	
Other comprehensive income, net of effects of deferred costs and taxes:			
Unrealized gains (losses) on securities:			
Net unrealized holding gains (losses) arising during period	10,892	(33,107)
Net unrealized liquidity gains (losses)	28	20	
Reclassification adjustment for net amounts included in net earnings	(1,946	)	(1,037)
Amortization of net unrealized (gains) losses related to transferred securities	—	—	
Net unrealized gains (losses) on securities	8,974	(34,124)
Foreign currency translation adjustments	(122	)	3
Benefit plans:			
Amortization of net prior service cost and net gain (loss)	(175	)	373
Other comprehensive income (loss)	8,677	(33,748)
Comprehensive income (loss)	\$37,860	(6,757)

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

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Six Months Ended June 30, 2014 and 2013

(Unaudited)

(In thousands)

	2014	2013	
Net earnings	\$49,009	43,623	
Other comprehensive income, net of effects of deferred costs and taxes:			
Unrealized gains (losses) on securities:			
Net unrealized holding gains (losses) arising during period	21,894	(34,232)
Net unrealized liquidity gains (losses)	51	158	
Reclassification adjustment for net amounts included in net earnings	(2,371	)	(2,396
Amortization of net unrealized (gains) losses related to transferred securities	—	—)
Net unrealized gains (losses) on securities	19,574	(36,470)
Foreign currency translation adjustments	(633	)	593
Benefit plans:			
Amortization of net prior service cost and net gain (loss)	(351	)	754
Other comprehensive income (loss)	18,590	(35,123)
Comprehensive income	\$67,599	8,500	

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

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CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Six Months Ended June 30, 2014 and 2013

(Unaudited)

(In thousands)

	2014	2013	
Common stock:			
Balance at beginning of period	\$3,635	3,635	
Shares exercised under stock option plan	1	—	
Balance at end of period	3,636	3,635	
Additional paid-in capital:			
Balance at beginning of period	37,767	37,767	
Shares exercised under stock option plan	349	—	
Balance at end of period	38,116	37,767	
Accumulated other comprehensive income:			
Unrealized gains on non-impaired securities:			
Balance at beginning of period	46,693	91,972	
Change in unrealized gains (losses) during period, net of tax	19,523	(36,628))
Balance at end of period	66,216	55,344	
Unrealized losses on impaired held to maturity securities:			
Balance at beginning of period	(1,287)	(1,426))
Amortization	117	77	
Other-than-temporary impairments, non-credit, net of tax	—	23	
Additional credit loss on previously impaired securities	—	14	
Change in shadow deferred policy acquisition costs	(67)	(77))
Balance at end of period	(1,237)	(1,389))
Unrealized losses on impaired available for sale securities:			
Balance at beginning of period	(2)	(196))
Other-than-temporary impairments, non-credit, net of tax	—	—	
Change in shadow deferred policy acquisition costs	(1)	(123))
Recoveries, net of tax	2	244	
Balance at end of period	(1)	(75))

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NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY(continued)
 For the Six Months Ended June 30, 2014 and 2013
 (Unaudited)
 (In thousands)

	2014	2013
Foreign currency translation adjustments:		
Balance at beginning of period	3,241	2,589
Change in translation adjustments during period	(633	) 593
Balance at end of period	2,608	3,182
Benefit plan liability adjustment:		
Balance at beginning of period	(10,565	) (16,153
Amortization of net prior service cost and net loss, net of tax	(351	) 754
Balance at end of period	(10,916	) (15,399
Accumulated other comprehensive income at end of period	56,670	41,663
Retained earnings:		
Balance at beginning of period	1,368,466	1,273,492
Net earnings	49,009	43,623
Stockholder dividends	—	—
Balance at end of period	1,417,475	1,317,115
Total stockholders' equity	\$1,515,897	\$1,400,180

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Six Months Ended June 30, 2014 and 2013

(Unaudited)

(In thousands)

	2014	2013
Cash flows from operating activities:		
Net earnings	\$49,009	43,623
Adjustments to reconcile net earnings to net cash from operating activities:		
Universal life and annuity contract interest	165,365	211,738
Surrender charges and other policy revenues	(9,104)	(7,105)
Realized (gains) losses on investments	(4,578)	(3,914)
Accretion/amortization of discounts and premiums, investments	(465)	(1,487)
Depreciation and amortization	1,741	2,813
(Increase) decrease in value of derivatives	(45,799)	(91,124)
(Increase) decrease in deferred policy acquisition and sales inducement costs	(6,062)	(4,984)
(Increase) decrease in accrued investment income	(449)	(2,224)
(Increase) decrease in other assets	(1,635)	(2,594)
Increase (decrease) in liabilities for future policy benefits	1,344	5,349
Increase (decrease) in other policyholder liabilities	7,127	16,669
Increase (decrease) in Federal income taxes	(984)	(563)
Increase (decrease) in other liabilities	(2,806)	87
Other, net	(1)	—
Net cash provided by operating activities	152,703	166,284
Cash flows from investing activities:		
Proceeds from sales of:		
Securities held to maturity	—	1,980
Securities available for sale	5,334	9,670
Other investments	1,016	9,945
Proceeds from maturities and redemptions of:		
Securities held to maturity	360,420	710,366
Securities available for sale	102,813	128,127
Derivatives, index options	105,268	54,640
Purchases of:		
Securities held to maturity	(477,353)	(970,658)
Securities available for sale	(195,023)	(191,387)
Derivatives, index options	(33,610)	(28,498)
Other investments	(296)	(15)
Principal payments on mortgage loans	10,240	25,490
Cost of mortgage loans acquired	(29,611)	(2,419)
Decrease (increase) in policy loans	981	754
Other, net	2	(4)
Net cash used in investing activities	(149,819)	(252,009)

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, (continued)

For the Six Months Ended June 30, 2014 and 2013

(Unaudited)

(In thousands)

	2014	2013
Cash flows from financing activities:		
Deposits to account balances for universal life and annuity contracts	460,611	477,776
Return of account balances on universal life and annuity contracts	(450,565	) (448,973
Issuance of common stock under stock option plan	350	—
Net cash provided by (used in) financing activities	10,396	28,803
Effect of foreign exchange	(633	) 593
Net increase (decrease) in cash and short-term investments	12,647	(56,329
Cash and short-term investments at beginning of period	120,859	124,561
Cash and short-term investments at end of period	\$133,506	\$68,232
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$20	\$30
Income taxes	\$24,416	\$22,695
Noncash operating activities:		
Deferral of sales inducements	\$(4,851	) \$1,429

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

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

(1) CONSOLIDATION AND BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for annual financial statements. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments necessary to present fairly the financial position of National Western Life Insurance Company and its subsidiaries ("Company" or "National Western") as of June 30, 2014, and the results of its operations and its cash flows for the three and six months ended June 30, 2014 and 2013. The results of operations for the six months ended June 30, 2014 are not necessarily indicative of the results to be expected for the full year. It is recommended that these condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 accessible free of charge through the Company's internet site at www.nationalwesternlife.com or the Securities and Exchange Commission internet site at www.sec.gov. The condensed consolidated balance sheet at December 31, 2013 has been derived from the audited consolidated financial statements as of that date.

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

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

The table below shows the unrealized gains and losses on available-for-sale securities that were reclassified out of accumulated other comprehensive income for the three and six months ended June 30, 2014 and 2013.

Affected Line Item in the Statements of Earnings	Amount Reclassified From Accumulated Other Comprehensive Income			
	Three Months Ended June 30, 2014		Six months ended June 30, 2014	
	2013	2013	2013	2013
	(In thousands)			
Other net investment gains (losses)	\$2,993	1,720	3,682	3,834
Net OTTI losses recognized in earnings	—	(125) (35) (148
Earnings before Federal income taxes	2,993	1,595	3,647	3,686

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Federal income taxes	1,047	558	1,276	1,290
Net earnings	\$1,946	1,037	2,371	2,396

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

(2) NEW ACCOUNTING PRONOUNCEMENTS

During February 2013, the Financial Accounting Standards Board ("FASB") issued new guidance related to the presentation of amounts reclassified out of accumulated other comprehensive income. The new guidance requires disclosure regarding the statement of income amounts affected by the reclassification. This information is provided in Note 1 of the condensed consolidated financial statements. Implementation of the new guidance did not have an impact on the Company's condensed consolidated financial statements and results of operations.

In July 2013, the FASB issued guidance to amend the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The new guidance states that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as reduction to deferred tax assets for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. This guidance is effective for annual reporting periods beginning on or after December 15, 2013 and interim periods within those annual periods. The Company adopted this guidance as of January 1, 2014 and the adoption did not have an effect on the deferred tax asset or liability classification on the Company's balance sheet and did not result in any additional disclosures to the financial statements.

In June 2014, the FASB issued guidance that applies to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. It requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition and follows existing accounting guidance for the treatment of performance conditions. The standard will be effective for annual periods and interim periods within those annual periods beginning after December 15, 2015, with early adoption permitted. The Company's current employee share-based plans do not require performance targets and the adoption of this guidance is not expected to have a material impact on the Company's financial position or results of operations.

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

(3) STOCKHOLDERS' EQUITY

The Company is restricted by state insurance laws as to dividend amounts which may be paid to stockholders without prior approval from the Colorado Division of Insurance. The restrictions are based on the greater of statutory earnings from operations excluding capital gains or 10% of statutory capital and surplus of the Company. The maximum dividend payment which may be made without prior approval in 2014 is \$112.3 million. The Company did not declare or pay cash dividends on common stocks during the six months ended June 30, 2014 and 2013.

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

(4) EARNINGS PER SHARE

Basic earnings per share of common stock are computed by dividing net income by the weighted-average basic common shares outstanding during the period. Diluted earnings per share assumes the issuance of common shares applicable to stock options in the denominator.

	Three Months Ended June 30,			
	2014		2013	
	Class A	Class B	Class A	Class B
	(In thousands except per share amounts)			
Numerator for Basic and Diluted Earnings Per Share:				
Net income	\$29,183		26,991	
Dividends - Class A shares	—		—	
Dividends - Class B shares	—		—	
Undistributed income	\$29,183		26,991	
Allocation of net income:				
Dividends	\$—	—	—	—
Allocation of undistributed income	28,358	825	26,227	764
Net income	\$28,358	825	26,227	764
Denominator:				
Basic earnings per share - weighted-average shares	3,435	200	3,435	200
Effect of dilutive stock options	2	—	7	—
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,437	200	3,442	200
Basic Earnings Per Share	\$8.26	4.13	7.64	3.82
Diluted Earnings Per Share	\$8.25	4.13	7.62	3.82

Stock options that were outstanding during the three months ended June 30, 2014 and 2013, but were not included in the computation of diluted earnings per share because the effect was anti-dilutive were approximately 22,300 and 32,000, respectively.

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

	Six Months Ended June 30,			
	2014	2013		
	Class A	Class B	Class A	Class B
	(In thousands except per share amounts)			
Numerator for Basic and Diluted Earnings Per Share:				
Net income	\$49,009		43,623	
Dividends - Class A shares	—		—	
Dividends - Class B shares	—		—	
Undistributed income	\$49,009		43,623	
Allocation of net income:				
Dividends	\$—	—	—	—
Allocation of undistributed income	47,623	1,386	42,389	1,234
Net income	\$47,623	1,386	42,389	1,234
Denominator:				
Basic earnings per share - weighted-average shares	3,435	200	3,435	200
Effect of dilutive stock options	2	—	6	—
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,437	200	3,441	200
Basic Earnings Per Share	\$13.86	6.93	12.34	6.17
Diluted Earnings Per Share	\$13.86	6.93	12.32	6.17

Stock options that were outstanding during the six months ended June 30, 2014 and 2013, but were not included in the computation of diluted earnings per share because the effect was anti-dilutive were approximately 22,300 and 32,000, respectively.

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

(5) PENSION AND OTHER POSTRETIREMENT PLANS

(A) Defined Benefit Pension Plans

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

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	2013	2013	2013	2013
	(In thousands)			
Service cost	\$42	47	84	95
Interest cost	239	218	479	436
Expected return on plan assets	(319	) (283	) (639	) (567
Amortization of prior service cost	1	1	2	2
Amortization of net loss	106	203	211	406
Net periodic benefit cost	\$69	186	137	372

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

The Company's minimum required contribution for the 2014 plan year is \$0.7 million. In addition, the Company had a remaining contribution payable for the 2013 plan year of \$0.1 million as of June 30, 2014 which it will pay during the remainder of 2014. As of June 30, 2014, the Company had contributed a total of \$0.3 million to the plan for the 2014 and 2013 plan years.

The Company also sponsors a non-qualified defined benefit plan primarily for senior officers. The plan provides benefits based on the participants' years of service and compensation. The pension obligations and administrative responsibilities of the plan are maintained by a pension administration firm, which is a subsidiary of American National Insurance Company ("ANICO"). ANICO has guaranteed the payment of pension obligations under the plan. However, the Company has a contingent liability with respect to the plan should these entities be unable to meet their obligations under the existing agreements. Also, the Company has a contingent liability with respect to the plan in the event that a plan participant continues employment with the Company beyond age seventy, the aggregate average annual participant salary increases exceed 10% per year, or any additional employees become eligible to participate in the plan. If any of these conditions are met, the Company would be responsible for any additional pension obligations

resulting from these items. Amendments were made to the plan to allow an additional employee to participate and to change the benefit formula for the Chairman of the Company. As previously mentioned, these additional obligations are a liability to the Company. Effective December 31, 2004, this plan was frozen with respect to the continued accrual of benefits of the Chairman and the President of the Company in order to comply with law changes under the American Jobs Creation Act of 2004 ("Act").

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

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

The following table summarizes the components of net periodic benefit costs for the Chairman and President non-qualified defined benefit plans.

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
	(In thousands)			
Service cost	\$74	45	147	89
Interest cost	251	200	502	400
Amortization of prior service cost	14	14	29	29
Amortization of net loss	324	293	647	587
Net periodic benefit cost	\$663	552	1,325	1,105

The Company expects to contribute \$2.0 million to these plans in 2014. As of June 30, 2014, the Company has contributed \$0.9 million to the plans.

(B) Defined Benefit Postretirement Healthcare Plans

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

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
	(In thousands)			
Interest cost	\$27	30	55	59
Amortization of prior service cost	26	25	52	51
Amortization of net loss	(1	) 8	(2	) 16
Net periodic benefit cost	\$52	63	105	126

The Company expects to contribute minimal amounts to the plan in 2014.

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(6) SEGMENT AND OTHER OPERATING INFORMATION

The Company defines its reportable operating segments as domestic life insurance, international life insurance, and annuities. These segments are organized based on product types and geographic marketing areas. A summary of segment information for the quarters ended June 30, 2014 and June 30, 2013 is provided below.

Selected Segment Information:

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
	(In thousands)				
June 30, 2014					
Condensed Consolidated Balance Sheet Items:					
Deferred policy acquisition costs and sales inducements	\$57,354	238,211	638,108	—	933,673
Total segment assets	670,565	1,229,589	8,749,666	274,434	10,924,254
Future policy benefits	581,946	934,791	7,776,048	—	9,292,785
Other policyholder liabilities	13,259	12,399	124,056	—	149,714
Three Months Ended					
June 30, 2014					
Condensed Consolidated Income Statements:					
Premiums and contract revenues	\$7,065	29,663	6,658	—	43,386
Net investment income	10,902	16,911	122,666	4,700	155,179
Other revenues	3	60	3	5,145	5,211
Total revenues	17,970	46,634	129,327	9,845	203,776
Life and other policy benefits	1,423	1,668	11,705	—	14,796
Amortization of deferred acquisition costs	1,780	8,808	16,670	—	27,258
Universal life and annuity contract interest	8,158	15,659	78,612	—	102,429
Other operating expenses	3,992	4,835	5,824	4,849	19,500
Federal income taxes (benefit)	851	4,963	5,227	1,561	12,602
Total expenses	16,204	35,933	118,038	6,410	176,585
Segment earnings (loss)	\$1,766	10,701	11,289	3,435	27,191

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	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
	(In thousands)				
Six months ended June 30, 2014					
Condensed Consolidated Income Statements:					
Premiums and contract revenues	\$15,230	58,771	11,661	—	85,662
Net investment income	17,185	27,629	209,283	9,533	263,630
Other revenues	21	301	40	10,612	10,974
Total revenues	32,436	86,701	220,984	20,145	360,266
Life and other policy benefits	3,915	6,703	17,141	—	27,759
Amortization of deferred acquisition costs	4,180	15,553	36,104	—	55,837
Universal life and annuity contract interest	13,263	25,864	126,238	—	165,365
Other operating expenses	8,271	11,860	12,920	9,912	42,963
Federal income taxes (benefit)	916	8,722	9,329	3,342	22,309
Total expenses	30,545	68,702	201,732	13,254	314,233
Segment earnings (loss)	\$1,891	17,999	19,252	6,891	46,033

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Selected Segment Information:

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
	(In thousands)				
June 30, 2013					
Condensed Consolidated Balance Sheet Items:					
Deferred policy acquisition costs and sales inducements	\$45,391	231,684	643,014	—	920,089
Total segment assets	522,003	1,134,181	8,420,780	253,831	10,330,795
Future policy benefits	454,359	875,672	7,477,608	—	8,807,639
Other policyholder liabilities	13,109	14,734	137,387	—	165,230
Three Months Ended					
June 30, 2013					
Condensed Consolidated Income Statements:					
Premiums and contract revenues	\$9,413	30,177	5,991	—	45,581
Net investment income	8,242	13,637	102,805	5,003	129,687
Other revenues	(3	) 108	(9	) 5,894	5,990
Total revenues	17,652	43,922	108,787	10,897	181,258
Life and other policy benefits	1,096	3,225	14,129	—	18,450
Amortization of deferred acquisition costs	2,210	7,926	18,716	—	28,852
Universal life and annuity contract interest	7,868	9,244	54,326	—	71,438
Other operating expenses	4,947	6,125	8,466	5,305	24,843
Federal income taxes (benefit)	468	5,456	4,087	1,714	11,725
Total expenses	16,589	31,976	99,724	7,019	155,308
Segment earnings (loss)	\$1,063	11,946	9,063	3,878	25,950

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	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Six months ended June 30, 2013					
Condensed Consolidated Income Statements:					
Premiums and contract revenues	\$19,023	58,196	10,125	—	87,344
Net investment income	16,015	32,267	253,183	9,036	310,501
Other revenues	9	151	30	11,942	12,132
Total revenues	35,047	90,614	263,338	20,978	409,977
Life and other policy benefits	4,126	6,870	20,144	—	31,140
Amortization of deferred acquisition costs	4,245	13,713	41,698	—	59,656
Universal life and annuity contract interest	15,059	31,235	165,444	—	211,738
Other operating expenses	8,714	12,833	14,552	10,668	46,767
Federal income taxes (benefit)	938	8,386	6,944	3,329	19,597
Total expenses	33,082	73,037	248,782	13,997	368,898
Segment earnings (loss)	\$1,965	17,577	14,556	6,981	41,079

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Premiums and Other Revenues:				
Premiums and contract revenues	\$43,386	45,581	85,662	87,344
Net investment income	155,179	129,687	263,630	310,501
Other revenues	5,211	5,990	10,974	12,132
Realized gains (losses) on investments	3,065	1,601	4,578	3,914
Total condensed consolidated premiums and other revenues	\$206,841	182,859	364,844	413,891

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Federal Income Taxes:				
Total segment Federal income taxes	\$12,602	11,725	22,309	19,597
Taxes on realized gains (losses) on investments	1,073	560	1,602	1,370
Total condensed consolidated Federal income taxes	\$13,675	12,285	23,911	20,967

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Net Earnings:				
Total segment earnings	\$27,191	25,950	46,033	41,079
Realized gains (losses) on investments, net of taxes	1,992	1,041	2,976	2,544
Total condensed consolidated net earnings	\$29,183	26,991	49,009	43,623

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	June 30, 2014 (In thousands)	2013
Assets:		
Total segment assets	\$ 10,924,254	10,330,795
Other unallocated assets	171,827	181,982
Total condensed consolidated assets	\$ 11,096,081	10,512,777

(7) SHARE-BASED PAYMENTS

The Company had a stock and incentive plan ("1995 Plan") which provided for the grant of any or all of the following types of awards to eligible employees: (1) stock options, including incentive stock options and nonqualified stock options; (2) stock appreciation rights, in tandem with stock options or freestanding; (3) restricted stock; and, (4) performance awards. The 1995 Plan began on April 21, 1995, and was amended on June 25, 2004 to extend the termination date to April 20, 2010. The number of shares of Class A, \$1.00 par value, common stock which were allowed to be issued under the 1995 Plan, or as to which stock appreciation rights or other awards were allowed to be granted, could not exceed 300,000. Effective June 20, 2008, the Company's shareholders approved a 2008 Incentive Plan ("2008 Plan"). The 2008 Plan is substantially similar to the 1995 Plan and authorized an additional number of Class A, \$1.00 par value, common stock shares eligible for issue not to exceed 300,000. These shares may be authorized and unissued shares. The Company has issued only nonqualified stock options and stock appreciation rights under these plans.

All of the employees of the Company and its subsidiaries are eligible to participate in the current 2008 Plan (as well as previously in the expired 1995 Plan). In addition, directors of the Company are eligible to receive the same types of awards as employees except that they are not eligible to receive incentive stock options. Company directors, including members of the Compensation and Stock Option Committee, are eligible for nondiscretionary stock options. The directors' grants vest 20% annually following one full year of service to the Company from the date of grant. The employees' grants vest 20% annually following three full years of service to the Company from the date of grant. All grants issued expire after ten years. No awards were issued during the first six months of 2014 or the first six months of 2013.

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

In August 2008, the Company implemented another limited stock buy-back program, substantially similar to the 2006 program, for shares issued under the 2008 Plan.

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The Company uses the current fair value method to measure compensation cost. As of June 30, 2014 and 2013, the liability balance was \$7.7 million and \$4.4 million, respectively. A summary of shares available for grant and activity during the six months ended June 30, 2014 is detailed below.

	Shares Available For Grant	Options Outstanding Shares	Weighted- Average Exercise Price
Stock Options:			
Balance at January 1, 2014	291,000	36,668	\$229.24
Exercised	—	(5,000)	) \$150.00
Forfeited	—	(400)	) \$255.13
Expired	—	—	\$—
Stock options granted	—	—	\$—
Balance at June 30, 2014	291,000	31,268	\$241.58
		Stock Appreciation Rights Outstanding Awards	Weighted- Average Exercise Price
Stock Appreciation Rights:			
Balance at January 1, 2014	99,461		\$156.93
Exercised	(1,675)		) \$114.64
Forfeited	(1,400)		) \$158.38
Granted	—		\$—
Balance at June 30, 2014	96,386		\$157.64

Stock options and stock appreciation rights (SARs) shown as forfeited in the above tables represent vested and unvested awards not exercised by plan participants prior to their termination from the Company. Forfeited stock options during the six months ended June 30, 2014 were awarded under the 1995 Plan. As the 1995 Plan terminated during calendar year 2010, the forfeited shares are not shown as being added back to the "Shares Available For Grant" balance.

The total intrinsic value of options exercised was \$0.7 million and \$1.3 million for the six months ended June 30, 2014 and 2013, respectively. The total share-based liabilities paid were \$0.6 million and \$1.3 million for the six months ended June 30, 2014 and 2013, respectively. The total fair value of shares vested during the six months ended June 30, 2014 and 2013 was \$0.6 million and \$0.4 million, respectively. For the quarters ended June 30, 2014 and 2013, the total cash received from the exercise of options under the Plans was \$0.2 million and \$0, respectively.

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The following table summarizes information about stock options and SARs outstanding at June 30, 2014.

	Options/SARs Outstanding		
	Number Outstanding	Weighted-Average Remaining Contractual Life	Number Exercisable
Exercise prices:			
\$255.13 (options)	22,268	3.8 years	17,815
\$208.05 (options)	9,000	4.0 years	9,000
\$236.00 (SARs)	250	4.2 years	150
\$114.64 (SARs)	26,868	4.6 years	17,911
\$132.56 (SARs)	32,268	7.5 years	3,600
\$210.22 (SARs)	37,000	9.5 years	—
Totals	127,654		48,476
Aggregate intrinsic value (in thousands)	\$7,767		\$3,209

The aggregate intrinsic value in the table above is based on the closing stock price of \$249.41 per share on June 30, 2014.

In estimating the fair value of the options outstanding at June 30, 2014 and December 31, 2013, the Company employed the Black-Scholes option pricing model with assumptions as detailed below.

	June 30, 2014	December 31, 2013
Expected term of options	3.8 to 9.5 years	0 to 10 years
Expected volatility:		
Range	17.50% to 38.54%	21.03% to 42.71%
Weighted-average	22.71	% 30.50
Expected dividend yield	0.14	% 0.16
Risk-free rate:		
Range	0.10% to 1.59%	0.12% to 3.93%
Weighted-average	0.49	% 2.10

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

The pre-tax compensation cost recognized in the financial statements related to the two plans defined above was \$0.8 million and \$2.5 million for the three and six months ended June 30, 2014 compared to \$1.5 million and \$3.0 million for the three and six months ended June 30, 2013. The related tax expense recognized was \$0.3 million and \$0.8

million for the three and six months ended June 30, 2014 compared to \$0.5 million and \$1.0 million for the three and six months ended June 30, 2013.

As of June 30, 2014, the total compensation cost related to nonvested options not yet recognized was \$3.1 million. This amount is expected to be recognized over a weighted-average period of 2.4 years. The Company recognizes compensation cost over the graded vesting periods.

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(8) COMMITMENTS AND CONTINGENCIES

(A) Legal Proceedings

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

The Company has resolved a class action lawsuit pending since 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*. The complaint asserted 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. On July 12, 2010 the Court certified a nationwide class of policyholders under the RICO allegation and a California class under all of the remaining causes of action except breach of fiduciary duty. The parties entered into a Settlement and Release Agreement in August of 2013 ("Settlement") which was finally approved by the Court on February 11, 2014. On February 12, 2014, the Court issued a redacted final approval order granting the Motion for Final Approval of Class Action Settlement. The Settlement became final and non-appealable on April 12, 2014. The Settlement Agreement and Plaintiffs' Request for Attorneys' Fees and Costs were approved by the Court, and the Company paid the Court-approved amount of attorneys' fees and costs in April 2014. The Company also made certain payments to surrendered and annuitized policyholders in June 2014. In addition, the Company has agreed to provide bonuses on annuitization for active policyholders who choose a 10-year or a 20-year certain and life settlement option. At December 31, 2013 and March 31, 2014, the Company held reserves of \$6.5 million for the matter which approximated the settlement amounts described above.

In addition to the class action lawsuit described above, the Company was 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 including actual damages of \$113,000 and amounts for attorney's fees, and prejudgment interest on the actual damages. In addition, the Final Judgment included \$150 million for exemplary damages. The Company vigorously defended this case and appealed the Final Judgment to the Court of Appeals Second District of Texas in Fort Worth. The Court of Appeals on August 11, 2011, reversed the trial court judgment in its entirety and rendered a take nothing verdict in favor of National Western. Plaintiffs (Appellees) filed a motion for a rehearing which the Court ruled on October 13, 2011, that the trial court's judgment was still reversed and judgment was still entered that Newman take nothing, all in favor of National Western. The Plaintiffs (Appellees) filed a Motion for Reconsideration En Banc which the Court of Appeals denied on October 27, 2011. The Plaintiffs (Appellees) then filed a Motion for Rehearing of the Court's amended decision, which the Court of Appeals denied on December 22, 2011. On March 21, 2012, Plaintiffs (Appellees) filed a petition for review with the Texas Supreme Court and the Company filed its response on April 20, 2012. The Supreme Court asked the parties for briefs

on the issues before deciding on whether to hear the case and both parties submitted their briefs. On February 14, 2013, the Supreme Court denied the Plaintiffs petition for review. On April 3, 2013, Plaintiff filed a Motion for Rehearing. The Supreme Court denied Plaintiff's Motion for Rehearing on June 7, 2013. As a result, this case is now over.

On October 26, 2011 the Brazilian Superintendence of Private Insurance (“SUSEP”) attempted to serve the Company with a subpoena regarding an administrative proceeding initiated by SUSEP in which it alleged that the Company was operating as an insurance company in Brazil without due authorization. The Company has been informed that SUSEP is attempting to impose a penal fine of approximately \$6.0 billion on the Company. SUSEP has unsuccessfully attempted to serve the Company with notice regarding this matter. The Company does not transact business in Brazil and has no officers, employees, property, or assets in Brazil. The Company and its legal advisors believe that SUSEP has no jurisdiction over the Company, that SUSEP's attempts at service of process have been invalid, and that any penal fine would be unenforceable. For the reasons described above, the Company does not believe that this matter meets the definition of a material pending legal proceeding as such term is defined in Item 103 of Regulation S-K but has included the foregoing description solely due to the purported amount of the fine sought.

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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.

(B) Financial Instruments

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

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

The Company had no commitments to extend credit relating to mortgage loans at June 30, 2014. The Company evaluates each customer's creditworthiness on a case-by-case basis.

(9) INVESTMENTS

(A) Investment Gains and Losses

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Available for sale debt securities:				
Realized gains on disposal	\$2,985	1,528	3,677	3,324
Realized losses on disposal	(14	) —	(22) —
Held to maturity debt securities:				
Realized gains on disposal	32	61	814	390
Realized losses on disposal	(6	) (3	) (17	) (72
Equity securities realized gains (losses)	23	193	27	511
Real estate gains (losses)	45	—	134	—
Mortgage loans write-downs	—	—	—	—
Other	—	—	—	—

Totals	\$3,065	1,779	4,613	4,153
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The Company uses the specific identification method in computing realized gains and losses. Approximately 96% of the gains on bonds are due to calls of securities rather than sales. This includes calls out of the Company's available for sale portfolio of debt securities.

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

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014		2013	
	(In thousands)					
Total other-than-temporary impairment gains (losses) on debt securities	\$—	(58	)	(4	)	324
Portion of loss (gain) recognized in comprehensive income	—	(106	)	(3	)	(549)
Net impairment losses on debt securities recognized in earnings	—	(164	)	(7	)	(225)
Equity securities impairments	—	(14	)	(28	)	(14)
Totals	\$—	(178	)	(35	)	(239)

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

	Three months ended June 30, 2014	Six months ended June 30, 2014	Twelve Months Ended December 31, 2013
	(In thousands)		
Beginning balance, cumulative credit losses related to other-than-temporary impairments	\$2,479	2,472	2,247
Reductions for securities sold during current period	—	—	(17)
Additions for credit losses not previously recognized in other-than-temporary impairments	—	7	242
Ending balance, cumulative credit losses related to other-than-temporary impairments	\$2,479	2,479	2,472

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(B) Debt and Equity Securities

The table below presents amortized costs and fair values of securities held to maturity at June 30, 2014.

	Securities Held to Maturity			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
	(In thousands)			
Debt securities:				
U.S. agencies	\$23,075	1,177	—	24,252
U.S. Treasury	1,917	436	—	2,353
States and political subdivisions	431,661	25,868	(2,165	) 455,364
Foreign governments	—	—	—	—
Public utilities	862,772	67,976	(1,040	) 929,708
Corporate	3,595,636	206,319	(19,883	) 3,782,072
Mortgage-backed	1,700,161	67,049	(12,735	) 1,754,475
Home equity	19,762	4,907	—	24,669
Manufactured housing	6,099	353	—	6,452
Totals	\$6,641,083	374,085	(35,823)