

MASSMUTUAL PARTICIPATION INVESTORS
 Form 40-17G
 May 25, 2011

[LOGO]	Administrative Offices	INSURED COPY
GREATAMERICAN	580 Walnut Street	234-64-44 - 01
INSURANCE	Cincinnati, Ohio 45202	
GROUP	Tel: 1-513-369-5000	

INVESTMENT COMPANY BOND

GREAT AMERICAN INSURANCE COMPANY

(A Stock Insurance Company, Herein Called the Underwriter)

- DECLARATIONS
- Item 1. Name of Insured (herein called Insured): Bond No. 234-64-44 - 01
 Principal Address: MassMutual Corporate Investors & MassMutual
 Participation Investors
 1500 Main Street
 Springfield, MA 01115
- Item 2. Bond Period from 12:01 a.m. 11/04/2010 to 12:01 a.m. 11/04/2011 the effective date of the termination or cancellation of this bond, standard time at the Principal Address as to each of said dates.
- Item 3. Limit of Liability - Subject to Sections 9, 10 and 12 hereof,

Amount applicable to

	Limit of Liability	Deductible
Insuring Agreement (A)-FIDELITY	\$1,275,000	\$0
Insuring Agreement (B)-ON PREMISES	\$1,275,000	\$10,000
Insuring Agreement (C)-IN TRANSIT	\$1,275,000	\$10,000
Insuring Agreement (D)-FORGERY OR ALTERATION	\$1,275,000	\$10,000
Insuring Agreement (E)-SECURITIES	\$1,275,000	\$10,000
Insuring Agreement (F)-COUNTERFEIT CURRENCY	\$1,275,000	\$10,000
Insuring Agreement (G)-STOP PAYMENT	\$ 100,000	\$ 5,000
Insuring Agreement (H)-UNCOLLECTIBLE ITEMS OF DEPOSIT	\$ 100,000	\$ 5,000
Insuring Agreement (I)-AUDIT EXPENSE	\$ 100,000	\$ 5,000
Insuring Agreement (J)-TELEFACSIMILE TRANSMISSIONS	\$1,275,000	\$10,000
Insuring Agreement (K)-UNAUTHORIZED SIGNATURES	\$ 100,000	\$ 5,000

Optional Insuring Agreements and Coverages

Insuring Agreement (L)-COMPUTER SYSTEMS	\$1,275,000	\$10,000
Insuring Agreement (M)-AUTOMATED PHONE SYSTEMS	Not Covered	N/A

If "Not Covered" is inserted above opposite any specified Insuring Agreement or Coverage, such Insuring Agreement or Coverage and any other reference thereto in this bond shall be deemed to be deleted therefrom.

- Item 4. Offices or Premises Covered-Offices acquired or established subsequent to the effective date of this bond are covered according to the terms of General Agreement A. All the Insured's offices or premises in existence at the time this bond becomes effective are covered under this bond except the offices or premises located as follows: N/A

Item 5. The liability of the Underwriter is subject to the terms of the following riders attached hereto: Riders No. 1, 2 and 3

Item 6. The Insured by the acceptance of this bond gives to the Underwriter terminating or cancelling prior bond(s) or policy(ies) No.(s) 234-64-44 - 00 such termination or cancellation to be effective as of the time this bond becomes effective.

By: /s/
(Authorized Representative)

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INVESTMENT COMPANY BOND

The Underwriter, in consideration of an agreed premium, and subject to the Declarations made a part hereof, the General Agreements, Conditions and Limitations and other terms of this bond, agrees with the Insured, in accordance with Insuring Agreements hereof to which an amount of insurance is applicable as set forth in Item 3 of the Declarations and with respect to loss sustained by the Insured at any time but discovered during the Bond period, to indemnify and hold harmless the Insured for:

INSURING AGREEMENTS

(A) FIDELITY

Loss resulting from any dishonest or fraudulent act(s), including Larceny or Embezzlement committed by an Employee, committed anywhere and whether committed alone or in collusion with others, including loss of Property resulting from such acts of an Employee, which Property is held by the Insured for any purpose or in any capacity and whether so held gratuitously or not and whether or not the Insured is liable therefor.

Dishonest or fraudulent act(s) as used in this Insuring Agreement shall mean only dishonest or fraudulent act(s) committed by such Employee with the manifest intent:

- (a) to cause the Insured to sustain such loss; and
- (b) to obtain financial benefit for the Employee, or for any other person or organization intended by the Employee to receive such benefit, other than salaries, commissions, fees, bonuses, promotions, awards, profit sharing, pensions or other employee benefits earned in the normal course of employment.

(B) ON PREMISES

Loss of Property (occurring with or without negligence or violence) through robbery, burglary, Larceny, theft, holdup, or other fraudulent means, misplacement, mysterious unexplainable disappearance, damage thereto or destruction thereof, abstraction or removal from the possession, custody or control of the Insured, and loss of subscription, conversion, redemption or deposit privileges through the misplacement or loss of Property, while the Property is (or is supposed or believed by the Insured to be) lodged or deposited within any offices or premises located anywhere, except in an office listed in Item 4 of the Declarations or amendment thereof or in the mail or with a carrier for hire other than an armored motor vehicle company, for the purpose of transportation.

Offices and Equipment

- (1) Loss of or damage to furnishings, fixtures, stationary, supplies or equipment, within any of the Insured's offices covered under this bond caused by Larceny or theft in, or by burglary, robbery or hold-up of such office, or attempt thereat, or by vandalism or malicious mischief; or
- (2) loss through damage to any such office by Larceny or theft in, or by burglary, robbery or hold-up of such office or attempt thereat.

(C) IN TRANSIT

Loss of Property (occurring with or without negligence or violence) through robbery, Larceny, theft, hold-up, misplacement, mysterious unexplainable disappearance, being lost or otherwise made away with, damage thereto or destruction thereof, and loss of subscription, conversion, redemption or deposit privileges through the misplacement or loss of Property, while the Property is in transit anywhere in the custody of any person or persons acting as messenger, except while in the mail or with a carrier for hire, other than an armored motor vehicle company, for the purpose of transportation, such transit to begin immediately upon receipt of such Property by the transporting person or persons, and to end immediately upon delivery thereof at destination.

(D) FORGERY OR ALTERATION

Loss through FORGERY or ALTERATION of, on or in any bills of exchange, checks, drafts, acceptances, certificates of deposit, promissory notes, or other written promises, orders or directions to pay sums certain in money due bills, money orders, warrants, orders upon public treasuries, letters of credit, written instructions, advices or applications directed to the Insured, authorizing or acknowledging the transfer, payment, delivery or receipt of funds or Property, which instructions or advices or applications purport to have been signed or endorsed by any customer of the Insured, shareholder or subscriber to shares, whether certificated or uncertificated, of any Investment Company or by any financial or banking institution or stock-broker but which instructions, advices or applications either bear the forged signature or endorsement or have been altered without the knowledge and consent of such customer, shareholder or subscriber to shares, whether certificated or uncertificated, of an Investment Company, financial or banking institution or stockbroker, withdrawal orders or receipts for the withdrawal of funds or Property, or receipts or certificates of deposit for Property and bearing the name of the Insured as issuer, or of another Investment Company for which the Insured acts as agent, excluding, however, any loss covered under Insuring Agreement (F) hereof whether or not coverage for Insuring Agreement (F) is provided for in the Declarations of this bond.

Any check or draft (a) made payable to a fictitious payee and endorsed in the name of such fictitious payee or (b) procured in a transaction with the maker or drawer thereof or

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with one acting as an agent of such maker or drawer or anyone impersonating another and made or drawn payable to the one so impersonated and endorsed by anyone other than the one impersonated, shall be deemed to be forged as to such endorsement.

Mechanically reproduced facsimile signatures are treated the same as handwritten signatures.

(E) SECURITIES

Loss sustained by the Insured, including loss sustained by reason of a violation of the constitution, by-laws, rules or regulations of any Self Regulatory Organization of which the Insured is a member or which would have been imposed upon the Insured by the constitution, by-laws, rules or regulations of any Self Regulatory Organization if the Insured had been a member thereof,

- (1)through the Insured's having, in good faith and in the course of business, whether for its own account or for the account of others, in any representative, fiduciary, agency or any other capacity, either gratuitously or otherwise, purchased or otherwise acquired, accepted or received, or sold or delivered, or given any value, extended any credit or assumed any liability, on the faith of, or otherwise acted upon, any securities, documents or other written instruments which prove to have been
 - (a) counterfeited, or
 - (b) forged as to the signature of any maker, drawer, issuer, endorser, assignor, lessee, transfer agent or registrar, acceptor, surety or guarantor or as to the signature of any person signing in any other capacity, or
 - (c) raised or otherwise altered, or lost, or stolen, or
- (2)through the Insured's having, in good faith and in the course of business, guaranteed in writing or witnessed any signatures whether for valuable consideration or not and whether or not such guaranteeing or witnessing is ultra vires the Insured, upon any transfers, assignments, bills of sale, powers of attorney, guarantees, endorsements or other obligations upon or in connection with any securities, documents or other written instruments and which pass or purport to pass title to such securities, documents or other written instruments; EXCLUDING, losses caused by FORGERY or ALTERATION of, on or in those instruments covered under Insuring Agreement (E) hereof.

Securities, documents or other written instruments shall be deemed to mean original (including original counterparts) negotiable or non-negotiable agreements which in and of themselves represent an equitable interest, ownership, or debt, including an assignment thereof which instruments are in the ordinary course of business, transferable by delivery of such agreements with any necessary endorsement or assignment.

The word "counterfeited" as used in this Insuring Agreement shall be deemed to mean any security, document or other written instrument which is intended to deceive and to be taken for an original.

Mechanically reproduced facsimile signatures are treated the same as handwritten signatures.

(F) COUNTERFEIT CURRENCY

Loss through the receipt by the Insured, in good faith, of any counterfeited money orders or altered paper currencies or coin of the United States of America or Canada issued or purporting to have been issued by the United States of

America or Canada or issued pursuant to a United States of America or Canadian statute for use as currency.

(G) STOP PAYMENT

Loss against any and all sums which the Insured shall become obligated to pay by reason of the Liability imposed upon the Insured by law for damages:

For having either complied with or failed to comply with any written notice of any customer, shareholder or subscriber of the Insured or any Authorized Representative of such customer, shareholder or subscriber to stop payment of any check or draft made or drawn by such customer, shareholder or subscriber or any Authorized Representative of such customer, shareholder or subscriber, or

For having refused to pay any check or draft made or drawn by any customer, shareholder or subscriber of the Insured, or any Authorized Representative of such customer, shareholder or subscriber.

(H) UNCOLLECTIBLE ITEMS OF DEPOSIT

Loss resulting from payments of dividends or fund shares, or withdrawals permitted from any customer's, shareholder's or subscriber's account based upon Uncollectible items of Deposit of a customer, shareholder or subscriber credited by the Insured or the Insured's agent to such customer's, shareholder's or subscriber's Mutual Fund Account: or

loss resulting from any item of Deposit processed through an Automated Clearing House which is reversed by the customer, shareholder or subscriber and deemed uncollectible by the Insured.

Loss includes dividends and interest accrued not to exceed 15% of the Uncollectible items which are deposited.

This Insuring Agreement applies to all Mutual Funds with "exchange privileges" if all Fund(s) in the exchange program are insured by a Great American Insurance Company of Cincinnati, OH for Uncollectible Items of Deposit. Regardless of the number of transactions between Fund(s) the minimum number of days of deposit within the Fund(s) before withdrawal as declared in the Fund(s) prospectus shall begin from the date a deposit was first credited to any Insured Fund(s).

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(I) AUDIT EXPENSE

Expense incurred by the Insured for that part of the costs of audits or examinations required by any governmental regulatory authority to be conducted either by such authority or by an independent accountant by reason of the discovery of loss sustained by the Insured through any dishonest or fraudulent act(s), including Larceny or Embezzlement of any of the Employees. The total liability of the Underwriter for such expense by reason of such acts of any Employee or in which such Employee is concerned or implicated or with respect to any one audit or examination is limited to the amount stated opposite Audit Expense in Item 3 of the Declarations; it being understood, however, that such expense shall be deemed to be a loss sustained by the Insured through any dishonest or fraudulent act(s), including Larceny or Embezzlement of one or more of the Employees and the liability under this paragraph shall be in addition to the Limit of Liability stated in Insuring Agreement (A) in Item 3 of the Declarations.

(J) TELEFACSIMILE TRANSMISSIONS

Loss resulting by reason of the Insured having transferred, paid or delivered any funds or Property, established any credit, debited any account, or given any value relying on any fraudulent instructions sent by a customer or financial institution by Telefacsimile Transmission directed to the Insured, authorizing or acknowledging the transfer, payment, or delivery of funds or property, the establishment of a credit, debiting of any account, or the giving of value by the Insured, but only if such telefacsimile instructions:

- (i) bear a valid test key exchanged between the Insured and a customer or another financial institution with authority to use such test key for Telefacsimile instructions in the ordinary course of business, but which test key has been wrongfully obtained by a person who was not authorized to initiate, make, validate or authenticate a test key arrangement; and
- (ii) fraudulently purport to have been sent by such customer or financial institution, but which telefacsimile instructions are transmitted without the knowledge or consent of such customer or financial institution by a person other than such customer or financial institution and which bear a forged signature.

"Telefacsimile" means a system of transmitting written documents by electronic signals over telephone lines to equipment maintained by the Insured within its communication room for the purposes of reproducing a copy of said document. It does not mean electronic communication sent by Telex, TWC, or electronic mail, or Automated Clearing House.

(K) UNAUTHORIZED SIGNATURES

Loss resulting directly from the Insured having accepted, paid or cashed any check or withdrawal order, draft, made or drawn on a customer's account which bears the signature or endorsement of one other than a person whose name and signature is on the application on file with the Insured as a signatory on such account.

It shall be a condition precedent to the Insured's right to recovery under this Insuring Agreement that the Insured shall have on file signatures of all persons who are authorized signatories on such account.

GENERAL AGREEMENTS

(A) ADDITIONAL OFFICES OR EMPLOYEES- CONSOLIDATION OR MERGER-NOTICE

- (1) If the Insured shall, while this bond is in force, establish any additional office or offices, such office or offices shall be automatically covered hereunder from the dates of their establishment, respectively. No notice to the Underwriter of an increase during any premium period in the number of offices or in the number of Employees at any of the offices covered hereunder need be given and no additional premium need be paid for the remainder of such premium period.
- (2) If an Investment Company, named as Insured herein, shall, while this bond is in force, merge or consolidate with, or purchase the assets of another institution, coverage for such acquisition shall apply automatically from the date of acquisition. The Insured shall notify the Underwriter of such acquisition within 60 days of said date, and an additional premium shall be computed only if such acquisition involves additional offices or employees.

(B) WARRANTY

No statement made by or on behalf of the Insured, whether contained in the application or otherwise, shall be deemed to be a warranty of anything except that it is true to the best of the knowledge and belief of the person making the statement.

(C) COURT COSTS AND ATTORNEYS' FEES (Applicable to all Insuring Agreements or Coverages now or hereafter forming part of this bond)

The Underwriter will Indemnify the Insured against court costs and reasonable attorneys' fees incurred and paid by the Insured in defense, whether or not successful, whether or not fully litigated on the merits and whether or not settled of any suit or legal proceeding brought against the Insured to enforce the Insured's liability or alleged liability on account of any loss,

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claim or damage which, if established against the Insured, would constitute a loss sustained by the Insured covered under the terms of this bond provided, however, that with respect to Insuring Agreement (A) this indemnity shall apply only in the event that

- (1) an Employee admits to being guilty of any dishonest or fraudulent act(s), including Larceny or Embezzlement; or
- (2) an Employee is adjudicated to be guilty of any dishonest or fraudulent act(s), including Larceny or Embezzlement;
- (3) in the absence of (1) or (2) above an arbitration panel agrees, after a review of an agreed statement of facts, that an Employee would be found guilty of dishonesty if such Employee were prosecuted.

The Insured shall promptly give notice to the Underwriter of any such suit or legal proceeding and at the request of the Underwriter shall furnish it with copies of all pleadings and other papers therein. At the Underwriter's election the Insured shall permit the Underwriter to conduct the defense of such suit or legal proceeding, in the Insured's name, through attorneys of the Underwriter's selection. In such event, the Insured shall give all reasonable information and assistance which the Underwriter shall deem necessary to the proper defense of such suit or legal proceeding.

If the Insured's liability or alleged liability is greater than the amount recoverable under this bond, or if a Deductible Amount is applicable, the liability of the Underwriter under this General Agreement is limited to that percentage of litigation expense determined by pro ration of the bond limit of liability to the amount claimed, after the application of any deductible. This litigation expense will be in addition to the Limit of Liability for the applicable Insuring Agreement.

(D) FORMER EMPLOYEE

Acts of Employee, as defined in this bond, are covered under Insuring Agreement (A) only while the Employee is in the Insured's employ. Should loss involving a former Employee of the Insured be discovered subsequent to the termination of employment, coverage would still apply under Insuring Agreement (A) if the direct proximate cause of the loss occurred while the former Employee performed duties within the scope of his/her employment.

THE FOREGOING INSURING AGREEMENTS AND
GENERAL AGREEMENTS ARE SUBJECT TO
THE FOLLOWING CONDITIONS AND
LIMITATIONS:

SECTION I. DEFINITIONS

The following terms, as used in this bond, shall have the respective meanings stated in this Section:

(a) "Employee" means:

- (1) any of the Insured's officers, partners, or employees, and
- (2) any of the officers or employees of any predecessor of the Insured whose principal assets are acquired by the Insured by consolidation or merger with, or purchase of assets of capital stock of such predecessor, and

- (3) attorneys retained by the Insured to perform legal services for the Insured and the employees of such attorneys while such attorneys or the employees of such attorneys are performing such services for the Insured, and
 - (4) guest students pursuing their studies or duties in any of the Insured's offices, and
- (5) directors or trustees of the Insured, the investment advisor, underwriter (distributor), transfer agent, or shareholder accounting record keeper, or administrator authorized by written agreement to keep financial and/or other required records, but only while performing acts coming within the scope of the usual duties of an officer or employee or while acting as a member of any committee duly elected or appointed to examine or audit or have custody of or access to the Property of the Insured, and
- (6) any individual or individuals assigned to perform the usual duties of an employee within the premises of the Insured by contract, or by any agency furnishing temporary personnel on a contingent or part-time basis, and
- (7) each natural person, partnership or corporation authorized by written agreement with the Insured to perform services as electronic data processor of checks or other accounting records of the Insured, but excluding any such processor who acts as transfer agent or in any other agency capacity in issuing checks, drafts or securities for the Insured, unless included under Sub-section (9) hereof, and
 - (8) those persons so designated in section 15, Central Handling of Securities, and
- (9) any officer, partner or Employee of
 - a) an investment advisor,
 - b) an underwriter (distributor),

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c) a transfer agent or shareholder accounting record-keeper, or
d) an administrator authorized by written agreement to keep financial and/or other required records,
for an Investment Company, named as Insured while performing acts coming within the scope of the usual duties of an officer or Employee of any Investment Company named as Insured herein, or while acting as a member of any committee duly elected or appointed to examine or audit or have custody of or access to the Property of any such Investment Company, provided that only Employees or partners of a transfer agent, shareholder accounting record-keeper or administrator which is an affiliated person as defined in the Investment Company Act of 1940, of an Investment Company named as Insured or is an affiliated person of the adviser, underwriter or administrator of such Investment Company, and which is not a bank, shall be included within the definition of Employee.

Each employer of temporary personnel or processors as set forth in Sub-Sections (6) and (7) of Section 1 (a) and their partners, officers and employees shall collectively be deemed to be one person for all the purposes of this bond, excepting, however, the last paragraph of Section 13.

Brokers, or other agents under contract or representatives of the same general character shall not be considered Employees.

(b) "Property" means money (i.e. currency, coin, bank notes, Federal Reserve notes), postage and revenue stamps, U.S. Savings Stamps, bullion, precious metals of all kinds and in any form and articles made therefrom, jewelry, watches, necklaces, bracelets, gems, precious and semi-precious stones, bonds, securities, evidences of debts, debentures, scrip, certificates, interim receipts, warrants, rights, puts, calls, straddles, spreads, transfers, coupons, drafts, bills of exchange, acceptances, notes, checks, withdrawal orders, money orders, warehouse receipts, bills of lading, conditional sales contracts, abstracts of title, insurance policies, deeds, mortgages under real estate and/or chattels and upon interests therein, and assignments of such policies, mortgages and instruments, and other valuable papers, including books of account and other records used by the Insured in the conduct of its business, and all other instruments similar to or in the nature of the foregoing including Electronic Representations of such Instruments enumerated above (but excluding all data processing records) in which the Insured has an interest or in which the Insured acquired or should have acquired an interest by reason of a predecessor's declared financial condition at the time of the Insured's consolidation or merge with, or purchase of the principal assets of, such predecessor or which are held by the Insured for any purpose or in any capacity and whether so held by the Insured for any purpose or in any capacity and whether so held gratuitously or not and whether or not the Insured is liable therefor.

(c) "Forgery" means the signing of the name of another with the intent to deceive; it does not include the signing of one's own name with or without authority, in any capacity, or for any purpose.

(d) "Larceny and Embezzlement" as it applies to any named Insured means those acts as set forth in Section 37 of the Investment Company Act of 1940.

(e) "Items of Deposit" means any one or more checks and drafts.

SECTION 2. EXCLUSIONS

THIS BOND DOES NOT COVER:

- (a) loss effected directly or indirectly by means of forgery or alteration of, on or in any instrument, except when covered by Insuring Agreement (A), (D), (E) or (F).
- (b) loss due to riot or civil commotion outside the United States of America and Canada; or loss due to military, naval or usurped power, war or insurrection unless such loss occurs in transit in the circumstances recited in Insuring Agreement (D), and unless, when such transit was initiated, there was no knowledge of such riot, civil commotion, military, naval or usurped power, war or insurrection on the part of any person acting for the Insured in initiating such transit.
- (c) loss, in time of peace or war, directly or indirectly caused by or resulting from the effects of nuclear fission or fusion or radioactivity; provided, however, that this paragraph shall not apply to loss resulting from industrial uses of nuclear energy.
- (d) loss resulting from any wrongful act or acts of any person who is a member of the Board of Directors of the Insured or a member of any equivalent body by whatsoever name known unless such person is also an Employee or an elected official, partial owner or partner of the Insured in some other capacity, nor, in any event, loss resulting from the act or acts of any person while acting in the capacity of a member of such Board or equivalent body.
- (e) loss resulting from the complete or partial nonpayment of, or default upon, any loan or transaction in the nature of, or amounting to, a loan made by or obtained from the Insured or any of its partners, directors or Employees, whether authorized

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or unauthorized and whether procured in good faith or through trick, artifice, fraud or false pretenses, unless such loss is covered under Insuring Agreement (A), (E) or (F).

(f) loss resulting from any violation by the Insured or by any Employee

(1) of law regulating (a) the issuance, purchase or sale of securities, (b) securities transactions upon Security Exchanges or over the counter market, (c) Investment Companies, or (d) Investment Advisors, or

(2) of any rule or regulation made pursuant to any such law.

unless such loss, in the absence of such laws, rules or regulations, would be covered under Insuring Agreements (A) or (E).

(g) loss of Property or loss of privileges through the misplacement or loss of Property as set forth in Insuring Agreement while the Property is in the custody of any armored motor vehicle company, unless such loss shall be in excess of the amount recovered or received by the

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Total revenues 225,435

Benefits and expenses:

Life and other policy benefits 5,744

Amortization of deferred policy acquisition costs 26,775

Universal life and annuity contract interest 124,145

Other operating expenses 24,037

Total benefits and expenses 180,701

Earnings before Federal income taxes 44,734

Federal
income taxes 9,093

Net earnings \$ 35,641

Basic
earnings per
share:

Class A \$ 10.08

Class B \$ 5.04

Diluted
earnings per
share:

Class A \$ 10.08

Class B \$ 5.04

See accompanying notes to Condensed Consolidated Financial Statements (unaudited).

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CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

For the Nine Months Ended September 30, 2018 and 2017

(Unaudited)

(In thousands, except per share amounts)

	2018	2017
Premiums and other revenues:		
Universal life and annuity contract charges	\$ 116,753	122,329
Traditional life premiums	13,282	13,639
Net investment income	358,100	466,045
Other revenues	15,396	13,714
Net realized investment gains (losses):		
Total other-than-temporary impairment (“OTTI”) gains (losses)	9	69
Portion of OTTI (gains) losses recognized in other comprehensive income	(9) (69)
Net OTTI losses recognized in earnings	—	—
Other net investment gains (losses)	5,582	10,906
Total net realized investment gains (losses)	5,582	10,906
 Total revenues	 509,113	 626,633
Benefits and expenses:		
Life and other policy benefits	44,607	58,626
Amortization of deferred policy acquisition costs	90,073	85,992
Universal life and annuity contract interest	183,316	299,862
Other operating expenses	72,467	74,031
 Total benefits and expenses	 390,463	 518,511
 Earnings before Federal income taxes	 118,650	 108,122
 Federal income taxes	 23,668	 37,288
 Net earnings	 \$94,982	 70,834
Basic earnings per share:		
Class A	\$26.86	\$20.03
Class B	\$13.43	\$10.02
Diluted earnings per share:		
Class A	\$26.86	\$20.03
Class B	\$13.43	\$10.02

See accompanying notes to Condensed Consolidated Financial Statements (unaudited).

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NATIONAL WESTERN LIFE GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

For the Three Months Ended September 30, 2018 and 2017

(Unaudited)

(In thousands)

	2018	2017
Net earnings	\$35,641	21,813
Other comprehensive income (loss), net of effects of deferred costs and taxes:		
Unrealized gains (losses) on securities:		
Net unrealized holding gains (losses) arising during period	(1,416)	2,212
Net unrealized liquidity gains (losses)	—	9
Reclassification adjustment for net amounts included in net earnings	(936)	(988)
Net unrealized gains (losses) on securities	(2,352)	1,233
Foreign currency translation adjustments	20	166
Benefit plans:		
Amortization of net prior service cost and net gain (loss)	2,801	(910)
Other comprehensive income (loss)	469	489
Comprehensive income (loss)	\$36,110	22,302

See accompanying notes to Condensed Consolidated Financial Statements (unaudited).

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NATIONAL WESTERN LIFE GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

For the Nine Months Ended September 30, 2018 and 2017

(Unaudited)

(In thousands)

	2018	2017
Net earnings	\$94,982	70,834
Other comprehensive income, net of effects of deferred costs and taxes:		
Unrealized gains (losses) on securities:		
Net unrealized holding gains (losses) arising during period	(51,238)	15,479
Net unrealized liquidity gains (losses)	2	22
Reclassification adjustment for net amounts included in net earnings	(2,533)	(2,746)
Net unrealized gains (losses) on securities	(53,769)	12,755
Foreign currency translation adjustments	1,227	(5)
Benefit plans:		
Amortization of net prior service cost and net gain (loss)	8,403	(2,730)
Other comprehensive income (loss)	(44,139)	10,020
Comprehensive income (loss)	\$50,843	80,854

See accompanying notes to Condensed Consolidated Financial Statements (unaudited).

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NATIONAL WESTERN LIFE GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

For the Nine Months Ended September 30, 2018 and 2017

(Unaudited)

(In thousands)

	2018	2017
Common stock:		
Balance at beginning of period	\$36	36
Shares exercised under stock option plan	—	—
Balance at end of period	36	36
Additional paid-in capital:		
Balance at beginning of period	41,716	41,716
Shares exercised under stock option plan	—	—
Balance at end of period	41,716	41,716
Accumulated other comprehensive income:		
Unrealized gains (losses) on non-impaired securities:		
Balance at beginning of period	33,662	22,813
Change in unrealized gains (losses) during period, net of tax	(53,771)	12,733
Cumulative effect of change in accounting principle, net of tax (See Note 2)	(4,414)	—
Balance at end of period	(24,523)	35,546
Unrealized losses on impaired held to maturity securities:		
Balance at beginning of period	(10)	(203)
Amortization	7	45
Other-than-temporary impairments, non-credit, net of tax	—	—
Additional credit loss on previously impaired securities	—	—
Change in shadow deferred policy acquisition costs	(4)	(23)
Balance at end of period	(7)	(181)
Unrealized losses on impaired available for sale securities:		
Balance at beginning of period	(1)	(1)
Other-than-temporary impairments, non-credit, net of tax	—	—
Change in shadow deferred policy acquisition costs	(1)	—
Recoveries, net of tax	—	—
Balance at end of period	(2)	(1)

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NATIONAL WESTERN LIFE GROUP, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES
 IN STOCKHOLDERS' EQUITY (continued)

For the Nine Months Ended September 30, 2018 and 2017

(Unaudited)

(In thousands)

	2018	2017
Foreign currency translation adjustments:		
Balance at beginning of period	3,223	2,661
Change in translation adjustments during period	1,227	(5)
Balance at end of period	4,450	2,656
Benefit plan liability adjustment:		
Balance at beginning of period	(22,595)	(14,718)
Amortization of net prior service cost and net loss, net of tax	8,403	(2,730)
Balance at end of period	(14,192)	(17,448)
Accumulated other comprehensive income (loss) at end of period	(34,272)	20,572
Retained earnings:		
Balance at beginning of period	1,776,141	1,669,524
Cumulative effect of change in accounting principle, net of tax (See Note 2)	4,414	—
Net earnings	94,982	70,834
Stockholder dividends	—	—
Balance at end of period	1,875,537	1,740,358
Total stockholders' equity	\$ 1,883,017	1,802,682

See accompanying notes to Condensed Consolidated Financial Statements (unaudited).

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NATIONAL WESTERN LIFE GROUP, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 For the Nine Months Ended September 30, 2018 and 2017
 (Unaudited)
 (In thousands)

	2018	2017
Cash flows from operating activities:		
Net earnings	\$94,982	70,834
Adjustments to reconcile net earnings to net cash from operating activities:		
Universal life and annuity contract interest	183,316	299,862
Surrender charges and other policy revenues	(28,429)	(33,682)
Realized (gains) losses on investments	(5,582)	(10,905)
Accretion/amortization of discounts and premiums, investments	(86)	308
Depreciation and amortization	8,769	7,379
(Increase) decrease in value of equity securities	(254)	—
(Increase) decrease in value of derivatives	(35,581)	(138,552)
(Increase) decrease in deferred policy acquisition and sales inducement costs	31,645	19,895
(Increase) decrease in accrued investment income	(4,245)	(3,793)
(Increase) decrease in other assets	(12,489)	(7,762)
Increase (decrease) in liabilities for future policy benefits	(11,566)	6,616
Increase (decrease) in other policyholder liabilities	1,520	(6,319)
Increase (decrease) in Federal income tax liability	(696)	(8,647)
Increase (decrease) in deferred Federal income tax	4,680	(14,370)
Increase (decrease) in other liabilities	(3,882)	12,530
Net cash provided by operating activities	222,102	193,394
Cash flows from investing activities:		
Proceeds from sales of:		
Debt securities held to maturity	—	—
Debt securities available for sale	13,098	22,184
Other investments	2,749	5,405
Proceeds from maturities and redemptions of:		
Debt securities held to maturity	360,036	303,081
Debt securities available for sale	168,638	222,379
Derivatives, index options	160,094	151,298
Property and equipment	8	2,731
Purchases of:		
Debt securities held to maturity	(391,548)	(377,821)
Debt securities available for sale	(228,172)	(191,510)
Equity securities	(1,678)	(1,160)
Derivatives, index options	(63,524)	(55,780)
Other investments	(5,581)	(329)
Property and equipment	(3,070)	(1,697)

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NATIONAL WESTERN LIFE GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

For the Nine Months Ended September 30, 2018 and 2017

(Unaudited)

(In thousands)

	2018	2017
Principal payments on mortgage loans	32,374	24,199
Cost of mortgage loans acquired	(24,803)	(38,166)
Decrease (increase) in policy loans	1,931	1,233
Net cash provided by/(used in) investing activities	20,552	66,047
Cash flows from financing activities:		
Deposits to account balances for universal life and annuity contracts	442,795	546,966
Return of account balances on universal life and annuity contracts	(749,245)	(687,087)
Net cash provided by (used in) financing activities	(306,450)	(140,121)
Effect of foreign exchange	1,553	(7)
Net increase (decrease) in cash and cash equivalents	(62,243)	119,313
Cash and cash equivalents at beginning of period	217,624	51,247
Cash and cash equivalents at end of period	\$ 155,381	170,560

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid (received) during the period for:

Interest	\$ 30	30
Income taxes	\$ 19,683	60,304

Noncash operating activities:

Deferral of sales inducements	\$(8,152)	(9,696)
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See accompanying notes to Condensed Consolidated Financial Statements (unaudited).

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NATIONAL WESTERN LIFE GROUP, INC.
 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 Group, Inc. ("NWLGI") and its wholly owned subsidiaries ("Company") as of September 30, 2018, and the results of its operations and its cash flows for the three and nine months ended September 30, 2018 and September 30, 2017. Such adjustments are of a normal recurring nature. The results of operations for the nine months ended September 30, 2018 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, 2017 which is accessible free of charge through the Company's internet site at www.nwlg.com or the Securities and Exchange Commission internet site at www.sec.gov. The Condensed Consolidated Balance Sheet at December 31, 2017 has been derived from the audited consolidated financial statements as of that date.

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of NWLGI and its wholly owned subsidiaries: National Western Life Insurance Company ("NWLIC" or "National Western"), Regent Care San Marcos Holdings, LLC, NWL Investments, Inc., and NWL Services, Inc. National Western's wholly owned subsidiaries include The Westcap Corporation, NWL Financial, Inc., NWLSM, Inc., and Braker P III, LLC. Where comments or disclosures are made specifically in reference to the insurance operations of National Western, the "company" is used in order to distinguish such comments from the consolidated entity. All significant intercorporate transactions and accounts have been eliminated in consolidation.

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

The table below shows the unrealized gains and losses on available-for-sale securities that were reclassified out of accumulated other comprehensive income for the three and nine months ended September 30, 2018 and September 30, 2017.

Affected Line Item in the Statements of Earnings	Amount Reclassified From Accumulated Other Comprehensive Income	
	Three Months Ended	Nine Months Ended

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	September 30, 2018		September 30, 2017	
	(In thousands)			
Other net investment gains (losses)	\$1,185	1,519	3,206	4,224
Net OTTI losses recognized in earnings	—	—	—	—
Earnings before Federal income taxes	1,185	1,519	3,206	4,224
Federal income taxes	249	532	673	1,478
Net earnings	\$936	987	2,533	2,746

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

(2) NEW ACCOUNTING PRONOUNCEMENTS

Recent accounting pronouncements not yet adopted

In August, the FASB issued ASU 2018-12 Financial Services-Insurance (Topic 944) - Targeted Improvements to the Accounting for Long-Duration Contracts. This update aimed at improving the Codification as it relates to long-duration contracts which will improve the timeliness of recognizing changes in the liability for future policy benefits, simplify accounting for certain market-based options, simplify the amortization of deferred acquisition costs, and improve the effectiveness of required disclosures. Amendments include the following:

A. Require insurance entity to (1) review and update assumptions used to measure cash flows at least annually (with changes recognized in net income) and (2) update discount rate assumption at each reporting date (with changes recognized in other comprehensive income).

B. Require insurance entity to measure all market risk benefits associated with deposit (i.e. account balance) contracts at fair value, with change in fair value attributable to change in instrument-specific credit risk recognized in other comprehensive income.

C. Simplify amortization of deferred acquisition costs and other balances amortized in proportion to premiums, gross profits, or gross margins and require those balances be amortized on constant level basis over expected term of related contract. Deferred acquisition costs are required to be written off for unexpected contract terminations but are not subject to impairment test.

D. Require insurance entity to add disclosures of disaggregated rollforwards of beginning to ending balances of the liability for future policy benefits, policyholder account balances, market risk benefits, separate account liabilities, and deferred acquisition costs. Insurance entity must also disclose information about significant inputs, judgments, assumptions, and methods used in measurement, including changes in those inputs, judgments, and assumptions, and the effect of those changes on measurement.

These update will need to be applied retrospectively to the earliest period presented in the financial statements for periods beginning after December 15, 2020, with early adoption permitted. The Company is currently evaluating the impact of the new guidance on its consolidated financial statements.

In August, the FASB issued a new Concepts Statement No. 8 Conceptual Framework for Financial Reporting - Chapter 8, Notes to Financial Statements. This was issued as part of a disclosure framework project aimed at improving disclosures in financial statements. This issuance provides conceptual guidance that may be followed when determining items to include as disclosures in the notes to financial statements. In conjunction with this issuance, the FASB also issued two accounting standard updates (“ASU”) which identified a particular FASB Topic and evaluated its disclosures through the new conceptual framework of Concepts Statement No. 8, Chapter 8. This process resulted in the issuance of the following two ASUs.

In August, FASB issued ASU 2018-13 Fair Value Measurement (Topic 820) Disclosure Framework - Changes to the Disclosure requirements for Fair Value Measurement. This update removed disclosures for 1) amount of and reasons for transfers between Level 1 and Level 2 for fair value hierarchy, 2) policy for timing of transfers between levels, 3) valuation process for Level 3 fair value measurements. This update also added disclosure requirement as follows: 1)

changes in unrealized gains and losses for the period included in OCI for recurring Level 3 fair value measurements held at end of reporting period; 2) range and weighted average (or other reasonable quantitative measurement) of significant unobservable inputs used to develop Level 3 fair value measurements.

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NATIONAL WESTERN LIFE GROUP, INC.
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(UNAUDITED)

In August, FASB issued ASU 2018-14 Compensation-Retirement Benefits - Defined Benefit Plans-General (Subtopic 715-20) Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans. This update removed disclosures for 1) amounts in AOCI expected to be recognized as components of net periodic benefit cost over the next fiscal year, 2) amount and timing of plan assets expected to be returned to the employer, 3) related party disclosures about the amount of future annual benefits covered by insurance and annuity contracts and significant transactions between the employer or related parties and the plan, 4) the effects of a one-percentage-point change in assumed health care cost trend rates on the (a) aggregate of the service and interest cost components of the net periodic benefit costs and (b) benefit obligation for postretirement health care benefits. This update also added disclosures as follow: 1) weighted-average interest crediting rates for cash balance plans and other plans with promised crediting rates, 2) explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. Finally, this update clarified that the following information for defined benefit pension plans should be disclosed: 1) projected benefit obligation (PBO) and fair value of plan assets for plans with PBO in excess of plan assets. 2) accumulated benefit obligation (ABO) and fair value of plan assets for plans with ABOs in excess of plan assets.

In August, the SEC released a final rule updating disclosure requirements, Disclosure Update and Simplification, which resulted in the additional interim disclosure of an analysis of changes in stockholders' equity to be required for the current and comparative quarter and year-to-date interim periods. Registrants will be required to provide an analysis of changes in each caption of stockholders' equity and noncontrolling interests, which will need to be accompanied by dividends per share and in the aggregate for each class of shares. The disclosure must be presented in the form of a reconciliation, either as a separate statement or in the footnotes. The amendments will be effective for interim periods beginning after November 5, 2018.

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

In March 2017, the FASB issued ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs: Premium Amortization on Purchased Callable Debt Securities, which amends the amortization period for certain purchased callable debt securities held at a premium. The amortization period for premiums is being shortened to the earliest call date. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. Adoption of the guidance is not expected to have a material effect on the Company's results of operations or financial position.

In July 2017, the FASB released ASU 2017-11, Earnings Per Share; Distinguishing Liabilities from Equity; and, Derivatives and Hedging. This update includes: (I) Accounting for Certain Financial Instruments with Down Round Features, and (II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interest with a Scope Exception. Part

I of this update changes the classification analysis of certain equity-linked financial instruments with down round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. Part II of this update recharacterizes the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Codification, to a scope exception. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. The Company does not expect a material effect on the results of operations or financial position with the adoption of this ASU.

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

In June 2018, the FASB released ASU 2018-07 Compensation - Stock Compensation (Topic 718) - Improvements to Nonemployee Share-Based Payment Accounting. This update largely aligns the accounting for share-based payment awards issued to employees and nonemployees. Previously, nonemployee stock compensation was accounted for under Subtopic 505-50 but will now fall under Topic 718. Changes to the accounting for nonemployee awards include 1) measurement based on fair value of the equity instrument at grant date, rather than previous requirement to measure based on the more reliable option of the fair value of the consideration or the fair value of the equity instrument, 2) initial measurement at grant date, rather than the earlier of the date at which commitment for performance is reached or performance is complete, and 3) when performance conditions are present, the probability of satisfying performance conditions should be considered in measurement rather than the previous requirement to measure at the lowest aggregate fair value. The amendments in the new guidance are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal period. The Company does not expect a material effect on the results of operations or financial position with the adoption of this ASU.

In February 2016, the FASB issued new guidance on leasing transactions (ASU 2016-02, Leases - Topic 842). The new guidance is effective for the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and requires a modified retrospective transition approach (subject to optional practical expedients). The new guidance requires a lessee to recognize assets and liabilities for leases with lease terms of more than 12 months. Leases would be classified as finance or operating leases and both types of leases will be recognized on the balance sheet. Lessor accounting will remain largely unchanged from current guidance except for certain targeted changes. The new guidance will also require new qualitative and quantitative disclosures. Early adoption is permitted. The Company does not expect a significant impact to the financial statements resulting from this change.

Recent accounting pronouncements adopted

In January 2018, the Company adopted ASU 2017-07 Compensation-Retirement Benefits (Topic 615): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The new guidance requires that an employer that offers to its employees defined benefit pension or other postretirement benefit plans report the service cost component in the same line item or items as other compensation costs. The other components of net periodic benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item is not used, the line item used in the income statement to present the other components of net periodic benefit cost must be disclosed. In addition, the guidance allows only the service cost component to be eligible for capitalization when applicable. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

In February 2018, the FASB released ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The update addresses certain stranded income tax effects in accumulated other comprehensive income caused by the Tax Cuts and Job Act ("Tax Act") which was passed in December 2017. Under the new FASB rules, financial statement preparers are provided the option to reclassify stranded tax effects within accumulated other comprehensive income in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Act is recorded. Companies must apply the new guidance for fiscal years, including interim periods within such years, starting after December 15, 2018, with early adoption permitted. The amendments are to be applied in either the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the federal corporate income tax rate from the Tax Act is recognized. The Company's accounting policy for the release of stranded tax effects in AOCI is on an aggregate portfolio basis. The Company elected to adopt the requirements of this update in its Consolidated Financial Statements for the year ended December 31, 2017 and has reported the resultant reclassification amount, \$2.5 million, as a charge to Retained Earnings in the accompanying Consolidated Statements of Changes in Stockholders' Equity.

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

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). The guidance requires companies to recognize revenue that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. As an insurance enterprise, the primary sources of revenue are excluded from this guidance, including insurance premiums, contract charges, and investment revenues. We have certain types of non-insurance and non-investment revenue from contracts with customers that fall under this guidance. These revenues are recognized when obligations under the terms of the contract are satisfied. The amount of revenue recognized reflects the consideration we expect to be entitled to in exchange for those services. For these revenues, the performance obligation is fulfilled as services are rendered. Revenues from contracts with customers identified under Topic 606 are not material, approximately 2% of total revenues for the year ended December 31, 2017. The guidance was effective for reporting periods beginning after December 15, 2017. The adoption of this ASU did not have a material effect on the results of operations or financial position of the Company.

In January 2016, the FASB released ASU 2016-01, Recognition and Measurement of Financial Assets and Liabilities. The main provisions of the update eliminate the available for sale classification of accounting for equity securities and to adjust the fair value disclosures for financial instruments carried at amortized costs such that the disclosed fair values represent an exit price as opposed to an entry price. The provisions of this update require that equity securities be carried at fair market value on the balance sheet and any periodic changes in value be recorded as adjustments directly to the income statement. The provisions of this update became effective for the Company beginning January 1, 2018. The prospective adoption of this update resulted in the reclassification of \$4.4 million pertaining to unrealized gains, net of tax, out of Accumulated Other Comprehensive Income into Retained Earnings as a cumulative effect of a change in accounting principle, as shown in the Condensed Consolidated Statements of Changes in Stockholders' Equity. Equity securities, previously included in Securities Available for Sale are now reported as a separate line item on the Consolidated Balance Sheet. The change in fair value of equity securities, previously reported in Other Comprehensive income, is now included in net investment income in the Condensed Consolidated Statements of Earnings. As the Company's equity securities holdings are not significant, the adoption of the requirements of this update did not have a material impact on the Company's financial position, results of operations or cash flows.

In May 2017, the FASB released ASU 2017-09, Compensation - Stock Compensation. The update provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Accounting Standards Codification ("ASC") Topic 718. An entity shall account for the effects of a modification described in ASC paragraphs 718-20-35-3 through 35-9, unless all the following are met: (1) The fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; (2) The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (3) The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The provisions of this update became effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. The adoption of this ASU did not have a material effect on the results of operations or financial position of the Company.

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

(3) STOCKHOLDERS' EQUITY

NWLIC is restricted by state insurance laws as to dividend amounts which may be paid to stockholders without prior approval from the Colorado Division of Insurance. The restrictions are based on the lesser of statutory earnings from operations, excluding capital gains, from the prior calendar year or 10% of statutory surplus of the company as of the previous calendar year-end. The maximum dividend payment which may be made without prior approval in 2018 is \$127.3 million. As the sole owner of NWLIC, all dividends declared by National Western are payable entirely to NWLGI and are eliminated in consolidation.

In the first quarter of 2018, National Western declared and paid a \$3.0 million dividend to NWLGI. In the third quarter of 2018, National Western declared a \$3.0 million dividend to NWLGI which was subsequently paid on October 17, 2018. During the second quarter of 2017 National Western declared and paid a \$4.0 million dividend to NWLGI. During the third quarter of 2017 National Western declared a \$3.0 million dividend payable to NWLGI which was subsequently paid on October 16, 2017.

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

NWLG I did not declare or pay cash dividends on its common shares during the nine months ended September 30, 2018 and 2017.

(4) EARNINGS PER SHARE

Basic earnings per share of common stock are computed by dividing net income available to each class of common stockholders on an as if distributed basis by the weighted-average number of common shares outstanding for the period. Diluted earnings per share, by definition, reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock, that then shared in the distributed earnings of each class of common stock. U.S. GAAP requires a two-class presentation for the Company's two classes of common stock. The Company currently has no share-based compensation awards outstanding that could be redeemed for shares of common stock.

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

Net income for the periods shown below is allocated between Class A shares and Class B shares based upon (1) the proportionate number of shares issued and outstanding as of the end of the period, and (2) the per share dividend rights of the two classes under the Company's Restated Certificate of Incorporation (the Class B dividend per share is equal to one-half the Class A dividend per share).

	Three Months Ended September 30,			
	2018	2017		
	Class A	Class B	Class A	Class B
	(In thousands except per share amounts)			
Numerator for Basic and Diluted Earnings Per Share:				
Net income	\$35,641		21,813	
Dividends - Class A shares	—		—	
Dividends - Class B shares	—		—	
Undistributed income	\$35,641		21,813	
Allocation of net income:				
Dividends	\$—	—	—	—
Allocation of undistributed income	34,633	1,008	21,196	617
Net income	\$34,633	1,008	21,196	617
Denominator:				
Basic earnings per share - weighted-average shares	3,436	200	3,436	200
Effect of dilutive stock options	—	—	—	—
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,436	200	3,436	200
Basic Earnings Per Share	\$10.08	5.04	6.17	3.08
Diluted Earnings Per Share	\$10.08	5.04	6.17	3.08

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

	Nine Months Ended September 30,			
	2018	2017		
	Class A	Class B	Class A	Class B
	(In thousands except per share amounts)			
Numerator for Basic and Diluted Earnings Per Share:				
Net income	\$94,982		70,834	
Dividends - Class A shares	—		—	
Dividends - Class B shares	—		—	
Undistributed income	\$94,982		70,834	
Allocation of net income:				
Dividends	\$—	—	—	—
Allocation of undistributed income	92,296	2,686	68,831	2,003
Net income	\$92,296	2,686	68,831	2,003
Denominator:				
Basic earnings per share - weighted-average shares	3,436	200	3,436	200
Effect of dilutive stock options	—	—	—	—
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,436	200	3,436	200
Basic Earnings Per Share	\$26.86	13.43	20.03	10.02
Diluted Earnings Per Share	\$26.86	13.43	20.03	10.02

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

(5) PENSION AND OTHER POSTRETIREMENT PLANS

(A) Defined Benefit Pension Plans

National Western sponsors a qualified defined benefit pension plan covering employees enrolled prior to 2008. The plan provides benefits based on the participants' years of service and compensation. The company makes annual contributions to the plan that comply with the minimum funding provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). On October 19, 2007, National Western's Board of Directors approved an amendment to freeze the pension plan as of December 31, 2007. The freeze ceased future benefit accruals to all participants and closed the plan to any new participants. In addition, all participants became immediately 100% vested in their accrued benefits as of that date. As participants are no longer earning a credit for service, future qualified defined benefit plan expense is projected to be minimal. Fair values of plan assets and liabilities are measured as of the prior December 31 for each year. The following table summarizes the components of net periodic benefit cost.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Service cost	\$28	27	84	81
Interest cost	225	240	675	718
Expected return on plan assets	(325)	(306)	(975)	(920)
Amortization of prior service cost	—	—	—	—
Amortization of net loss	131	159	393	477
Net periodic benefit cost	\$59	120	177	356

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

The company's minimum required contribution for the 2018 plan year is \$0.1 million. There was no remaining contribution payable for the 2017 plan year as of September 30, 2018. As of September 30, 2018, the company had \$0.1 million contributions to the plan for the 2018 plan year.

National Western also sponsors three non-qualified defined benefit pension plans. The first plan covers certain senior officers and provides benefits based on the participants' years of service and compensation. The primary 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"), a related party. ANICO has guaranteed the payment of pension obligations under the plan. However, the company has a contingent liability with respect to the plan should these entities be unable to meet their obligations under the existing agreements. Also, the company has a contingent liability with respect to the plan in the event that a plan participant continues employment with National Western

beyond age seventy, the aggregate average annual participant salary increases exceed 10% per year, or any additional employees become eligible to participate in the plan. If any of these conditions are met, the company would be responsible for any additional pension obligations resulting from these items. Amendments were made to the plan to allow an additional employee to participate and to change the benefit formula for the then Chairman of the company. As previously mentioned, these additional obligations are a liability to the company. Effective December 31, 2004, this plan was frozen with respect to the continued accrual of benefits of the then Chairman and the then President of the company in order to comply with law changes under the American Jobs Creation Act of 2004 ("Act").

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

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

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Service cost	\$90	204	270	612
Interest cost	213	347	639	1,041
Amortization of prior service cost	15	15	45	45
Amortization of net loss	176	818	528	2,455
Net periodic benefit cost	\$494	1,384	1,482	4,153

The company expects to contribute \$2.0 million to these plans in 2018. As of September 30, 2018, the company has contributed \$1.6 million to the plans.

(B) Postretirement Employment Plans Other Than Pension

National Western sponsors two healthcare plans that were amended in 2004 to provide postretirement benefits to certain fully-vested individuals. The plan is unfunded. The following table summarizes the components of net periodic benefit costs.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			

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Interest cost	\$40	35	120	104
Amortization of prior service cost	26	25	78	77
Amortization of net loss	38	10	113	31
Net periodic benefit cost	\$104	70	311	212

The company expects to contribute minimal amounts to the plan in 2018.

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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. As disclosed in the Form 10-Q filed for the quarter ended March 31, 2018, National Western discontinued accepting applications for the company's international products from foreign residents in May 2018. A summary of segment information as of September 30, 2018 and December 31, 2017 for the Condensed Consolidated Balance Sheet items and for the three and nine months ended September 30, 2018 and September 30, 2017 for the Condensed Consolidated Statement of Earnings is provided below.

Condensed Consolidated Balance Sheet Items:

	September 30, 2018				
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
	(In thousands)				
Deferred policy acquisition costs and sales inducements	\$ 117,900	241,823	620,366	—	980,089
Total segment assets	1,217,781	1,227,365	8,922,137	365,195	11,732,478
Future policy benefits	1,045,922	918,658	7,970,775	—	9,935,355
Other policyholder liabilities	14,556	21,898	93,075	—	129,529
	December 31, 2017				
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
	(In thousands)				
Deferred policy acquisition costs and sales inducements	\$ 101,253	250,128	603,700	—	955,081
Total segment assets	1,106,410	1,236,733	9,269,956	398,597	12,011,696
Future policy benefits	950,884	915,384	8,232,216	—	10,098,484
Other policyholder liabilities	13,643	11,318	103,048	—	128,009

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Condensed Consolidated Statement of Earnings:

	Three Months Ended September 30, 2018				Totals
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	
	(In thousands)				
Premiums and contract revenues	\$10,060	26,839	5,597	—	42,496
Net investment income	26,912	19,731	123,525	5,385	175,553
Other revenues	11	5	11	5,084	5,111
Total revenues	36,983	46,575	129,133	10,469	223,160
Life and other policy benefits	5,839	6,609	(6,704)	—	5,744
Amortization of deferred policy acquisition costs	2,978	6,307	17,490	—	26,775
Universal life and annuity contract interest	22,355	30,596	71,194	—	124,145
Other operating expenses	5,215	4,982	8,719	5,121	24,037
Federal income taxes (benefit)	122	(322)	7,714	1,101	8,615
Total expenses	36,509	48,172	98,413	6,222	189,316
Segment earnings (loss)	\$474	(1,597)	30,720	4,247	33,844

	Nine Months Ended September 30, 2018				Totals
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	
	(In thousands)				
Premiums and contract revenues	\$29,775	82,218	18,042	—	130,035
Net investment income	41,131	32,305	263,983	20,681	358,100
Other revenues	12	39	48	15,297	15,396
Total revenues	70,918	114,562	282,073	35,978	503,531
Life and other policy benefits	15,751	16,872	11,984	—	44,607
Amortization of deferred acquisition costs	8,362	21,023	60,688	—	90,073
Universal life and annuity contract interest	29,401	37,046	116,869	—	183,316
Other operating expenses	15,368	15,991	25,741	15,367	72,467
Federal income taxes (benefit)	405	4,701	13,290	4,100	22,496
Total expenses	69,287	95,633	228,572	19,467	412,959

Segment earnings (loss)	\$1,631	18,929	53,501	16,511	90,572
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	Three Months Ended September 30, 2017				Totals
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	
	(In thousands)				
Premiums and contract revenues	\$9,907	30,353	5,293	—	45,553
Net investment income	17,385	15,711	114,123	4,472	151,691
Other revenues	11	26	26	4,609	4,672
Total revenues	27,303	46,090	119,442	9,081	201,916
Life and other policy benefits	3,483	8,437	9,095	—	21,015
Amortization of deferred acquisition costs	2,517	(21,585)	37,790	—	18,722
Universal life and annuity contract interest	14,119	9,112	84,568	—	107,799
Other operating expenses	4,086	5,661	8,714	4,135	22,596
Federal income taxes (benefit)	1,061	15,473	(7,007)	1,792	11,319
Total expenses	25,266	17,098	133,160	5,927	181,451
Segment earnings (loss)	\$2,037	28,992	(13,718)	3,154	20,465
	Nine Months Ended September 30, 2017				
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
	(In thousands)				
Premiums and contract revenues	\$27,822	91,563	16,583	—	135,968
Net investment income	51,998	48,581	346,031	19,435	466,045
Other revenues	30	73	90	13,521	13,714
Total revenues	79,850	140,217	362,704	32,956	615,727
Life and other policy benefits	13,850	19,399	25,377	—	58,626
Amortization of deferred acquisition costs	8,300	(7,874)	85,566	—	85,992
Universal life and annuity contract interest	41,576	36,871	221,415	—	299,862
Other operating expenses	13,975	18,846	28,588	12,622	74,031
Federal income taxes (benefit)	740	25,125	605	7,001	33,471
Total expenses	78,441	92,367	361,551	19,623	551,982
Segment earnings (loss)	\$1,409	47,850	1,153	13,333	63,745

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Reconciliations of segment information to the Company's Condensed Consolidated Financial Statements are provided below.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Premiums and Other Revenues:				
Premiums and contract revenues	\$42,496	45,553	130,035	135,968
Net investment income	175,553	151,691	358,100	466,045
Other revenues	5,111	4,672	15,396	13,714
Realized gains (losses) on investments	2,275	2,074	5,582	10,906
Total condensed consolidated premiums and other revenues	\$225,435	203,990	509,113	626,633

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Federal Income Taxes:				
Total segment Federal income taxes	\$8,615	11,319	22,496	33,471
Taxes on realized gains (losses) on investments	478	726	1,172	3,817
Total condensed consolidated Federal income taxes	\$9,093	12,045	23,668	37,288

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Net Earnings:				
Total segment earnings	\$33,844	20,465	90,572	63,745
Realized gains (losses) on investments, net of taxes	1,797	1,348	4,410	7,089
Total condensed consolidated net earnings	\$35,641	21,813	94,982	70,834

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	September	December
	30,	31,
	2018	2017

(In thousands)

Assets:

Total segment assets	\$11,732,478	12,011,696
Other unallocated assets	359,362	213,398

Total condensed consolidated assets	\$12,091,840	12,225,094
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(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 non-qualified stock options; (2) stock appreciation rights ("SARs"), in tandem with stock options or freestanding; (3) restricted stock or restricted stock units; and, (4) performance awards. The 1995 Plan began on April 21, 1995, and was amended on June 25, 2004 to extend the termination date to April 20, 2010. The number of shares of Class A, \$1.00 par value, common stock which were allowed to be issued under the 1995 Plan, or as to which SARs or other awards were allowed to be granted, could not exceed 300,000. Effective June 20, 2008, the Company's shareholders approved a 2008 Incentive Plan ("2008 Plan"). The 2008 Plan is substantially similar to the 1995 Plan and authorized an additional number of Class A common stock shares eligible for issue not to exceed 300,000. These plans were assumed by NWLGI from National Western pursuant to the terms of the holding company reorganization in 2015. On June 15, 2016, stockholders of NWLGI approved the Incentive Plan, which is a stock and incentive plan essentially similar to the 2008 Plan. The Incentive Plan includes additional provisions, most notably regarding the definition of performance objectives which could be used in the issuance of the fourth type of award noted above (performance awards).

All of the employees of the Company and its subsidiaries are eligible to participate in the current Incentive Plan. In addition, directors of the Company are eligible to receive the same types of awards as employees except that they are not eligible to receive incentive stock options. Company directors, including members of the Compensation and Stock Option Committee, are eligible for nondiscretionary stock options. All stock options granted were under the 1995 Plan and 2008 Plan. Employee stock options and SARs granted prior to 2016 vest 20% annually following three years of service following the grant date. Employee SARs granted 2016 forward vest 33.3% annually following one year of service from the date of the grant. Directors' stock options and SARs grants vest 20% annually following one year of service from the date of grant.

Effective during March 2006, the Company adopted and implemented a limited stock buy-back program with respect to the 1995 Plan which provides stock 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. These plans were assumed as well by NWLGI from National Western pursuant to the terms of the holding company reorganization.

The Incentive Plan allows for certain other share or unit awards which are solely paid out in cash based on the value of the Company's shares, or changes therein, as well as the financial performance of the Company under pre-determined target performance metrics. Certain awards, such as restricted stock units ("RSUs") provide solely for cash settlement based upon the market price of the Company's Class A common shares, often referred to as "phantom stock-based awards". Unlike share-settled awards, which have a fixed grant-date fair value, the fair value of unsettled or unvested liability awards is remeasured at the end of each reporting period based on the change in fair value of a share. The liability and corresponding expense are adjusted accordingly until the award is settled. For employees, the vesting period for RSUs is 100% at the end of three years from the grant date. The RSUs are payable in cash at the vesting date equal to the closing price of the Company's Class A common shares at that time.

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Other awards may involve performance share units ("PSUs") which are units granted at a specified dollar amount per unit, typically linked to the Company's Class A common share price, that are subsequently multiplied by an attained performance factor to derive the number of PSUs to be paid as cash compensation at the vesting date. PSUs also vest three years from the date of grant. For PSUs, the performance period begins the first day of the calendar year in which the PSUs are granted and runs three calendar years. At that time, the three-year performance outcome will be measured against the pre-defined target amounts to determine the number of PSUs earned as compensation.

Directors of the Company are eligible to receive RSUs under the Incentive Plan. Unlike RSUs granted to officers, the RSUs granted to directors vest one year from the date of grant. They are payable in cash at the vesting date equal to the closing price of the Company's Class A common shares at that time.

The following table shows all grants issued to officers and directors for the three and nine months ended September 30, 2018 and 2017. These grants were made based upon closing market price per Class A common share at the time of the grant.

	Three Months Ended		
	September 30, 2018	September 30, 2017	
	Officer	Officer	Director
SARs	—	—	—
RSUs	—	—	—
PSUs	—	—	—
	Nine Months Ended		
	September 30, 2018	September 30, 2017	
	Officer	Officer	Director
SARs	—	11,715	—
RSUs	—	2,725	1,660
PSUs	—	4,526	—

The Company uses the current fair value method to measure compensation cost for awards granted under the share-based plans. As of September 30, 2018 and 2017, the liability balance was \$15.5 million and \$16.6 million, respectively. A summary of awards by type and related activity is detailed below.

	Options Outstanding		
	Shares Available For Grant	Shares	Weighted- Average Exercise Price
Stock Options:			
Balance at January 1, 2018	291,000	18,018	\$ 242.07

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Exercised	—	(18,018)	\$ 242.07
Forfeited	—	—	\$ —
Expired	—	—	\$ —
Stock options granted	—	—	\$ —
Balance at September 30, 2018	291,000	—	\$ —

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	Liability Awards		
	SAR	RSU	PSU
Other Share/Unit Awards:			
Balance at January 1, 2018	92,667	11,721	14,052
Exercised	(2,984)	(1,494)	—
Forfeited	(1,780)	(556)	—
Granted	—	—	—
Balance at September 30, 2018	87,903	9,671	14,052

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

The total intrinsic value of share-based compensation exercised was \$2.2 million and \$1.0 million for the nine months ended September 30, 2018 and 2017, respectively. The total share-based compensation paid was \$2.2 million and \$1.0 million for the nine months ended September 30, 2018 and 2017, respectively. The total fair value of stock options and SARs vested during the nine months ended September 30, 2018 and 2017 was \$0.8 million and \$0.6 million, respectively. For the nine months ended September 30, 2018 and 2017, the total cash received from the exercise of stock options under the Plans was \$0.0 million and \$0.0 million, respectively.

The following table summarizes information about SARs outstanding at September 30, 2018. There were no options outstanding as of September 30, 2018.

	SARs Outstanding		Number Exercisable
	Weighted- Average Outstanding Contractual Life	Number Remaining	
Exercise prices:			
114.64 (SARs)	10,500	0.4 years	10,500
132.56 (SARs)	19,818	3.2 years	15,915
210.22 (SARs)	25,300	5.2 years	10,800
216.48 (SARs)	11,649	7.4 years	7,589
311.16 (SARs)	10,427	8.4 years	3,444
310.55 (SARs)	203	8.6 years	67
334.34 (SARs)	10,006	9.2 years	—
Totals	87,903		48,315
Aggregate intrinsic value	\$9,886		\$ 7,103

(in thousands)

The aggregate intrinsic value in the table above is based on the closing Class A stock price of \$319.20 per share on September 30, 2018.

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The SARs shown above with exercise price of \$114.64 have a remaining contractual life of less than one year. The holders for this grant have until the end of the contractual life of February 19, 2019 to exercise these holdings or otherwise forfeit the grants held.

In estimating the fair value of the share-based awards outstanding at September 30, 2018 and December 31, 2017, the Company employed the Black-Scholes option pricing model with assumptions detailed below.

	September 30, 2018	December 31, 2017		
Expected term	0.4 to 9.2 years	0.3 to 10.0 years		
Expected volatility weighted-average	21.55	% 21.55	%	%
Expected dividend yield	0.11	% 0.11	%	%
Risk-free rate weighted-average	2.63	% 1.82	%	%

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/SARs expected exercise date.

The pre-tax compensation cost/(benefit) recognized in the financial statements related to these plans was \$1.7 million and \$2.4 million for the three and nine months ended September 30, 2018 and \$1.3 million and \$5.6 million for the three and nine months ended September 30, 2017, respectively. The related tax expense/(benefit) recognized was \$(0.4) million and \$(0.5) million for the three and nine months ended September 30, 2018 and \$(0.5) million and \$(2.0) million for the three and nine months ended September 30, 2017, respectively.

As of September 30, 2018, the total compensation cost related to non-vested share-based awards not yet recognized was \$4.0 million. This amount is expected to be recognized over a weighted-average period of 1.2 years. The Company recognizes compensation cost over the graded vesting periods.

(8) COMMITMENTS AND CONTINGENCIES

(A) Legal Proceedings

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

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National Western was the named defendant in the case of Damaris Maldonado Vinas, et al. vs. National Western Life Insurance, in which the plaintiffs, after National Western had paid the death benefits to the beneficiary (Francisco Iglesias-Alvarez) upon the annuitant's (Carlos Iglesias-Alvarez) death, sought to annul two annuity policies issued by National Western at the behest of Carlos Iglesias-Alvarez and which named Francisco Iglesias-Alvarez as their beneficiary. On March 31, 2016, the United States District Court for the District of Puerto Rico (the "Court") issued its Opinion and Order on the pending Motions for Summary Judgment submitted by the parties, and therein denied National Western's motion and granted plaintiffs' motion voiding the two annuities and requesting a refund of the premiums paid (\$2.9 million). National Western vigorously defended the case and believes that the Court's Opinion and Order is contrary to applicable law. As such, National Western filed a Motion for Reconsideration of Opinion and Order and Corresponding Judgment with the Court on April 27, 2016, which the Court denied on May 5, 2016. National Western filed a Notice of Appeal on June 10, 2016, filed its Appeal Brief on September 12, 2016, and oral arguments with the U.S. Court of Appeals for the First Circuit were held on March 9, 2017. On June 29, 2017, the Court of Appeals vacated the district court's judgment and remanded to the district court to determine whether it is nevertheless equitable for the case to proceed without Francisco Iglesias-Alvarez. Plaintiffs filed a Motion in Support of Determination in Equity and Good Conscience That Action Should Proceed Among Existing Parties Under Fed.R.Civ.P. 19(B) on September 14, 2017, and National Western filed its Opposition to Plaintiffs' Motion on October 27, 2017. On April 2, 2018 the Court asked the parties for additional briefing regarding the Court's jurisdiction over Francisco Iglesias-Alvarez, which the parties filed on April 30, 2018. On May 14, 2018, National Western filed its Opposition to Plaintiffs' Brief. Plaintiffs filed a Motion to Strike on May 22, 2018, which National Western opposed on June 4, 2018. On August 6, 2018, the Court issued an Opinion and Order dismissing plaintiffs' case without prejudice and plaintiffs filed a Notice of Appeal to the First Circuit Court of Appeals on September 4, 2018. The company continues to hold an accrual of \$2.9 million for this matter as of September 30, 2018.

On September 28, 2017, a purported shareholder derivative lawsuit was filed in the 122nd District Court of Galveston County, State of Texas entitled Robert L. Moody, Jr. derivatively on behalf of National Western Life Insurance Company and National Western Life Group, Inc. v. Ross Rankin Moody, et al., naming certain current and former directors and current officers as defendants. The complaint challenges the directors' oversight of insurance sales to non-U.S. residents and alleges that the defendants breached their fiduciary duties in the conduct of their duties as board members by failing to act (i) on an informed basis and (ii) in good faith or with the honest belief that their actions were in the best interests of the Company. The complaint seeks an undetermined amount of damages, attorneys' fees and costs, and equitable relief, including the removal of the Company's Chairman and Chief Executive Officer and other board members and/or officers of the Company. The Company believes that the claims in the complaint are baseless and without merit, will vigorously defend this lawsuit, and will seek reimbursement of all legal costs and expenses from plaintiff. The Company believes, based on information currently available, that the final outcome of this lawsuit will not have a material adverse effect on the Company's business, results of operations, or consolidated financial position. The companies and directors filed their respective Pleas to the Jurisdiction ("Pleas") contesting the plaintiff's standing to even pursue this action, along with their Answers, on October 27, 2017. On December 14, 2017, plaintiff filed a Response to the Pleas and on December 21, 2017, the Court heard oral argument on the Pleas. Plaintiff then filed a First Amended Petition on January 11, 2018. The companies and directors filed a Supplement to the Pleas on January 30, 2018, to which plaintiff responded on February 1, 2018, and the companies and directors replied on February 9, 2018. On May 3, 2018, the Court issued a memorandum to all attorneys of record stating that the Court will grant the defendants' Pleas and asking the attorney for defendants to prepare and submit proposed orders/judgments granting the requested relief for consideration by the Court. The defendants filed such proposed order granting the Pleas on May 7, 2018. On May 16, 2018 the Court issued an Order granting the Pleas and dismissing Robert L. Moody, Jr.'s claims with prejudice, and plaintiff then filed a Motion to Transfer Venue ("MTTV").

Defendants filed an Application for Fees, seeking to recover defendants' legal costs and expenses from plaintiff, and a Response to the MTTV on June 8, 2018. In response plaintiff filed a Motion to Vacate, a Response to the Application for Fees, and their own Request for Attorney's Fees on July 5, 2018. Defendants filed a Response to the Motion to Vacate and to plaintiff's Request for Attorney's Fees on July 11, 2018, and the Court heard oral arguments on July 16, 2018. Plaintiff filed supplemental briefing in support of their July 5, 2018 filings on July 25, 2018, and defendants filed their response to plaintiff's supplemental briefing on July 27, 2018. On August 8, 2018 the Court issued an Order denying plaintiff's Motion to Vacate. Pursuant to the Court's instructions, on October 5, 2018, defendants filed an Order Granting Application for Expenses. Defendants then filed a Motion for Entry of Final Judgment and a Request for Submission Date on Motion for Entry of Final Judgment on October 11, 2018, which the Court set as October 30, 2018. Plaintiff filed his Objection to Proposed Final Judgment and Objection to Proposed Order on Attorneys' Fees on October 25, 2018, to which defendants filed a response on October 30, 2018.

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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.

Separately, Brazilian authorities commenced an investigation into possible violations of Brazilian criminal law in connection with the issuance of National Western insurance policies to Brazilian residents, and in assistance of such investigation a Commissioner appointed by the U.S. District Court for the Western District of Texas issued a subpoena in March of 2015 upon the company to provide information relating to such possible violations. No conclusion can be drawn at this time as to its outcome or how such outcome may impact the Company's business, results of operations or financial condition. National Western has been cooperating with the relevant governmental authorities in regard to this matter.

(B) Financial Instruments

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

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

The Company had \$4.3 million commitments to fund new loans and \$6.2 million in commitments to extend credit relating to existing loans at September 30, 2018. The Company evaluates each customer's creditworthiness on a case-by-case basis.

(9) INVESTMENTS**(A) Investment Gains and Losses**

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Available for sale debt securities:				
Realized gains on disposal	\$1,191	1,529	3,212	4,137

(In thousands)

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Realized losses on disposal	(6)	—	(6)	—
Held to maturity debt securities:				
Realized gains on disposal	1,090	555	2,395	4,059
Realized losses on disposal	—	—	(19)	(34)
Equity securities realized gains (losses)	—	(10)	—	87
Real estate gains (losses)	—	—	—	2,657
Totals	\$2,275	2,074	5,582	10,906

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

The Company uses the specific identification method in computing realized gains and losses. For the three months ended September 30, 2018 and 2017 the percentage of gains on bonds due to the call of securities was 97.3% and 100.0%, respectively. For the nine months ended September 30, 2018 and 2017 the percentage of gains on bonds due to the call of securities was 98.7% and 88.0%, respectively. This includes calls out of the Company's available for sale portfolio of debt securities.

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

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2017		
	(In thousands)			
Total other-than-temporary impairment gains (losses) on debt securities	\$3	26	9	69
Portion of loss (gain) recognized in comprehensive income	(3)	(26)	(9)	(69)
Net impairment losses on debt securities recognized in earnings	—	—	—	—
Equity securities impairments	—	—	—	—
Totals	\$—	—	—	—

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

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018	Year Ended December 31, 2017
	(In thousands)		
Beginning balance, cumulative credit losses related to other-than-temporary impairments	\$627	627	1,440
Reductions for securities sold during current period	—	—	(813)
Additions for credit losses not previously recognized in other-than-temporary impairments	—	—	—

Ending balance, cumulative credit losses related to other-than-temporary impairments	\$627 627	627
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(B) Debt Securities

The table below presents amortized costs and fair values of debt securities held to maturity at September 30, 2018.

	Debt Securities Held to Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
U.S. Treasury	\$1,341	113	—	1,454
States and political subdivisions	457,379	8,136	(5,147)	460,368
Public utilities	964,889	5,251	(16,305)	953,835
Corporate	4,655,058	26,262	(92,282)	4,589,038
Residential mortgage-backed	1,198,121	8,228	(28,752)	1,177,597
Home equity	3,496	53	(9)	3,540
Manufactured housing	747	52	—	799
Totals	\$7,281,031	48,095	(142,495)	7,186,631

The table below presents amortized costs and fair values of debt securities available for sale at September 30, 2018. As indicated in Note (2) New Accounting Pronouncements, effective January 1, 2018, equity securities are no longer included in the Securities Available for Sale category.

	Debt Securities Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
States and political subdivisions	\$571	5	—	576
Foreign governments	9,971	36	—	10,007
Public utilities	84,947	1,119	(609)	85,457
Corporate	2,895,100	17,156	(66,875)	2,845,381
Residential mortgage-backed	16,854	836	(59)	17,631
Home equity	6,446	290	—	6,736
Totals	\$3,013,889	19,442	(67,543)	2,965,788

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The table below presents amortized costs and fair values of securities held to maturity at December 31, 2017.

	Securities Held to Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
U.S. Treasury	\$1,337	177	—	1,514
States and political subdivisions	467,437	21,907	(100)	489,244
Public utilities	1,062,545	30,527	(894)	1,092,178
Corporate	4,430,099	121,978	(7,876)	4,544,201
Residential mortgage-backed	1,280,307	27,445	(6,216)	1,301,536
Home equity	4,262	57	(4)	4,315
Manufactured housing	1,037	79	—	1,116
Totals	\$7,247,024	202,170	(15,090)	7,434,104

The table below presents amortized costs and fair values of securities available for sale at December 31, 2017.

	Securities Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
States and political subdivisions	\$575	—	(29)	546
Foreign governments	9,964	326	—	10,290
Public utilities	83,466	3,640	—	87,106
Corporate	2,842,381	81,737	(10,744)	2,913,374
Residential mortgage-backed	20,246	1,376	(52)	21,570
Home equity	7,878	367	—	8,245
Manufactured housing	—	—	—	—
	2,964,510	87,446	(10,825)	3,041,131
Equity securities	12,890	5,708	(120)	18,478
Totals	\$2,977,400	93,154	(10,945)	3,059,609

The Company does not consider securities to be other-than-temporarily impaired when the market decline is attributable to factors such as market volatility, liquidity, spread widening and credit quality where it is anticipated that a recovery of all amounts due under the contractual terms of the security will occur and the Company has the intent and ability to hold until recovery or maturity. Based on its review, the Company does not consider these

investments to be other-than-temporarily impaired at September 30, 2018. The Company will monitor the investment portfolio for future changes in issuer facts and circumstances that could result in future impairments beyond those currently identified.

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During the three and nine months ended September 30, 2018, the Company recorded no other-than-temporary impairment on debt securities.

Unrealized losses for debt securities held to maturity and debt securities available for sale increased during the first nine months of 2018 primarily due to the upward movement in market interest rates during this period (which decreases the market price of debt securities).

The following table shows the gross unrealized losses and fair values of the Company's held to maturity debt securities by investment category and length of time the individual securities have been in a continuous unrealized loss position at September 30, 2018.

	Debt Securities Held to Maturity					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	\$113,773	(4,819)	6,297	(328)	120,070	(5,147)
Public utilities	530,455	(13,676)	39,437	(2,629)	569,892	(16,305)
Corporate	2,499,421	(65,166)	471,244	(27,116)	2,970,665	(92,282)
Residential mortgage-backed	649,298	(14,345)	215,053	(14,407)	864,351	(28,752)
Home equity	—	—	2,218	(9)	2,218	(9)
Total temporarily impaired securities	\$3,792,947	(98,006)	734,249	(44,489)	4,527,196	(142,495)

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The following table shows the gross unrealized losses and fair values of the Company's available for sale debt securities by investment category and length of time the individual securities have been in a continuous unrealized loss position at September 30, 2018.

	Debt Securities Available for Sale					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	\$—	—	—	—	—	—
Public utilities	38,807	(609)	—	—	38,807	(609)
Corporate	1,570,824	(42,632)	357,876	(24,243)	1,928,700	(66,875)
Residential mortgage-backed	—	—	933	(59)	933	(59)
Home equity	—	—	—	—	—	—
Total temporarily impaired securities	\$1,609,631	(43,241)	358,809	(24,302)	1,968,440	(67,543)

The following table shows the gross unrealized losses and fair values of the Company's held to maturity investments by investment category and length of time the individual securities have been in a continuous unrealized loss position at December 31, 2017.

	Securities Held to Maturity					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	\$6,308	(14)	4,869	(86)	11,177	(100)
Public utilities	68,368	(407)	34,091	(487)	102,459	(894)
Corporate	248,844	(1,296)	431,591	(6,580)	680,435	(7,876)
Residential mortgage-backed	130,015	(738)	192,399	(5,478)	322,414	(6,216)
Home equity	2,830	(4)	—	—	2,830	(4)
Total temporarily impaired securities	\$456,365	(2,459)	662,950	(12,631)	1,119,315	(15,090)

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The following table shows the gross unrealized losses and fair values of the Company's available for sale investments by investment category and length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2017.

	Securities Available for Sale					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	\$546	(29)	—	—	546	(29)
Corporate	201,575	(1,134)	296,845	(9,610)	498,420	(10,744)
Residential mortgage-backed	1,325	(14)	1,085	(38)	2,410	(52)
Home equity	1,653	—	—	—	1,653	—
	205,099	(1,177)	297,930	(9,648)	503,029	(10,825)
Equity securities	1,246	(77)	289	(43)	1,535	(120)
Total temporarily impaired securities	\$206,345	(1,254)	298,219	(9,691)	504,564	(10,945)

Debt securities. The gross unrealized losses for debt securities are made up of 723 individual issues, or 55.8% of the total debt securities held by the Company at September 30, 2018. The market value of these bonds as a percent of amortized cost approximates 96.9%. Of the 723 securities, 142, or 19.6%, fall in the 12 months or greater aging category; and 714 were rated investment grade at September 30, 2018.

The amortized cost and fair value of investments in debt securities at September 30, 2018, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Debt Securities Available for Sale		Debt Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Due in 1 year or less	\$103,995	106,063	326,104	331,101
Due after 1 year through 5 years	1,137,368	1,141,487	2,729,171	2,727,219
Due after 5 years through 10 years	1,663,318	1,609,872	2,646,213	2,570,349
Due after 10 years	85,909	83,999	377,179	376,026
	2,990,590	2,941,421	6,078,667	6,004,695
Mortgage and asset-backed securities	23,299	24,367	1,202,364	1,181,936

Total \$3,013,889 2,965,788 7,281,031 7,186,631

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(C) Transfer of Securities

During the three and nine months ended September 30, 2018 the Company made no transfers from the held to maturity category to securities available for sale.

(D) Mortgage Loans and Real Estate

A financing receivable is a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in a company's statement of financial position. The Company's mortgage, participation and mezzanine loans on real estate are the only financing receivables included in the Consolidated Balance Sheets.

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

Loans in foreclosure, loans considered impaired or loans past due 90 days or more are placed on a non-accrual status. If a mortgage loan is determined to be on non-accrual status, the mortgage loan does not accrue any revenue into the Condensed Consolidated Statements of Earnings. The loan is independently monitored and evaluated as to potential impairment or foreclosure. If delinquent payments are made and the loan is brought current, then the Company returns the loan to active status and accrues income accordingly. The Company had no mortgage loans past due 90 days or more at September 30, 2018 or 2017 and as a result all interest income was recognized at September 30, 2018 and 2017.

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

	September 30, 2018		December 31, 2017	
	Amount	%	Amount	%
	(In thousands)		(In thousands)	
Mortgage Loans by Loan-to-Value Ratio (1):				
Less than 50%	\$67,837	33.7	\$82,224	39.4
50% to 60%	23,666	11.7	27,395	13.1
60% to 70%	97,899	48.6	86,849	41.6
70% to 80%	6,716	3.3	—	—
80% to 90%	5,408	2.7	6,929	3.3
Greater than 90%	—	—	5,502	2.6
Gross balance	201,526	100.0	208,899	100.0
Allowance for possible losses	(650)	(0.3)	(650)	(0.3)

Totals	\$200,876	99.7	\$208,249	99.7
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(1) Loan-to-Value Ratio is determined using the most recent appraised value. Appraisals are required at the time of funding and may be updated if a material change occurs from the original loan agreement.

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

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

The following table represents the mortgage loan allowance for the periods shown.

	September 30, 2018	December 31, 2017
	(In thousands)	
Balance, beginning of period	\$ 650	650
Provision	—	—
Releases	—	—
Balance, end of period	\$ 650	650

The Company's direct investments in real estate are not a significant portion of its total investment portfolio and totaled approximately \$36.8 million and \$37.4 million at September 30, 2018 and December 31, 2017, respectively. The Company recognized operating income on real estate properties of approximately \$1.7 million and \$2.1 million for the first nine months of 2018 and 2017, respectively.

(10) FAIR VALUES OF FINANCIAL INSTRUMENTS

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

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

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

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

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

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

	September 30, 2018			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale	\$2,965,788	—	2,965,788	—
Equity securities	19,661	19,661	—	—
Derivatives, index options	136,435	—	—	136,435
Total assets	\$3,121,884	19,661	2,965,788	136,435
Policyholder account balances (a)	\$147,357	—	—	147,357
Other liabilities (b)	15,479	—	—	15,479
Total liabilities	\$162,836	—	—	162,836

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During the three and nine months ended September 30, 2018, the Company made no transfers into or out of Levels 1, 2 or 3.

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale	\$3,041,131	—	3,041,131	—
Equity securities, available for sale	18,478	18,478	—	—
Derivatives, index options	194,731	—	—	194,731
Total assets	\$3,254,340	18,478	3,041,131	194,731
Policyholder account balances (a)	\$211,159	—	—	211,159
Other liabilities (b)	15,242	—	—	15,242
Total liabilities	\$226,401	—	—	226,401

(a) Represents the fair value of certain product-related embedded derivatives that were recorded at fair value.

(b) Represents the liability for share-based compensation.

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

	September 30, 2018			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale:				
Priced by third-party vendors	\$2,965,788	—	2,965,788	—
Priced internally	—	—	—	—
Subtotal	2,965,788	—	2,965,788	—
Equity securities:				
Priced by third-party vendors	19,661	19,661	—	—
Priced internally	—	—	—	—
Subtotal	19,661	19,661	—	—
Derivatives, index options:				
Priced by third-party vendors	136,435	—	—	136,435
Priced internally	—	—	—	—
Subtotal	136,435	—	—	136,435
Total	\$3,121,884	19,661	2,965,788	136,435

Percent of total 100.0 % 0.6 % 95.0 % 4.4 %

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	December 31, 2017				
	Total	Level 1	Level 2	Level 3	
	(In thousands)				
Debt securities, available for sale:					
Priced by third-party vendors	\$3,041,131	—	3,041,131	—	
Priced internally	—	—	—	—	
Subtotal	3,041,131	—	3,041,131	—	
Equity securities, available for sale:					
Priced by third-party vendors	18,478	18,478	—	—	
Priced internally	—	—	—	—	
Subtotal	18,478	18,478	—	—	
Derivatives, index options:					
Priced by third-party vendors	194,731	—	—	194,731	
Priced internally	—	—	—	—	
Subtotal	194,731	—	—	194,731	
Total	\$3,254,340	18,478	3,041,131	194,731	
Percent of total	100.0	% 0.6	% 93.4	% 6.0	%

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

	Three Months Ended September 30, 2018			
	Debt Securities, Equity Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)			
Balance at July 1, 2018	\$—	102,007	102,007	133,013
Total realized and unrealized gains (losses):				
Included in net income	—	69,683	69,683	65,316
Purchases, sales, issuances and settlements, net:				
Purchases	—	19,026	19,026	19,026
Sales	—	—	—	—
Issuances	—	—	—	—
Settlements	—	(54,281)	(54,281)	(54,519)
Transfers into (out of) Level 3	—	—	—	—
Balance at end of period	\$—	136,435	136,435	162,836
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:				
Net investment income	\$—	65,927	65,927	—
Benefits and expenses	—	—	—	67,640
Total	\$—	65,927	65,927	67,640

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	Three Months Ended September 30, 2017				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Balance at July 1, 2017	\$—	149,341	149,341	173,356	
Total realized and unrealized gains (losses):					
Included in net income	—	45,130	45,130	48,927	
Purchases, sales, issuances and settlements, net:					
Purchases	—	19,847	19,847	19,847	
Sales	—	—	—	—	
Issuances	—	—	—	531	
Settlements	—	(50,782)	(50,782)	(50,799)	
Transfers into (out of) Level 3	—	—	—	—	
Balance at end of period	\$—	163,536	163,536	191,862	
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	\$—	16,436	16,436	—	
Benefits and expenses	—	—	—	17,195	
Total	\$—	16,436	16,436	17,195	

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	Nine Months Ended September 30, 2018				
	Debt	Securities, Equity, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Beginning balance, January 1, 2018	\$—	194,731		194,731	226,401
Total realized and unrealized gains (losses):					
Included in net income	—	35,581		35,581	32,496
Purchases, sales, issuances and settlements, net:					
Purchases	—	63,303		63,303	63,303
Sales	—	—		—	—
Issuances	—	—		—	—
Settlements	—	(157,180)		(157,180)	(159,364)
Transfers into (out of) Level 3	—	—		—	—
Balance at end of period	\$—	136,435		136,435	162,836
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	\$—	42,200		42,200	—
Other operating expenses	—	—		—	44,621
Total	\$—	42,200		42,200	44,621

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 (UNAUDITED)

	Nine Months Ended September 30, 2017				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Beginning balance, January 1, 2017	\$ —	120,644		120,644	134,693
Total realized and unrealized gains (losses):					
Included in net income	—	138,552		138,552	152,569
Purchases, sales, issuances and settlements, net:					
Purchases	—	55,226		55,226	55,226
Sales	—	—		—	—
Issuances	—	—		—	1,275
Settlements	—	(150,886))	(150,886)	(151,901)
Transfers into (out of) Level 3	—	—		—	—
Balance at end of period	\$ —	163,536		163,536	191,862
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	\$ —	83,540		83,540	—
Other operating expenses	—	—		—	87,894
Total	\$ —	83,540		83,540	87,894

The following table presents the valuation method for financial assets and liabilities categorized as level 3, as well as the unobservable inputs used in the valuation of those financial instruments:

	September 30, 2018		
	Fair Value (In thousands)	Valuation Technique	Unobservable Input
Derivatives, index options	\$ 136,435	Broker prices	Implied volatility Inputs from broker proprietary models
Total assets	\$ 136,435		
Policyholder account balances	\$ 147,357	Deterministic cash flow model	Projected option cost
Other liabilities	15,479	Black-Scholes model	Expected term

Forfeiture assumptions

Total liabilities \$162,836

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	December 31, 2017		
	Fair Value	Valuation Technique	Unobservable Input
	(In thousands)		
Derivatives, index options	\$ 194,731	Broker prices	Implied volatility Inputs from broker proprietary models
Total assets	\$ 194,731		
Policyholder account balances	\$ 211,159	Deterministic cash flow model	Projected option cost
Other liabilities	15,242	Black-Scholes model	Expected term Forfeiture assumptions
Total liabilities	\$ 226,401		

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

Effective January 1, 2018, the change in fair value of equity securities is reported in the Condensed Consolidated Statement of Earnings as net investment income.

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

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

	September 30, 2018		Fair Value Hierarchy Level		
	Carrying Values (In thousands)	Fair Values	Level 1	Level 2	Level 3
ASSETS					
Debt securities held to maturity	\$7,281,031	7,186,631	—	7,184,713	1,918
Debt securities available for sale	2,965,788	2,965,788	—	2,965,788	—
Cash and cash equivalents	155,381	155,381	155,381	—	—
Mortgage loans	200,876	200,591	—	—	200,591
Policy loans	54,474	87,686	—	—	87,686
Other loans	9,053	9,429	—	—	9,429
Derivatives, index options	136,435	136,435	—	—	136,435
Equity securities	19,661	19,661	19,661	—	—
Life interest in Trust	8,676	12,775	—	—	12,775
LIABILITIES					
Deferred annuity contracts	\$7,611,248	7,127,224	—	—	7,127,224
Immediate annuity and supplemental contracts	415,905	417,079	—	—	417,079

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	December 31, 2017		Fair Value Hierarchy Level		
	Carrying Values	Fair Values	Level 1	Level 2	Level 3
	(In thousands)				
ASSETS					
Investments in debt and equity securities:					
Securities held to maturity	\$7,247,024	7,434,104	—	7,431,810	2,294
Securities available for sale	3,059,609	3,059,609	18,478	3,041,131	—
Cash and cash equivalents	217,624	217,624	217,624	—	—
Mortgage loans	208,249	208,815	—	—	208,815
Policy loans	56,405	100,230	—	—	100,230
Other loans	5,431	5,603	—	—	5,603
Derivatives, index options	194,731	194,731	—	—	194,731
Life interest in Trust	8,676	12,775	—	—	12,775
LIABILITIES					
Deferred annuity contracts	\$7,865,786	7,338,637	—	—	7,338,637
Immediate annuity and supplemental contracts	430,494	443,437	—	—	443,437

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

(11) DERIVATIVE INVESTMENTS

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

The company purchases over-the-counter index options, which are derivative financial instruments, to hedge the equity return component of its fixed-index annuity and life products. The index options act as hedges to match closely the returns on the underlying index or indices. The amounts which may be credited to policyholders are linked, in part, to the returns of the underlying index or indices. As a result, changes to policyholders' liabilities are substantially

offset by changes in the value of the options. Cash is exchanged upon purchase of the index options and no principal or interest payments are made by either party during the option periods. Upon maturity or expiration of the options, cash may be paid to the company depending on the performance of the underlying index or indices and terms of the contract.

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

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

The tables below present the fair value of derivative instruments as of September 30, 2018 and December 31, 2017, respectively.

	September 30, 2018		Liability Derivatives	
	Asset Derivatives		Balance	
	Balance	Fair	Sheet	Fair
	Sheet	Value	Location	Value
	Location	(In		(In
		thousands)		thousands)
Derivatives not designated as hedging instruments				
Equity index options	Derivatives, Index Options	\$ 136,435		
Fixed-index products			Universal Life and Annuity Contracts	\$ 147,357
Total		\$ 136,435		\$ 147,357
	December 31, 2017		Liability Derivatives	
	Asset Derivatives		Balance	
	Balance	Fair	Sheet	Fair
	Sheet	Value	Location	Value
	Location	(In		(In
		thousands)		thousands)
Derivatives not designated as hedging instruments				

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Equity index options	Derivatives, Index Options	\$ 194,731	
Fixed-index products			Universal Life and Annuity Contracts
Total		\$ 194,731	\$ 211,159

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The table below presents the effect of derivative instruments in the Condensed Consolidated Statements of Earnings for the three months ended September 30, 2018 and 2017.

Derivatives Not Designated As Hedging Instruments	Location of Gain or (Loss) Recognized In Income on Derivatives	September 30,	
		2018	2017
		Amount of Gain or (Loss) Recognized in Income on Derivatives (In thousands)	
Equity index options	Net investment income	\$69,683	45,131
Fixed-index products	Universal life and annuity contract interest	(63,602)	(48,168)
		\$6,081	(3,037)

The table below presents the effect of derivative instruments in the Condensed Consolidated Statements of Earnings for the nine months ended September 30, 2018 and 2017.

Derivatives Not Designated As Hedging Instruments	Location of Gain or (Loss) Recognized In Income on Derivatives	September 30,	
		2018	2017
		Amount of Gain or (Loss) Recognized in Income on Derivatives (In thousands)	
Equity index options	Net investment income	\$35,581	138,552
Fixed-index products	Universal life and annuity contract interest	(30,074)	(148,214)
		\$5,507	(9,662)

(12) SUBSEQUENT EVENTS

On October 4, 2018, NWLGI announced that National Western had entered into a Stock Purchase Agreement to acquire Ozark National Life Insurance Company and its affiliate, N.I.S. Financial Services, Inc. The transaction is expected to close during the first quarter of 2019 subject to obtaining the appropriate regulatory approvals. The cash purchase price to be paid by National Western at closing is approximately \$203 million in exchange for all of the outstanding stock of the two entities.

Subsequent events have been evaluated through the date of filing and no other reportable items were identified.

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

FORWARD-LOOKING STATEMENTS

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

Management's discussion and analysis of the financial condition and results of operations (“MD&A”) of National Western Life Group, Inc. for the three and nine months ended September 30, 2018 follows. Where appropriate, discussion specific to the insurance operations of National Western Life Insurance Company is denoted by "National Western" or "company". This discussion should be read in conjunction with the Company's Condensed Consolidated Financial Statements and related notes beginning on page 3 of this report and with the 2017 Annual Report filed on Form 10-K with the SEC.

Overview

National Western has historically provided 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. As disclosed in the Form 10-Q filed for the quarter ended March 31, 2018, the company discontinued accepting applications for the company's international products from foreign residents in May 2018.

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
- persistence of policies and contracts
- return on investments sufficient to produce acceptable spread margins over interest crediting rates
- investment credit quality which minimizes the risk of default or impairment
- levels of policy benefits and costs to acquire business
- the level of operating expenses
- effect of interest rate changes on revenues and investments including asset and liability matching
- maintaining adequate levels of capital and surplus
- actual levels of surrenders, withdrawals, claims and interest spreads
- changes in assumptions for amortization of deferred policy acquisition expenses and deferred sales inducements

changes in the fair value of derivative index options and embedded derivatives pertaining to fixed-index life and annuity products
pricing and availability of adequate reinsurance
litigation subject to unfavorable judicial development, including the time and expense of litigation

The Company monitors these factors continually as key business indicators. The discussion that follows in this Item 2 includes these indicators and presents information useful to an overall understanding of the Company's business performance for the nine months ended September 30, 2018, incorporating required disclosures in accordance with the rules and regulations of the Securities and Exchange Commission.

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Insurance Operations - Domestic

National Western is currently licensed to do business in all states and the District of Columbia except for New York. Products marketed are annuities, universal life insurance, fixed-index universal life, and traditional life insurance, which include both term and whole life products. The company's domestic sales have historically been more heavily weighted toward annuity products, which include single and flexible premium deferred annuities, single premium immediate annuities, and fixed-index annuities. Most of these annuities can be sold either as tax qualified or non-qualified products. Presently, 98% of National Western's domestic life premium sales come from single premium life products. At September 30, 2018, the company maintained approximately 128,500 annuity contracts in force and 49,400 domestic life insurance policies in force representing \$3.2 billion in face amount of coverage.

National Western markets and distributes its domestic products primarily through independent national marketing organizations ("NMOs"). These NMOs assist the company in recruiting, contracting, and managing independent agents. The company's agents are independent contractors who are compensated on a commission basis. The company currently has approximately 30,000 domestic independent agents contracted.

During the third quarter of 2017, the company hired a new chief marketing officer over domestic marketing who initiated new marketing and distribution strategies to include general agents, banks, broker/dealers, and wirehouses. This effort has included the subsequent addition of officers at the vice president level possessing industry experience and expertise in these new areas. The expansion of resources reflects the strategic opportunities identified by the company in the domestic market segment and aims to increase and balance sales between single and recurring premium life products. As discussed in the Sales section which follows, these efforts have resulted in a very strong start to the company's life sales in the first nine months of 2018 with domestic life insurance sales increasing 42% over the comparable prior year period.

Insurance Operations - International

The company does not conduct business or maintain offices or employees in any other country, but historically did accept applications at its home office in Austin, Texas, and issued policies from there to non-U.S. residents. The company's international clientèle in force consists mainly of foreign nationals in upper socioeconomic classes. Insurance products issued during the current period have been primarily to residents of countries in South America and the Caribbean based upon applications received in the company's home office.

As disclosed in the Company's 2018 first quarter report on Form 10-Q, the company ceased accepting applications from residents of Venezuela during the first quarter of 2018 due to the unsettled political, economic, civil, and social climate existing in that country. The company had previously ceased accepting applications from residents of Brazil, Central America, and the Pacific Rim region in the fourth quarter of 2015 and from residents in the Eastern European region, primarily Russian-speaking, during 2017. As noted in Note (12) Subsequent Events in the Notes to Condensed Consolidated Financial Statements in the first quarter filing, the company ceased accepting applications for the company's international products from all remaining foreign residents effective May 11, 2018.

Issuing universal life and traditional life insurance policies to residents of countries in these different regions has provided diversification helping to minimize large fluctuations that could arise due to various economic, political, and competitive pressures that may occur from one country to another, as well as a diversification of earnings relative to the company's domestic life insurance segment. The company's decision to cease accepting applications from residents of the remaining foreign countries was primarily due to the reduced sales activity associated with this segment, the incremental expenses associated with underwriting products in this line of business, and the lower anticipated incremental contribution to profits from new sales. The company will continue to service and maintain the block of international policies in force. At September 30, 2018, the company had approximately 58,000 international

life insurance policies in force representing approximately \$15.8 billion in face amount of coverage.

There were some inherent risks of issuing policies to residents of other countries, which while not present within the domestic market, were reduced substantially by the company's policies and procedures in several ways. As previously described, National Western's policies for insurance coverage were with foreign nationals in upper socioeconomic classes who possessed substantial financial resources and had access to quality health care. This customer base, coupled with the company's conservative underwriting practices, has historically resulted in claims experience, due to natural causes, similar to that in the United States. In addition, the company minimized exposure to foreign currency risks by requiring payment of premiums, claims and other benefits entirely in United States dollars (except for a small block of business in Haiti whose policies are denominated in Haitian gourdes).

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SALES

Life Insurance

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2017	2018	2017	2018
	(In thousands)			
Domestic:				
Equity-index life	\$5,614	4,431	18,580	13,263
Traditional life	118	20	354	78
Universal life	12	8	41	18
	5,744	4,459	18,975	13,359
International:				
Equity-index life	522	1,580	4,603	4,997
Traditional life	196	479	1,082	1,452
Universal life	18	755	600	1,482
	736	2,814	6,285	7,931
Totals	\$6,480	7,273	25,260	21,290

Life insurance sales, as measured by annualized first year premiums, decreased 11% in the third quarter of 2018 as compared to the third quarter of 2017 due to the company's decision to cease accepting applications for new policies from international residents during the second quarter of 2018. Within this total, the domestic life insurance line of business increased 29% over the comparable results of the third quarter of 2017. For the nine months ended September 30, 2018, total life sales increased 19% from 2017 levels as domestic life insurance sales expanded 42% during this period. Increasing domestic life insurance business has been a strategic point of emphasis for company management for several years.

The company's domestic operations life insurance product portfolio includes single premium universal life ("SPUL") and equity-index universal life ("EIUL") products as well as hybrids of the EIUL and SPUL products, combining features of these core products. Equity-index universal life products continue to be the predominant product sold in the domestic life market. Most of these sales are single premium mode products (one year, five year, or ten year) designed for transferring accumulated wealth tax efficiently into life insurance policies with limited underwriting due to lesser net insurance amounts at risk (face amount of the insurance policy less cash premium contributed). These products were designed and implemented several years ago targeting the accumulated savings of the segment of the

population entering their retirement years. The wealth transfer life products have been valuable offerings for the company's distributors as evidenced by their comprising 98% of total domestic life sales in the first nine months of 2018. The company introduced a new domestic term insurance product in the first quarter of 2018 which is included in the traditional life sales amounts for the quarter and nine months ended September 30, 2018.

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The company's international life business consisted of applications submitted by independent contractors of Latin America during the first nine months of 2018. As noted previously, the company ceased accepting new applications from residents outside the U.S. effective May 11, 2018. Due to underwriting requirements, there is a lag between the time applications are submitted and policies are issued for approved risks. This lag can take up to ninety days or more in some cases and is the reason the company continued to report international life insurance sales through the third quarter of 2018. The company's international life sales in the nine months ended September 30, 2018 came principally from residents of Columbia, Ecuador, Peru and Chile.

The average new policy face amounts since 2012 are as shown in the following table.

	Average New Policy Face Amount	
	Domestic	International
Year ended December 31, 2012	254,900	380,200
Year ended December 31, 2013	286,000	384,000
Year ended December 31, 2014	286,600	382,600
Year ended December 31, 2015	274,500	342,500
Year ended December 31, 2016	308,700	336,500
Year ended December 31, 2017	317,200	306,300
Nine months ended September 30, 2018	332,200	296,200

The company's efforts were historically directed toward accepting applications from upper socio-economic residents of international countries and to issuing single premium life products as part of its wealth transfer strategies for domestic life sales. In both of these strategies the company's portfolio of fixed-index (equity indexed) life insurance products plays an important role. Fixed-index life products accounted for 92% of total life sales in the first nine months of 2018, as compared to 86% for the same period in 2017.

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

	Insurance In Force as of September 30,	
	2018	2017
	(\$ in thousands)	
Universal life:		
Number of policies	37,600	41,070
Face amounts	\$3,449,840	4,271,900
Traditional life:		
Number of policies	31,200	32,570
Face amounts	\$3,395,580	3,459,330
Fixed-index life:		
Number of policies	38,570	38,300
Face amounts	\$8,955,450	9,104,030
Rider face amounts	\$3,220,960	3,043,010

Total life insurance:

Number of policies	107,370	111,940
Face amounts	\$19,021,830	19,878,270

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At September 30, 2018, the company's face amount of life insurance in force was comprised of \$15.8 billion from the international line of business and \$3.2 billion from the domestic line of business. At September 30, 2017, these amounts were \$16.8 billion and \$3.1 billion for the international and domestic lines of business, respectively.

Annuities

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	2018
	(In thousands)			
Fixed-index annuities	\$83,234	147,966	290,583	420,757
Other deferred annuities	3,305	3,057	10,770	14,517
Immediate annuities	378	1,789	1,767	2,871
Totals	\$86,917	152,812	303,120	438,145

The company's mix of annuity sales has historically shifted with interest rate levels and the relative performance of the equity market. With the decline in interest rates subsequent to the subprime crisis, sales of fixed-index products have become proportionately greater generally accounting for 90% or more of all annuity sales the past several years. During the first nine months of 2018, this percentage approached 96% reflecting the ongoing bull market run in equities since bottoming out in 2009. For all fixed-index products, the company purchases over the counter call options to hedge the equity return feature. The options are purchased relative to the issuance of the annuity contracts in such a manner to minimize timing risk. Generally, the index return during the indexing period (if the underlying index increases) becomes a component in a formula (set forth in the annuity), the result of which is credited as interest to contract holders electing the index formula crediting method at the beginning of the indexing period. The formula result can never be less than zero with these products. The company does not deliberately mismatch or under hedge for the equity feature of the products. Fixed-index products also provide the contract holder the alternative to elect a fixed interest rate crediting option.

With the advent of a low interest rate policy engineered by the Federal Reserve in response to the subprime financial crisis, company management evaluated the potential ramifications of continuing a high level of annuity sales in a depressed interest rate environment. Under the auspices of the company's enterprise risk management ("ERM") processes, taking into consideration the Federal Reserve's announced intention to maintain interest rates at historically reduced levels over a prolonged period of time, the decision was made beginning in 2012 to curtail new sales to desired levels in order to minimize the level of assets added at low yield rates. While National Western does not subsidize its interest crediting rates on new policies in order to obtain market share, the Company's ERM considerations determined that managing to a lower level of annuity sales was prudent given the environment.

Annuity sales beginning in 2017 declined further relative to prior year levels reflecting the impact of two regulatory changes. The first was the Department of Labor's "fiduciary rule" on standards for retirement investment advice. The uncertainty associated with the timing and ultimate requirements of the rule served to decrease activity for annuity sales involving qualified funds as insurance carriers, marketing organizations and independent distributors sought to develop strategies for operating under the fiduciary rule guidelines. The second change impacting the level of annuity

sales occurred late in 2016 when the state of California mandated more restrictive annuity product features for policies sold in the state. This required the company to refile products complying with the new standards for state approval. California regulators were slow to process and approve product filings received from insurance carriers in the aftermath of imposing these restrictive product features.

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

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

	Annuities In Force as of September 30, 2018 2017 (\$ in thousands)	
Fixed-index annuities		
Number of policies	74,310	75,070
GAAP annuity reserves	\$5,887,582	5,909,871
Other deferred annuities		
Number of policies	40,880	44,620
GAAP annuity reserves	\$1,629,477	1,804,826
Immediate annuities		
Number of policies	13,340	13,940
GAAP annuity reserves	\$357,119	369,188
Total annuities		
Number of policies	128,530	133,630
GAAP annuity reserves	\$7,874,178	8,083,885

Impact of Recent Business Environment

The Company's business is generally aided by an economic environment experiencing growth, whether moderate or vibrant, characterized by metrics which indicate improving employment data and increases in personal income. Recently, preliminary third quarter United States GDP results were reported which continued to suggest strong domestic economic growth, albeit at a slightly lower rate than that reported for the second quarter. Natural consequences of higher growth are higher interest rates. In addition, with the Federal Reserve unwinding the remains of quantitative easing, the less accommodating posture introduces higher volatility to financial markets. However, the primary uncertainty over domestic and global economies is the economic cold war between the United States and China. A prolonged United States vs. China trade war carries the risk of impeding real economic growth not only in the two economies but the world at large.

With regard to the credit market, industry analysts and observers generally agree that a sudden jump in interest rate levels, while presently a highly unlikely scenario, would be harmful to life insurers with interest-sensitive products as it could provide an impetus for abnormal levels of product surrenders and withdrawals at the same time fixed debt securities held by insurers declined in market value. The ten-year Treasury yield had held steady within a narrow range during the summer months before breaking out to the upside at the end of the third quarter. A general view is that the increase was fueled by higher real rates which is typically a reflection of stronger economic growth. The spread between short term rates and long term rates is tighter than historical averages which suggests that the Federal Reserve's monetary policy remains somewhat accommodative but at a lower level than in recent years. Ultimately, a mix of monetary policy adjustments, fiscal policy, and economic fundamentals will determine the future direction of interest rate movements and the speed of such shifts. It is uncertain what direction and at what pace interest rate movements may occur in the future and what impact, if any, such movements would have on the Company's business,

results of operations, cash flows or financial condition.

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

RESULTS OF OPERATIONS

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

Consolidated Operations

Revenues. The following details Company revenues.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Universal life and annuity contract charges	\$38,287	40,268	116,753	122,329
Traditional life premiums	4,209	5,285	13,282	13,639
Net investment income (excluding derivatives)	105,870	106,560	322,519	327,493
Other revenues	5,111	4,672	15,396	13,714
Operating revenues	153,477	156,785	467,950	477,175
Derivative gain (loss)	69,683	45,131	35,581	138,552
Net realized investment gains (losses)	2,275	2,074	5,582	10,906
Total revenues	\$225,435	203,990	509,113	626,633

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Universal life and annuity contract charges - Revenues for universal life and annuity contracts were lower for the first nine months in 2018 compared to 2017. Revenues for universal life and annuity products consist of policy charges for the cost of insurance, administration charges, surrender charges assessed against policyholder account balances, and amortization of deferred premium loads less reinsurance premiums, as shown in the following table.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Contract Revenues:				
Cost of insurance and administrative charges	\$32,516	33,915	97,041	100,823
Surrender charges	9,291	10,114	28,429	33,682
Other charges	786	(171)	4,226	(131)
Gross contract revenues	42,593	43,858	129,696	134,374
Reinsurance premiums	(4,306)	(3,590)	(12,943)	(12,045)
Net contract revenues	\$38,287	40,268	116,753	122,329

Cost of insurance charges typically trend with the size of the universal life insurance block in force and the amount of new business issued during the period. Universal life insurance in force during the nine months ended September 30, 2018 averaged approximately \$18.4 billion while for the same period of 2017 it averaged \$19.1 billion. For the three months ended September 30, 2018, cost of insurance charges decreased to \$26.4 million from \$26.9 million at September 30, 2017, and for the nine months ended September 30, 2018, cost of insurance charges decreased to \$79.7 million from \$80.6 million at September 30, 2017. Administrative charges pertaining to new business issued declined to \$6.1 million for the three months ended September 30, 2018 from \$7.1 million for the same period in 2017, and to \$17.3 million for the nine months ended September 30, 2018 versus \$20.3 million for the nine months ended September 30, 2017, due to a lower number of international life insurance policies issued.

Surrender charges assessed against policyholder account balances upon withdrawal decreased in the first nine months of 2018 versus the comparable prior year period. While the company earns surrender charge income that is assessed upon policy terminations, the company's overall profitability is enhanced when policies remain in force and additional contract revenues are realized and the company continues to make an interest rate spread equivalent to the difference it earns on its investment and the amount that it credits to policyholders. In the first nine months of 2018, lapse rates on international life insurance policies were better than the prior year while lapse rates for domestic insurance and annuity policies increased somewhat. Surrender charge income recognized is also dependent upon the duration of policies at the time of surrender (i.e. later duration policy surrenders having a lower surrender charge assessed and earlier duration surrenders having a higher surrender charge).

Other charges include the amortization into income of the premium load on single premium life insurance products which is deferred at the inception of the policy. As these products have become a substantial portion of domestic life insurance sales over the past several years, the amortization of accumulated deferrals has surpassed current period premium loads deferred.

Traditional life premiums - Traditional life premiums were lower in the three and nine months ended September 30, 2018 compared to the same periods in 2017 reflecting the company's decision to cease accepting applications from international residents in the second quarter of 2018. This has been offset in part by an increase in domestic life

insurance sales with new product offerings. Traditional life insurance premiums for products such as whole life and term life are recognized as revenues over the premium-paying period. The company's life insurance sales focus has historically been primarily centered around universal life products, although additional domestic life term products have been added to the company's portfolio recently. Universal life products, especially the company's equity indexed universal life products which offer the opportunity for consumers to acquire life insurance protection and receive credited interest linked in part to an outside market index, have been more popular product offerings in the company's markets representing 94% of new life insurance sales for 2018 thus far.

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Gross investment income:				
Debt and equities	\$ 100,036	101,664	301,867	307,540
Mortgage loans	3,661	2,645	9,606	8,333
Policy loans	824	885	2,384	2,638
Short-term investments	676	339	1,498	585
Other invested assets	1,023	1,408	8,226	9,363
Total investment income	106,220	106,941	323,581	328,459
Less: investment expenses	350	381	1,062	966
Net investment income (excluding derivatives)	105,870	106,560	322,519	327,493
Derivative gain (loss)	69,683	45,131	35,581	138,552
Net investment income	\$ 175,553	151,691	358,100	466,045

For the nine months ended September 30, 2018, debt and equity securities generated approximately 94% of total net investment income, excluding derivative gain (loss). The Company's strategy is to invest substantially all of its cash flows in fixed debt securities consistent with its guidelines for credit quality, duration, and diversification. The lower level of investment income from debt and equity securities through the third quarter of 2018 versus 2017, reflects higher yielding debt securities maturing or being called by borrowers and being replaced with lower yielding securities in the current interest rate environment. With the gradual increase in interest rate levels during the current period, investment yields on new bond purchases during the first nine months of 2018 approximated 4.08%, above the portfolio's weighted average yield of 3.90% at September 30, 2018.

Effective January 1, 2018, new accounting guidance requires that changes in fair values of equity securities be included in the Consolidated Statements of Earnings. For the quarter and nine months ended September 30, 2018, an unrealized gain/(loss) of \$0.3 million and \$0.1 million, respectively, is included in net investment income (in the Debt and equities line item in the above table) reflecting the change in fair value during each period. The carrying value of the Company's portfolio of equity securities was \$19.7 million at September 30, 2018.

Mortgage loan investment income for the nine months ended September 30, 2018 increased versus the comparable period in 2017 reflecting higher yielding loans paying off early and the resultant prepayment fees received. The portfolio balance increased from \$174.5 million at December 31, 2016 to \$208.2 million at December 31, 2017 as the Company identified this as an area of investment focus. The mortgage loan portfolio balance decreased slightly to \$200.9 million at September 30, 2018 reflecting seasonal competition in loan origination efforts (competing mortgage lenders are typically more active during the first calendar half of the year). During the nine months ended September 30, 2018 the Company originated new mortgage loans in the amount of \$24.8 million compared to \$38.2

million in the comparable period of 2017.

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

	Nine Months Ended	
	September 30,	
	2018	2017
	(In thousands)	
Excluding derivatives:		
Net investment income	\$322,519	327,493
Average invested assets, at amortized cost	\$10,769,351	10,580,953
Annual yield on average invested assets	3.99	% 4.13 %
Including derivatives:		
Net investment income	\$358,100	466,045
Average invested assets, at amortized cost	\$10,934,935	10,723,043
Annual yield on average invested assets	4.37	% 5.79 %

The yield on average invested assets during the first nine month of 2018, excluding derivatives, declined from 2017 as yields obtained on new fixed maturity debt securities investments during the first nine months of 2018 and the remainder of 2017 continued to be less than the yields on securities called or maturing during this timeframe. During 2017, the average yield on bond purchases to fund insurance operations was 3.57% representing a 1.20% spread over treasury rates. Insurance operation bond purchases through the third quarter of 2018 had a higher average yield of 4.08% as spreads held steady at 1.21% over treasury rates during this period. While treasury rates increased in the first nine months, the demand for fixed income securities kept the spread margin over treasury rates fairly level.

The bond yield rates obtained during 2017 were below the weighted average bond portfolio rate during the period. During the first nine months of 2018, yields on new purchases exceeded the weighted average bond portfolio rate for the first time in many years. The weighted average quality of new purchases during the first nine months of the current year was "BBB+" matching the overall quality rating of purchases during 2017. The composite duration of purchases during the first nine months of 2018 was approximately the same as that for purchases made in previous years. The Company's general investment strategy is to purchase debt securities with maturity dates approximating ten years in the future. Accordingly, an appropriate measure for benchmarking the direction of interest rate levels for the Company's debt security purchases is the ten year treasury bond rate. After ending 2017 at a rate of 2.41%, the daily closing yield of the ten year treasury bond ranged from a low of approximately 2.45% to a high of roughly 3.10% during the first nine months of 2018, and ended the third calendar quarter at 3.06%.

The pattern in average invested asset yield, including derivatives, incorporates increases and decreases in the fair value of index options purchased by the company to support its fixed-index products. Fair values of the purchased call options decreased during the first nine months of 2018 and increased during the comparable 2017 period, corresponding to the movement in equity market indices in these time frames. Refer to the derivatives discussion below for a more detailed explanation of these instruments.

Other revenues - Other revenues primarily pertain to the Company's two nursing home operations in Reno, Nevada and San Marcos, Texas, and the operations of Braker P III ("BP III"), a subsidiary created at the end of 2016 to own and manage a commercial office building BP III acquired. Revenues associated with the nursing operations were \$13.0 million and \$13.5 million for the nine months ended September 30, 2018 and 2017, respectively. Level nursing

home revenues reflect stable census figures at the facilities thus far in 2018 and a steady mix of payor sources by patient types. Revenues associated with BP III were \$2.3 million and \$1.0 million in the first nine months of 2018 and 2017, respectively. The increased revenues in 2018 reflect tenant leases that have been subsequently entered into.

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

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Gains and losses from index options are substantially due to changes in equity market conditions. Index options are intended to act as hedges to match the returns on the product's underlying reference index and the rise or decline in the index relative to the index level at the time of the option purchase which causes option values to likewise rise or decline. As income from index options fluctuates with the underlying index, the contract interest expense to policyholder accounts for the company's fixed-index products also fluctuates in a similar manner and direction. For the three and nine months ended September 30, 2018 and 2017, the Company recorded realized and unrealized gains/(losses) from index options as shown below.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Derivatives:				
Unrealized gain (loss)	\$35,249	13,197	(66,373)	44,053
Realized gain (loss)	34,434	31,934	101,954	94,499
Total gain (loss) included in net investment income	\$69,683	45,131	35,581	138,552
Total contract interest	\$124,144	107,799	183,316	299,862

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

The financial statement investment spread, the difference between investment income and interest credited to contractholders, is subject to variations from option performance during any given period. For example, many of the company's equity-index annuity products provide for the collection of asset management fees. These asset management fees are assessed when returns on expiring options are positive, and they are collected prior to passing any additional returns above the assessed management fees to the policy contractholders. During periods of positive returns, the collected asset management fees serve to increase the financial statement spread by increasing option realized gains reported as investment income in an amount greater than interest credited to policy contractholders which is reported as contract interest expense. Asset management fees collected in the first nine months of 2018 and 2017 were approximately \$18.9 million and \$24.3 million, respectively. For the three months ended September 30, 2018 and 2017, asset management fees collected were \$5.6 million and \$7.5 million, respectively.

Net realized investment gains (losses) - Realized gains (losses) on investments include proceeds from bond calls and sales as well as impairment write-downs on investments in debt securities and real estate. The net gains reported for the nine months ended September 30, 2018 consisted of gross gains of \$5.6 million offset by gross losses of \$0.0 million. The net gains reported for the nine months ended September 30, 2017 consisted of gross gains of \$11.0 million offset by gross losses of \$0.1 million. Gross gains in 2017 include approximately \$2.3 million from a partial sale of the company's former home office land property to the Texas Department of Transportation (TxDOT) to be used in the construction of roadway expansion.

The Company records impairment write-downs when a decline in value is considered to be other-than-temporary and full recovery of the investment is not expected. Impairments due to credit factors are recorded in the Company's Condensed Consolidated Statements of Earnings while non-credit (liquidity) impairment losses are included in Condensed Consolidated Statements of Comprehensive Income (Loss). No impairment or valuation write-downs were recorded in the Company's Condensed Consolidated Statements of Earnings for the nine months ended September 30, 2018 and 2017.

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Life and other policy benefits	\$5,744	21,015	44,607	58,626
Amortization of deferred policy acquisition costs	26,775	18,722	90,073	85,992
Universal life and annuity contract interest	124,145	107,799	183,316	299,862
Other operating expenses	24,037	22,596	72,467	74,031
Totals	\$180,701	170,132	390,463	518,511

Life and other policy benefits - Death claim benefits, the largest component of policy benefits, were \$33.4 million in the first nine months of 2018 compared to \$33.3 million for the first nine months of 2017. Death claim amounts are generally subject to variation from period to period. For the first nine months of 2018, the number of life insurance claims increased 10% from the comparable period in 2017 while the average dollar amount per net claim moved to \$49,900 from \$45,800. Despite the higher incidence of claims and the increase in average death claim amount, death claim benefits in 2018 year-to-date approximate those in the comparable period of 2017 due to higher cash value balances on universal life claims incurred in 2018 compared to the prior year period (cash values serve to reduce the company's out-of-pocket benefit expense). The company's overall mortality experience has generally been consistent with or better than its product pricing assumptions. Mortality exposure is managed through reinsurance treaties under which the Company's retained maximum net amount at risk on any one life is capped at \$500,000.

Life and other policy benefits also includes policy liabilities held associated with the company's traditional life products, including riders such as the company's guaranteed minimum withdrawal benefit rider ("WBR"), a popular rider to its equity-indexed annuity products. During the third quarter ended September 30, 2018, the company unlocked its policy benefit reserves associated with this rider which resulted in a decrease to the policy benefit liability (and policy benefit expenses) during the period of \$15.7 million. The primary unlocking adjustment included within this amount was an adjustment of the assumed rate of election by policyholders taking withdrawal payments to a rate consistent with actual experience (which was lower than that previously assumed).

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

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The following table identifies the effects of unlocking adjustments on DPAC balances recorded through amortization expense separate from recurring amortization expense components three and nine months ended September 30, 2018 and 2017.

Amortization of DPAC	Three Months		Nine Months	
	Ended September 30, 2018		Ended September 30, 2017	
	(In thousands)			
Unlocking adjustments	\$(950)	(12,935)	(950)	(11,856)
Other amortization components	27,725	31,657	91,023	97,848
Totals	\$26,775	18,722	90,073	85,992

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During the quarter ended September 30, 2018, the company unlocked DPAC balances associated with its Life and Annuity segments the effect of which was to increase DPAC balances by \$1.0 million (and reduce amortization expense). The Life DPAC balance was unlocked for assumptions involving mortality, extended death benefit reserves, and the investment portfolio yield supporting universal life policy liabilities. The Annuity DPAC balance was unlocked for assumptions concerning mortality, the election rate of the company's withdrawal benefit rider, and for investment portfolio yield supporting annuity contract accounts.

During the quarter ended September 30, 2017, the company unlocked the DPAC balances associated with its International Life insurance and Annuity segments the effect of which was to increase DPAC balances by \$12.9 million (and reduce amortization expense). The International Life insurance DPAC balance was unlocked for favorable mortality, lower than expected lapses from disengaged countries, and the implementation of an interest crediting clawback on certain universal life policies. The Annuity DPAC balance was unlocked for crediting rate spreads and surrender/annuitization assumptions. Earlier in 2017, the company unlocked the interest crediting rate spread on three of its equity-indexed universal life products the effect of which was to decrease the DPAC balance by \$1.1 million (and increase amortization expense).

The Company is required to evaluate its emergence of profits continually and management believes that the current amortization patterns of deferred policy acquisition costs are reflective of actual experience. It is the company's intent, absent intervening events or experience, to annually perform any necessary DPAC balance unlockings in the third calendar quarter of the year.

As the DPAC balance is an asset on the Company's Condensed Consolidated Balance Sheets, GAAP provides for an earned interest return on the unamortized balance each period. The earned interest serves to increase the DPAC balance and reduce other amortization component expense. The rate at which the DPAC balance earns interest is the average credited interest rate on the company's universal life and annuity policies in force, including credited interest on equity-indexed policies. The amount of earned interest on DPAC balances was \$7.9 million and \$7.6 million in the quarters ended September 30, 2018 and 2017, respectively, decreasing other amortization component expense. The amount of earned interest on DPAC balances for the nine months ended September 30, 2018 and 2017 was \$24.1 million and \$23.2 million, respectively.

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

The company's approximated average credited rates through the first nine months, excluding and including equity-indexed products, were as follows:

	September 30, 2018		September 30, 2017	
	(Excluding fixed-index products)	(Including fixed-index products)	(Excluding fixed-index products)	(Including fixed-index products)
Annuity	2.10%	2.20%	1.77%	3.57%
Interest sensitive life	3.38%	3.42%	5.80%	6.83%

Contract interest reported in financial statements also encompasses the performance of the index options associated with the company's fixed-index products. As previously noted, the market value changes of these derivative features resulted in net realized and unrealized gains/(losses) of \$35.6 million and \$138.6 million being included in net investment income for the nine months ended September 30, 2018 and 2017, respectively. These returns similarly increased/(decreased) the computed average credited rates for the periods shown above. Policyholders of equity-indexed products cannot receive an interest credit below 0% according to the policy contract terms.

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Generally, the impact of the market value change of index options on asset values aligns closely with the movement of the embedded derivative liability held for the company's fixed-index products such that the net effect upon pretax earnings is negligible (i.e. net realized and unrealized gains/(losses) included in net investment income approximate the change in contract interest associated with the corresponding embedded derivative liability change). However, other aspects of the embedded derivatives can cause deviations to occur between the change in index option asset values included in net investment income and the change in the embedded derivative liability included in contract interest. As noted in the discussion of net investment income, the collection of asset management fees in a period can cause investment income to increase marginally higher than contract interest expense since these collected fees are deducted from indexed interest credited to policyholders. During the three months ended September 30, 2018 and 2017, asset management fees collected were \$5.6 million and \$7.5 million, respectively, and for the nine months then ended \$18.9 million and \$24.3 million, respectively.

Accounting rules require the embedded derivative liability to include a projection of asset management fees estimated to be collected in the succeeding fiscal year. The change in this projection, plus or minus, is included in contract interest for the period being reported on. In the three month periods ended September 30, 2018 and 2017, contract interest was increased/(decreased) \$(7.0) million and \$1.5 million, respectively, for these projection changes. For the nine months ended September 30, 2018 and 2017, contract interest was increased/(decreased) \$(5.3) million and \$5.0 million, respectively.

Contract interest expense also includes reserve changes for immediate annuities, two tier annuities, excess death benefit reserves, excess annuitizations, and amortization of deferred sales inducement balances. These items are offset by policy charges assessed for policies having the withdrawal benefit rider (WBR). As changes in these items collectively impact contract interest expense, financial statement interest spread is also affected. For the three month periods ended September 30, 2018 and 2017, the changes in these items increased contract interest expense by \$5.7 million and \$10.0 million, respectively, while for the nine months then ended contract interest expense was increased by \$18.7 million and \$30.8 million, respectively. The lower contract interest charges in the 2018 periods reflect higher WBR charges assessed (which reduces contract interest expense) and smaller reserve increases associated with immediate and two-tier annuities due to decreases in the size of these blocks of business.

Similar to deferred policy acquisition costs, the company defers sales inducements in the form of first year credited interest bonuses on annuity products that are directly related to the production of new business. These bonus interest charges are deferred and amortized using the same methodology and assumptions used to amortize other capitalized acquisition costs and the amortization is included in contract interest. In addition, deferred sales inducement balances are also reviewed periodically to ascertain whether actual experience has deviated significantly from that assumed (unlock) and are adjusted to reflect current policy lapse or termination rates, expense levels and credited rates on policies compared to anticipated experience (true-up). These adjustments, plus or minus, are included in contract interest expense. During the quarters ended September 30, 2018 and 2017, the company unlocked its deferred sales inducement balance in conjunction with the Annuity DPAC balance unlocking discussed previously. The effect of these prospective unlockings was to increase the deferred sales inducement balance in the third quarter of 2018 by \$1.3 million (and decrease contract interest expense) and to decrease the balance in the third quarter of 2017 by \$4.3 million (and increase contract interest expense).

As previously discussed in the amortization of deferred policy acquisition costs section, the company unlocked its life insurance DPAC balance for mortality experience and extended benefit policy reserves. While these changes had a relatively modest impact on the DPAC unlocking, they had a larger effect on the policy benefits liability balance. The impact of these unlocking adjustments upon policy benefit reserves was an increase of \$14.2 million. This increase is included as a component of contract interest expense for the three and nine months ended September 30, 2018.

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Other operating expenses - Other operating expenses consist of general administrative expenses, licenses and fees, commissions not subject to deferral, nursing home expenses, real estate expenses, and compensation costs. These expenses for the three and nine months ended September 30, 2018 and 2017 are summarized in the table that follows.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	2018
	(In thousands)			
General insurance expenses	\$7,438	6,027	23,036	22,436
Nursing home expenses	3,966	4,135	11,866	12,622
Compensation expenses	8,062	7,140	22,036	22,203
Commission expenses	1,998	2,854	6,522	8,149
Real estate expenses	1,154	720	3,502	2,096
Taxes, licenses and fees	1,419	1,720	5,505	6,525
Totals	\$24,037	22,596	72,467	74,031

General insurance expenses include software amortization expense associated with the company's proprietary policy administration system which was phased into production over the past couple of years as well as other acquired software. Expenses pertaining to these items were \$2.5 million and \$2.1 million in the third quarter of 2018 and 2017, respectively, and \$8.1 million and \$6.6 million in the first nine months of 2018 and 2017, respectively. This category also includes employee benefit plan expenses for the various employee health and retirement plans the company sponsors. Related expenses for the third quarter of 2018 and 2017 were \$1.9 million and \$2.5 million, respectively, and for the first nine months of 2018 and 2017 were \$4.9 million and \$7.1 million, respectively. In the third quarter of 2017, the reserve for agent debit balances was reduced \$1.8 million which decreased expenses by a like amount for the three and nine months ended September 30. The reserve reduction was a result of a change in reserving methodology implemented in the third quarter of 2017.

Compensation expenses include share-based compensation costs related to outstanding vested and nonvested stock options and stock appreciation rights ("SARs"), restricted stock units ("RSUs") and performance share units ("PSUs"). The related share-based compensation costs move in tandem not only with the number of awards outstanding but also with the movement in the market price of the Company's Class A common stock as a result of marking the stock options, SARs, and RSUs to fair value under the liability method of accounting. Consequently, the related expense amount varies positive or negative in any given period. For the three-month periods shown, share-based compensation expense was \$1.7 million in 2018 and \$1.3 million in 2017. For the nine-month periods shown, share-based compensation expense was \$2.4 million in 2018 and \$5.6 million in 2017. The Company's Class A common share price decreased from \$331.02 at December 31, 2017 to \$307.26 at June 30, 2018 and increased nearly 4% to \$319.20 at September 30, 2018. This movement in share price is the cause for share-based compensation being higher for the quarter ended September 30, 2018 while being lower for the nine months then ended. No performance share awards were granted in the third quarter or first nine months of 2018. During the nine months ended September 30, 2017, the Company awarded 11,715 SARs, 4,385 RSUs, and 4,526 PSUs to directors and officers.

Real estate expenses pertain to the commercial building operated by Braker P III. The building was acquired at year-end 2016 and the company relocated to this facility during the fourth quarter of 2017. The higher operating expenses for the 2018 periods relative to the 2017 periods reflect the company's occupancy as well as other third party tenants.

Taxes, licenses and fees include premium taxes and licensing fees paid to state insurance departments, guaranty fund assessments, the company portion of social security and Medicare taxes, real estate taxes, state income taxes, and other state and municipal taxes. Premium tax expense decreased to \$2.3 million in the first nine months of 2018 from \$2.7 million in the comparable period of 2017 due to recoveries of overpaid taxes and the settlement of amounts less than what was originally estimated. Other state taxes decreased to \$0.1 million in the third quarter of 2018 from \$0.4 million in 2017 and to \$0.8 million in the first nine months of 2018 from \$1.9 million in the same period for 2017 due to a favorable resolution of a contingent state tax liability in 2018 and lesser state corporate income taxable income.

Federal Income Taxes. Federal income taxes on earnings from operations reflect an effective tax rate of 19.9% for the nine months ended September 30, 2018 compared to 34.5% for the nine months ended September 30, 2017. The Federal corporate tax rate decreased to 21% effective in 2018 under the Tax Cuts and Jobs Act ("Tax Act") passed in December 2017. The Company's effective tax rate is typically lower than the Federal statutory rate due to tax-exempt investment income related to municipal securities and dividends-received deductions on income from stocks, absent other permanent tax items.

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While the Company's overall effective tax rate remains close to the statutory rate level, the Company's current tax expense remains elevated due to another provision of the Tax Act which capped the amount of tax reserves a life insurer is able to deduct in arriving at its taxable income. This provision requires a recalculation of the reserves at January 1, 2018, limited to the greater of net surrender value or 92.81% of the reserve method prescribed by the National Association of Insurance Commissioners which covers such contracts as of the date the reserve is determined. Accordingly, the Company reduced its reserves as of January 1, 2018 by approximately \$400 million based upon estimates made at that time. The implementation guidance with respect to this provision of the Tax Act permitted companies to refine its analysis and calculations during the 2018 year. As of September 30, 2018, the Company's updated analysis determined that the tax reserve reduction approximated \$339 million rather than \$400 million. Based upon this revised figure, the effect of limiting the tax reserve deductible in the current tax computation serves to increase the Company's taxable income by approximately \$42 million per year through 2025. At the Federal statutory rate of 21%, the impact upon current tax expense is an increase of approximately \$6.7 million for the first nine months of 2018.

Segment Operations

Summary of Segment Earnings

A summary of segment earnings/(losses) for the three and nine months ended September 30, 2018 and 2017 is provided below. The segment earnings/(losses) exclude realized gains and losses on investments, net of taxes.

	Domestic Life Insurance (In thousands)	International Life Insurance	Annuities	All Others	Totals
Segment earnings (losses):					
Three months ended:					
September 30, 2018	\$474	(1,597)	30,720	4,247	33,844
September 30, 2017	\$2,037	28,992	(13,718)	3,154	20,465
Nine months ended:					
September 30, 2018	\$1,631	18,929	53,501	16,511	90,572
September 30, 2017	\$1,409	47,850	1,153	13,333	63,745

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Domestic Life Insurance Operations

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	2018
	(In thousands)			
Premiums and contract revenues:				
Premiums and contract charges	\$10,060	9,907	29,775	27,822
Net investment income	26,912	17,385	41,131	51,998
Other revenues	11	11	12	30
Total revenues	36,983	27,303	70,918	79,850
Benefits and expenses:				
Life and other policy benefits	5,839	3,483	15,751	13,850
Amortization of deferred policy acquisition costs	2,978	2,517	8,362	8,300
Universal life insurance contract interest	22,355	14,119	29,401	41,576
Other operating expenses	5,215	4,086	15,368	13,975
Total benefits and expenses	36,387	24,205	68,882	77,701
Segment earnings (loss) before Federal income taxes	596	3,098	2,036	2,149
Provision (benefit) for Federal income taxes	122	1,061	405	740
Segment earnings (loss)	\$474	2,037	1,631	1,409

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	2018
	(In thousands)			
Universal life insurance revenues	\$11,490	10,373	33,376	30,656
Traditional life insurance premiums	1,180	1,793	3,793	3,761
Reinsurance premiums	(2,610)	(2,259)	(7,394)	(6,595)
Totals	\$10,060	9,907	29,775	27,822

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The company's domestic life insurance in force, in terms of policy count, has been declining for some time. The pace of new policies issued has lagged the number of policies terminated from death or surrender by roughly a two-to-one rate over the past several years. While the in force policy count has declined, the level of insurance in force (face amount of policies) from which contract charge revenue is received has remained relatively constant as new policies issued have substantially higher amounts of insurance compared to those policies terminating. The number of domestic life insurance policies in force has declined from 51,600 at December 31, 2016 to 50,200 at December 31, 2017, and to 49,400 at September 30, 2018. Policy lapse rates in the first nine months of 2018 approximated 6.4% compared to 6.0% and 7.5% in 2017 and 2016, respectively.

Universal life insurance revenues are also generated with the issuance of new business based upon amounts per application and percentages of the face amount (volume) of insurance issued. The number of domestic life policies issued in the first nine months of 2018 was 40% higher than in the comparable period for 2017 and the volume of insurance issued was 52% more than that in 2017. Universal life insurance revenues also include surrender charge income realized on terminating policies and, in the case of domestic universal life, amortization into income of the premium load on single premium policies which the company began deferring in 2013.

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

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
	(In thousands)			

Universal life insurance:

First year and single premiums	\$39,291	30,170	130,689	92,495
Renewal premiums	5,080	5,166	14,844	15,297
Totals	\$44,371	35,336	145,533	107,792

During the past couple of years the company has achieved some success in growing sales of its domestic life insurance new business. Sales have been substantially weighted toward single premium policies which do not have much in the way of recurring premium payments. These products are targeting wealth transfer strategies involving the movement of accumulated wealth in alternative investment vehicles, including annuities, into life insurance products. As a result, renewal premium levels have not been exhibiting a corresponding level of increase. Traditional life insurance premiums remained level in the three and nine month periods ended September 30, 2018 compared to the prior year periods. The company released a new term insurance product series in 2018 to replace other traditional product offerings.

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

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

	Three Months Ended September 30, 2018 2017		Nine Months Ended September 30, 2018 2017	
	(In thousands)			
Net investment income (excluding derivatives)	\$ 10,503	9,353	30,058	27,675
Derivative gain (loss)	16,409	8,032	11,073	24,323
Net investment income	\$26,912	17,385	41,131	51,998

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Life and policy benefits for a smaller block of business are subject to variation from quarter to quarter. Claim count activity during the first nine months of 2018 increased 15% compared to the first nine months of 2017 while the average net claim amount (after reinsurance) increased to \$31,800 from \$26,900. The low face amount per claim relative to current issued amounts of insurance per policy reflects the older block of domestic life insurance policies sold which were final expense type products (i.e. purchased to cover funeral costs). GAAP reporting requires that claims be recorded after any cash value amounts that have been accumulated in the policies. While domestic claims increased in the first nine months of 2018 compared to 2017, the accumulated cash values on the claims incurred was substantially higher in the current period (which reduces the net amount at risk on policies). The company's overall mortality experience for this segment has been better than pricing assumptions.

As noted previously in the discussion of Results of Operations, the company records true-up adjustments to DPAC balances each period to reflect current policy lapse or termination rates, expense levels and credited rates on policies as compared to anticipated experience with the adjustment reflected in current period amortization expense. To the extent required, the company may also record unlocking adjustments to DPAC balances. The following table identifies the effects of unlocking adjustments on domestic life insurance DPAC balances recorded through amortization expense separate from recurring amortization expense components for the three and nine months ended September 30, 2018 and 2017.

Amortization of DPAC	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Unlocking adjustments	\$1,015	—	1,015	795
Other amortization components	1,963	2,517	7,347	7,505
Totals	\$2,978	2,517	8,362	8,300

During the quarter ended September 30, 2018, the company unlocked DPAC balances associated with its Domestic Life segment for favorable mortality, extended death benefit reserves, and the investment portfolio yield supporting universal life policy liabilities. The effect of the prospective unlocking was to decrease DPAC balances by \$1.0 million (and increase amortization expense). During the first nine months of 2017, the company unlocked the interest crediting rate spread on two of its equity-indexed universal life products, the effect of which was to decrease DPAC balances by \$0.8 million (and increase amortization expense).

As indicated in the discussion concerning net investment income, contract interest expense includes the fluctuations that are the result of the effect upon the embedded derivative for the performance of underlying equity indices associated with fixed-index universal life products. The amounts realized on purchase call options approximate the amounts the company credits to policyholders' policies. As part of the unlockings in the third quarter of 2018 discussed above, the company reduced its excess benefit reserve by \$1.0 million which served to decrease contract interest expense by a like amount.

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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.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Premiums and other revenues:				
Premiums and contract revenues	\$26,839	30,353	82,218	91,563
Net investment income	19,731	15,711	32,305	48,581
Other revenues	5	26	39	73
Total revenues	46,575	46,090	114,562	140,217
Benefits and expenses:				
Life and other policy benefits	6,609	8,437	16,872	19,399
Amortization of deferred policy acquisition costs	6,307	(21,585)	21,023	(7,874)
Universal life insurance and annuity contract interest	30,596	9,112	37,046	36,871
Other operating expenses	4,982	5,661	15,991	18,846
Total benefits and expenses	48,494	1,625	90,932	67,242
Segment earnings (losses) before Federal income taxes	(1,919)	44,465	23,630	72,975
Provision (benefit) for Federal income taxes	(322)	15,473	4,701	25,125
Segment earnings (loss)	\$(1,597)	28,992	18,929	47,850

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Universal life insurance revenues	\$25,505	28,190	78,278	87,134
Traditional life insurance premiums	3,029	3,494	9,489	9,879
Reinsurance premiums	(1,695)	(1,331)	(5,549)	(5,450)
Totals	\$26,839	30,353	82,218	91,563

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In general, universal life revenues and operating earnings are anticipated to emerge with growth in the amount of life insurance in force. The volume of international life insurance in force, primarily universal life, contracted from \$17.9 billion at December 31, 2016 to \$16.6 billion at December 31, 2017 and further decreased to \$15.8 billion at September 30, 2018. Universal life insurance revenues are also generated with the issuance of new business based upon amounts per application and percentages of the face amount (volume) of insurance issued. The number of international life policies issued in the first nine months of 2018 was 27% lower than in the first nine months of 2017 while the volume of insurance issued was 31% less than that issued in 2017 during the same period. As noted previously, the company ceased accepting new applications from residents outside of the U.S. in May 2018. The company had ceased accepting applications from residents of Venezuela during the first quarter of 2018 due to the unsettled political, economic, civil, and social climate existing in that country. Prior to that, the company had ceased accepting applications from residents of Brazil, Central America, and the Pacific Rim region in the fourth quarter of 2015 and from residents in the Eastern European region, primarily Russian-speaking, during 2017.

A third component of international universal life revenues include surrender charges assessed upon surrender of contracts by policyholders. In 2015, termination activity levels increased in conjunction with the company's decision to cease accepting application from residents in Brazil and certain other countries resulting in additional surrender charge fee revenues. This activity continued into 2016 and 2017 but has subsided thus far in 2018. The following table illustrates National Western's recent international life termination experience.

	Amount in \$'s (millions)	Annualized Termination Rate	
Volume In Force Terminations			
Nine months ended September 30, 2018	1,264.2	9.8	%
Year ended December 31, 2017	2,309.7	12.2	%
Year ended December 31, 2016	2,340.6	11.6	%
Year ended December 31, 2015	2,659.1	12.3	%
Year ended December 31, 2014	1,825.5	8.4	%
Year ended December 31, 2013	1,838.5	8.6	%

The higher incidence of terminations that occurred in the 2015 through 2017 time period related to policies with residents of the countries from which the company discontinued accepting applications. As a result of the higher termination incidence, the company unlocked its DPAC balances for this segment of the business during 2016 to incorporate a greater lapse assumption, among other things.

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

Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
2017	2018	2017	2018
(In thousands)			

Universal life insurance:

First year and single premiums	\$1,334	3,983	10,396	11,367
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Renewal premiums	19,792	22,204	59,089	64,392
Totals	\$21,126	26,187	69,485	75,759

National Western's most popular international products have been its fixed-index universal life products in which the policyholder can elect to have the interest rate credited to their policy account values linked in part to the performance of an outside equity index. These products issued were not generally available in the local markets when sold. Included in the totals in the above table are collected premiums for fixed-index universal life products of approximately \$44.9 million and \$47.9 million for the first nine

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months of 2018 and 2017, respectively. The reduced level of renewal premiums during 2018 compared to 2017 corresponds with the decline in policies in force due to termination activity as discussed above.

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Net investment income (excluding derivatives)	\$8,117	8,837	25,018	26,863
Derivative gain (loss)	11,614	6,874	7,287	21,718
Net investment income	\$19,731	15,711	32,305	48,581

For liability purposes, the embedded option in the company's policyholder obligations for this feature is bifurcated and reserved for separately. Accordingly, the impact for the embedded derivative component in the equity-index universal life product is reflected in the contract interest expense for each respective period.

Life and policy benefits primarily consist of death claims on policies. National Western's clientèle for international products are generally wealthy individuals with access to U.S. dollars and quality medical care. Consequently, the amounts of coverage purchased have historically tended to be larger amounts. In the year ended December 31, 2017, the average face amount of insurance purchased was \$306,300, while in the first nine months of 2018 the average was lower at \$296,200 reflecting the company's decision to disengage from certain markets and ultimately to cease accepting applications for international life products from international residents. Life and policy benefit expense for the international life segment reflects the larger policies historically purchased, however mortality due to natural causes is comparable to that in the United States. The company's maximum risk exposure per insured life is capped at \$500,000 through reinsurance. The average international life net claim amount (after reinsurance) in the first nine months of 2018 increased to \$207,200 from \$159,200 in the first nine months of 2017 while the number of claims incurred declined 20%.

The company records true-up adjustments to DPAC balances each period to reflect current policy lapse or termination rates, expense levels, and credited rates on policies as compared to anticipated experience as well as unlocking adjustments as necessary. The following table identifies the effects of unlocking adjustments on international life insurance DPAC balances recorded through amortization expense separate from recurring amortization expense components three and nine months ended September 30, 2018 and 2017.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Amortization of DPAC				

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Unlocking adjustments	\$251	(28,016)	251	(27,731)
Other amortization components	6,056	6,431	20,772	19,857

Totals	\$6,307	(21,585)	21,023	(7,874)
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During the quarter ended September 30, 2018, the company unlocked DPAC balances associated with its International Life segment for extended death benefit reserves and the investment portfolio yield supporting universal life policy liabilities. The effect of the prospective unlocking was to decrease DPAC balances by \$0.3 million (and increase amortization expense). During the third quarter of 2017, the company unlocked its International Life DPAC balance for favorable mortality, lower than expected lapses from disengaged countries, and the implementation of an interest crediting clawback on certain universal life policies. The effect

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of the prospective unlocking was to increase the DPAC balance by \$28.0 million (and decrease amortization expense). During the second quarter of 2017, the company unlocked the interest crediting rate spread on one of its international equity-indexed universal life products the effect of which was to decrease DPAC balances by \$0.3 million (and increase amortization expense).

As indicated in the discussion concerning net investment income, contract interest expense includes fluctuations that are the result of the effect upon the embedded derivative for the performance of underlying equity indices associated with fixed-index universal life products. The amounts realized on purchased call options generally approximate the amounts National Western credits to policyholders. In conjunction with the DPAC unlockings made in the third quarter of 2018, the company unlocked its International Life excess death benefit reserve the result of which was to increase the reserve by \$14.1 million. This increase is reflected as an increase in contract interest during the three and nine months ended September 30, 2018.

The decrease in other operating expenses during the three and nine months ended September 30, 2018 relative to the prior year periods reflects the company's decision to cease accepting new applications for insurance in May 2018.

Annuity Operations

National Western's annuity operations are exclusively in the United States. A comparative analysis of results of operations for National Western's annuity segment is detailed below.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Premiums and other revenues:				
Premiums and contract revenues	\$5,597	5,293	18,042	16,583
Net investment income	123,525	114,123	263,983	346,031
Other revenues	11	26	48	90
Total revenues	129,133	119,442	282,073	362,704
Benefits and expenses:				
Life and other policy benefits	(6,704)	9,095	11,984	25,377
Amortization of deferred policy acquisition costs	17,490	37,790	60,688	85,566
Annuity contract interest	71,194	84,568	116,869	221,415
Other operating expenses	8,719	8,714	25,741	28,588
Total benefits and expenses	90,699	140,167	215,282	360,946
Segment earnings (loss) before Federal income taxes	38,434	(20,725)	66,791	1,758
Provision (benefit) for Federal income taxes	7,714	(7,007)	13,290	605
Segment earnings (loss)	\$30,720	(13,718)	53,501	1,153

Premiums and contract charges primarily consist of surrender charge income recognized on terminated policies. The amount of the surrender charge income recognized is determined by the volume of surrendered contracts as well as the

duration of each contract at the time of surrender given the pattern of declining surrender charge rates over time that is common to most annuity contracts. The company's lapse rate for annuity contracts in the first nine months of 2018 was 7.6% which was higher than the 6.3% rate during the same period in 2017. Annuity lapse rates tend to increase with increases in secular interest rate levels and as contracts approach the end of their surrender charge period.

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Deposits collected on annuity contracts are not reflected as revenues in the Company's Condensed Consolidated Statements of Earnings, in accordance with GAAP. Actual annuity deposits collected in the three and nine months ended September 30, 2018 and 2017 are detailed below.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Fixed-index annuities	\$87,522	151,894	305,413	439,337
Other deferred annuities	4,639	4,617	16,263	19,917
Immediate annuities	748	1,918	3,142	4,984
Totals	\$92,909	158,429	324,818	464,238

Fixed-index products are more attractive for consumers when interest rate levels remain low and equity markets produce positive returns. Since National Western does not offer variable products or mutual funds, fixed-index products provide an important alternative to the company's existing fixed interest rate annuity products. Fixed-index annuity deposits as a percentage of total annuity deposits were 94% and 95% for the nine months ended September 30, 2018 and 2017, respectively. The percentage of fixed-index products to total annuity sales reflects the low interest rate environment and the ongoing bull market in equities.

Some of the company's deferred annuity products, including fixed-index annuity products, contain a first year interest bonus ranging from 1% to 7% depending upon the product, in addition to the base first year interest rate. Other products include a premium bonus ranging from 2% to 10% which is credited to the account balance when premiums are applied. These bonus rates are deferred in conjunction with other capitalized policy acquisition costs. The amounts deferred to be amortized over future periods amounted to approximately \$6.8 million and \$13.7 million during the first nine months of 2018 and 2017, respectively. Amortization of deferred sales inducements is included as a component of annuity contract interest as described later in this discussion of Annuity Operations.

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Net investment income (excluding derivatives)	\$81,865	83,898	246,762	253,520
Derivative gain (loss)	41,660	30,225	17,221	92,511
Net investment income	\$123,525	114,123	263,983	346,031

As previously described, derivatives are call options purchased to hedge the equity return component of National Western's fixed-index annuity products with any gains or losses from the sale or expiration of the options, as well as period-to-period changes in fair values, reflected in net investment income. Since the embedded derivative option in the policies is bifurcated when determining the contract reserve liability, the impact of the market value change of index options on asset values generally aligns closely with the movement of the embedded derivative liability such

that the net effect upon pretax earnings is generally small (i.e. net realized and unrealized gains/(losses) included in net investment income approximate the change in contract interest associated with the corresponding embedded derivative liability change). See further discussion below regarding contract interest activity.

these products. As noted in the discussion in the Consolidated Operations section, positive returns on expiring option contracts during the first nine months of 2018 led to collection of asset management fees by National Western which are subtracted from contract interest credited to policyholders. This serves to lessen the increase in contract interest expense relative to the option gains reported in the Company's net investment income. Asset management fees collected during the three and nine months ended September 30, 2018 were \$5.6 million and \$18.9 million, respectively, compared to \$7.5 million and \$24.3 million in the corresponding periods of 2017.

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Annuity contract interest includes true-up adjustments for the deferred sales inducement balance which are done each period similar to that done with respect to DPAC balances with the adjustment reflected in current period contract interest expense. To the extent required, the company may also record unlocking adjustments to deferred sales inducement balances in conjunction with DPAC balance unlockings. During the quarter ended September 30, 2018, in conjunction with the Annuity DPAC unlocking previously discussed, the company unlocked its deferred sales inducement balance increasing it \$1.3 million (and decreasing contract interest expense). In the third quarter of 2017, the company also unlocked its deferred sales inducement balance in conjunction with the Annuity DPAC balance unlocking and decreased its deferred sales inducement balance by \$4.3 million (and increasing contract interest expense).

Life and policy benefits for the Annuity segment include death claims and benefits associated with the company's withdrawal benefit rider. As part of the unlockings performed in the third quarter of 2018, the company unlocked its policy benefits reserves associated with the assumption regarding policyholder utilization of the withdrawal benefit rider provisions attached to annuity contracts. The assumptions were updated for actual utilization experience which was lower than that previously assumed. The effect of this prospective unlocking was to decrease policy reserves by \$15.7 million in the three and nine months ended September 30, 2018.

Other Operations

The Company's primary business encompasses its domestic and international life insurance operations and its annuity operations. However, the Company also has small real estate, nursing home, and other investment operations through its wholly owned subsidiaries. Nursing home operations generated \$1.1 million and \$0.9 million of pre-tax operating earnings in the first nine months of 2018 and 2017, respectively. Amounts for these periods also include the results of BP III which commenced operations at the beginning of 2017. BP III incurred pre-tax losses of \$(1.2) million and \$(1.1) million for the nine months ended September 30, 2018 and 2017, respectively.

The remaining pre-tax earnings of \$20.7 million and \$20.6 million in Other Operations during the nine-month periods represent investment income from real estate, municipal bonds, and common and preferred equities held in subsidiary company portfolios principally for tax-advantage purposes. Included in these amounts are semi-annual distributions from a life interest in the Libby Shearn Moody Trust which is held in NWLSM, Inc. Pretax distributions from this trust were \$4.0 million and \$3.1 million in the nine-month periods ended September 30, 2018 and 2017, respectively.

INVESTMENTS

General

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

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The Company's overall conservative investment philosophy is reflected in the allocation of its investments, which is detailed below. The Company emphasizes investment grade debt securities.

	September 30, 2018		December 31, 2017	
	Carrying Value (In thousands)	%	Carrying Value (In thousands)	%
Debt securities	\$10,246,819	95.6	\$10,288,155	95.2
Mortgage loans	200,876	1.9	208,249	1.9
Policy loans	54,474	0.5	56,405	0.5
Derivatives, index options	136,435	1.3	194,731	1.8
Real estate	36,832	0.3	37,420	0.3
Equity securities	19,661	0.2	18,478	0.2
Other	18,029	0.2	14,408	0.1
Totals	\$10,713,126	100.0	\$10,817,846	100.0

Debt Securities

The Company maintains a diversified portfolio which consists mostly of corporate, mortgage-backed, and public utility fixed income securities. Investments in mortgage-backed securities primarily include U.S. Government agency pass-through securities and collateralized mortgage obligations ("CMO"). The Company's investment guidelines prescribe limitations by type of security as a percent of the total investment portfolio and all holdings were within these threshold limits. As of September 30, 2018 and December 31, 2017, the Company's debt securities portfolio consisted of the following classes of securities:

	September 30, 2018		December 31, 2017	
	Carrying Value (In thousands)	%	Carrying Value (In thousands)	%
Corporate	\$7,500,439	73.2	\$7,343,473	71.4
Residential mortgage-backed securities	1,215,752	11.9	1,301,877	12.7
Public utilities	1,050,346	10.2	1,149,651	11.2
State and political subdivisions	457,955	4.5	467,983	4.5
Asset-backed securities	10,979	0.1	13,544	0.1
Foreign governments	10,007	0.1	10,290	0.1
U.S. Treasury	1,341	—	1,337	—
Totals	\$10,246,819	100.0	\$10,288,155	100.0

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Substantially all of the Company's investable cash flows are directed toward the purchase of long-term debt securities. The Company's investment policy calls for investing in debt securities that are investment grade, meet quality and yield objectives, and provide adequate liquidity for obligations to policyholders. Debt securities with intermediate maturities are targeted by the Company as they more closely match the intermediate nature of the Company's policy liabilities and provide an appropriate strategy for managing cash flows. Long-term debt securities purchased to fund insurance company operations are summarized below.

Nine
Months Year Ended
Ended December
September 31,
30,
2018 2017
(\$ In thousands)

Cost of acquisitions	\$619,720	\$840,861	
Average credit quality	BBB+	BBB+	
Effective annual yield	4.08	% 3.57	%
Spread to treasuries	1.21	% 1.19	%
Effective duration	8.4 years	8.1 years	

Rating agencies generally view mortgage-backed securities as having additional risk for insurers holding interest sensitive liabilities given the potential for asset/liability disintermediation. Consequently, the Company holds predominantly agency mortgage-backed securities. Because mortgage-backed securities are subject to prepayment and extension risk, the Company has substantially reduced these risks by investing in collateralized mortgage obligations ("CMO"), which have more predictable cash flow patterns than pass-through securities. These securities, known as planned amortization class I ("PAC I"), very accurately defined maturity ("VADM") and sequential tranches are designed to amortize in a more predictable manner than other CMO classes or pass-throughs. The Company does not purchase tranches, such as PAC II and support tranches, that subject the portfolio to greater than average prepayment risk. Using this strategy, the Company can more effectively manage and reduce prepayment and extension risks, thereby helping to maintain the appropriate matching of the Company's assets and liabilities.

In addition to diversification, an important aspect of the Company's investment approach is managing the credit quality of its investment in debt securities. Thorough credit analysis is performed on potential corporate investments including examination of a company's credit and industry outlook, financial ratios and trends, and event risks. This emphasis is reflected in the high average credit rating of the Company's debt securities portfolio with 98.8%, as of September 30, 2018, held in investment grade securities. In the table below, investments in debt securities are classified according to credit ratings by nationally recognized statistical rating organizations.

	September 30, 2018		December 31, 2017	
	Carrying Value (In thousands)	%	Carrying Value (In thousands)	%
AAA	\$107,236	1.1	\$114,873	1.1
AA	2,064,196	20.1	2,106,243	20.5
A	3,210,333	31.3	3,199,169	31.1

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BBB	4,740,648	46.3	4,766,525	46.3
BB and other below investment grade	124,406	1.2	101,345	1.0
Totals	\$10,246,819	100.0	\$10,288,155	100.0

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The Company's investment guidelines do not allow for the purchase of below investment grade securities. The investments held in debt securities below investment grade are the result of subsequent downgrades of the securities. These holdings are further summarized below.

Below Investment Grade Debt
Securities

Amortized Cost	Carrying Value	Fair Value	% of Invested Assets
-------------------	-------------------	---------------	----------------------------

(In thousands, except percentages)

September 30, 2018 \$128,196 124,406 124,076 1.2 %

December 31, 2017 \$100,992 101,345 101,140 0.9 %

The Company's percentage of below investment grade securities as of September 30, 2018 compared with the percentage at December 31, 2017 increased due to downgrades of several credit issuers during the period. The Company's holdings of below investment grade securities are relatively small and as a percentage of total invested assets low compared to industry averages.

Holdings in below investment grade securities by category as of September 30, 2018 are summarized below, including their comparable fair value as of December 31, 2017 for those debt securities rated below investment grade at September 30, 2018. The Company continually monitors developments in these industries for issues that may affect security valuation.

Industry Category	Below Investment Grade Debt Securities			
	Amortized Cost	Carrying Value	Fair Value	Fair Value
	September 30, 2018	September 30, 2018	September 30, 2018	December 31, 2017
	(In thousands)			
Asset-backed securities	\$4,948	5,075	5,171	5,175
Residential mortgage-backed	992	933	933	967
Oil & gas	26,999	26,044	26,044	26,091
Manufacturing	57,305	54,553	53,716	54,002
Utilities	17,989	17,989	18,400	19,034
Other	19,963	19,812	19,812	20,650
Totals	\$128,196	124,406	124,076	125,919

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

Generally accepted accounting principles require that investments in debt securities be written down to fair value when declines in value are judged to be other-than-temporary. Fair value is the price that would be received to sell an

asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price methodology). Refer to Note 10, Fair Values of Financial Instruments, of the accompanying Condensed Consolidated Financial Statements for further discussion.

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During the nine months ended September 30, 2018, the Company recorded no other-than-temporary impairment credit related write-downs on debt securities. See Note 9, Investments, of the accompanying Condensed Consolidated Financial Statements for further discussion. Since the Company's adoption of the GAAP guidance on the recognition and accounting for other-than-temporary impairments due to credit loss versus non-credit loss, the Company has recognized a cumulative total of \$0.6 million of other-than-temporary impairments of which \$0.6 million was deemed credit related and recognized as realized investment losses in earnings, and \$0.0 million, net of amortization, was deemed a non-credit related impairment and recognized in other comprehensive income.

The Company is required to classify its investments in debt securities into one of three categories: (a) trading securities; (b) securities available for sale; or (c) securities held to maturity. The Company purchases securities with the intent to hold to maturity and accordingly does not maintain a portfolio of trading securities. Of the remaining two categories, available for sale and held to maturity, the Company makes a determination on categorization based on various factors including the type and quality of the particular security and how it will be incorporated into the Company's overall asset/liability management strategy. As shown in the table below, 29.2% of the Company's total debt securities, based on fair values, were classified as securities available for sale at September 30, 2018. These holdings in available for sale provide flexibility to the Company to react to market opportunities and conditions and to practice active management within the portfolio to provide adequate liquidity to meet policyholder obligations and other cash needs.

	September 30, 2018		
	Fair Value	Amortized Cost	Unrealized Gains (Losses)
	(In thousands)		
Securities held to maturity:			
Debt securities	\$7,186,631	7,281,031	(94,400)
Securities available for sale:			
Debt securities	2,965,788	3,013,889	(48,101)
Totals	\$10,152,419	10,294,920	(142,501)

Mortgage Loans and Real Estate

The Company originates loans on high quality, income-producing properties such as shopping centers, freestanding retail stores, office buildings, industrial and sales or service facilities, selected apartment buildings, motels, and health care facilities. The location of these properties is typically in major metropolitan areas that offer a potential for property value appreciation. Credit and default risk is minimized through strict underwriting guidelines and diversification of underlying property types and geographic locations. In addition to being secured by the property, mortgage loans with leases on the underlying property are often guaranteed by the lease payments and also by the borrower. This approach has proved over time to result in quality mortgage loans with few defaults. Mortgage loan interest income is recognized on an accrual basis with any premium or discount amortized over the life of the loan. Prepayment and late fees are recorded on the date of collection.

The Company targets a minimum specified yield on mortgage loan investments determined by reference to currently available debt security instrument yields plus a desired amount of incremental basis points. During the past several years, the low interest rate environment has resulted in fewer loan opportunities being available that meet the Company's required rate of return. Mortgage loans originated by the Company totaled \$59.4 million for the year ended December 31, 2017 and \$24.8 million for the nine months ended September 30, 2018. Principal repayments on mortgage loans for the nine months ended September 30, 2018 were \$32.4 million.

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

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The Company held net investments in mortgage loans, after allowances for possible losses, totaling \$200.9 million and \$208.2 million at September 30, 2018 and December 31, 2017, respectively. The diversification of the portfolio by geographic region and by property type was as follows:

	September 30, 2018		December 31, 2017	
	Amount	%	Amount	%
	(In		(In	
	thousands)		thousands)	
Mortgage Loans by Geographic Region:				
West South Central	\$ 116,898	58.0 %	\$ 119,794	57.3 %
East North Central	21,092	10.5	30,876	14.8
East South Central	13,900	6.9	14,273	6.8
South Atlantic	25,235	12.5	19,155	9.2
West North Central	12,811	6.3	12,967	6.2
Pacific	7,860	3.9	8,014	3.8
Middle Atlantic	2,158	1.1	2,215	1.1
Mountain	1,572	0.8	1,605	0.8
Gross balance	201,526	100.0	208,899	100.0
Allowance for possible losses	(650)	(0.3)	(650)	(0.3)
Totals	\$ 200,876	99.7	\$ 208,249	99.7

	September 30, 2018		December 31, 2017	
	Amount	%	Amount	%
	(In		(In	
	thousands)		thousands)	
Mortgage Loans by Property Type:				
Retail	\$ 98,109	48.7	\$ 87,805	42.0
Office	67,376	33.4	74,301	35.6
Hotel/Motel	13,762	6.8	13,782	6.6
Land/Lots	3,498	1.8	10,563	5.1
All other	18,781	9.3	22,448	10.7
Gross balance	201,526	100.0	208,899	100.0
Allowance for possible losses	(650)	(0.3)	(650)	(0.3)
Totals	\$ 200,876	99.7	\$ 208,249	99.7

The Company's direct investments in real estate are not a significant portion of its total investment portfolio and consist primarily of income-producing properties which are being operated by a wholly owned subsidiary of National Western. The Company's real estate investments totaled approximately \$36.8 million and \$37.4 million at September 30, 2018 and December 31, 2017, respectively.

The Company recognized operating income of approximately \$1.7 million and \$2.1 million on real estate properties in the first nine months of 2018 and 2017, respectively. The Company monitors the conditions and market values of

these properties on a regular basis and makes repairs and capital improvements to keep the properties in good condition.

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Market Risk

Market risk is the risk of change in market values of financial instruments due to changes in interest rates, currency exchange rates, commodity prices, or equity prices. The most significant market risk exposure for National Western is interest rate risk. Substantial and sustained increases and decreases in market interest rates can affect the profitability of insurance products and fair value of investments. The yield realized on new investments generally increases or decreases in direct relationship with interest rate changes. The fair values of fixed income debt securities correlate to external market interest rate conditions as market values typically increase when market interest rates decline and decrease when market interest rates rise. However, market values may fluctuate for other reasons, such as changing economic conditions, market dislocations or increasing event-risk concerns.

Interest Rate Risk

A gradual increase in interest rates from current levels would generally be a positive development for the Company. Rate increases would be expected to provide incremental net investment income, produce increased sales of fixed rate products, and limit the potential erosion of the Company's interest rate spread on products due to minimum guaranteed crediting rates in products. Alternatively, a rise in interest rates would reduce the fair value of the Company's investment portfolio and if long-term rates rise dramatically within a relatively short time period the Company could be exposed to disintermediation risk. Disintermediation risk is the risk that policyholders will surrender their policies in a rising interest rate environment forcing the Company to liquidate assets when they are in an unrealized loss position.

A decline in interest rates could cause certain mortgage-backed securities in the Company's portfolio to be more likely to pay down or prepay. In this situation, the Company typically will be unable to reinvest the proceeds at comparable yields. Lower interest rates will likely also cause lower net investment income, subject the Company to reinvestment rate risks, and possibly reduce profitability through reduced interest rate margins associated with products with minimum guaranteed crediting rates. Alternatively, the fair value of the Company's investment portfolio will increase when interest rates decline.

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

	September 30, 2018	June 30, 2018	December 31, 2017	
	(In thousands except percentages)			
Debt securities - fair value	\$10,152,419	10,241,866	10,475,235	
Debt securities - amortized cost	\$10,294,920	10,338,053	10,211,534	
Fair value as a percentage of amortized cost	98.62	% 99.07	% 102.58	%
Net unrealized gain (loss) balance	\$(142,501)	(96,187)	263,701	
Ten-year U.S. Treasury bond – (decrease) increase in yield for the period	0.32	% 0.12	% (0.04)%

Net Unrealized Gain (Loss) Balance

	At September 30, 2018	At June 30, 2018	At December 31, 2017	Quarter Change in Unrealized Balance	Year-to-date Change in Unrealized Balance
Debt securities held to maturity	\$(94,400)	(54,184)	187,080	(40,216)	(281,480)
Debt securities available for sale	(48,101)	(42,003)	76,621	(6,098)	(124,722)

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

The Company has the ability to adjust interest rates, participation rates, and asset management fees and caps, as applicable, in response to changes in investment portfolio yields for a substantial portion of its business in force. The ability to adjust these rates is subject to competitive forces in the market for the Company's products. Surrender rates could increase and new sales could be negatively affected if crediting rates are not competitive with the rates on competing products offered by other insurance companies and financial service entities. The Company designs its products with features encouraging persistency. Interest sensitive life and annuity products have surrender and withdrawal penalty provisions. Typically, surrender charge rates gradually decrease each year the contract is in force.

The Company performed detailed sensitivity analysis as of December 31, 2017, for its interest rate-sensitive assets and liabilities. The changes in market values of the Company's debt securities in the first nine months of 2018 were reasonable given the expected range of results of this analysis.

Credit Risk

The Company is exposed to credit risk through counterparties and within its investment portfolio. Credit risk relates to the uncertainty associated with an obligor's continued ability to make timely payments of principal and interest in accordance with the contractual terms of an instrument or contract. As previously discussed, the Company manages credit risk through established investment credit policies and guidelines which address the quality of creditors and counterparties, concentration limits, diversification practices and acceptable risk levels. These policies and guidelines are regularly reviewed and approved by senior management and National Western's Board of Directors.

In connection with the Company's use of call options to hedge the equity return component of its fixed-indexed annuity and life products, the Company is exposed to the risk that a counterparty fails to perform under terms of the option contract. The Company purchases one-year option contracts from multiple counterparties and evaluates the creditworthiness of all counterparties prior to the purchase of the contracts. For consideration in contracting with a counterparty, the rating required by the Company is a credit rating of "A" or higher. Accordingly, all options are purchased from nationally recognized financial institutions with a demonstrated performance for honoring their financial obligations and possessing substantial financial capacity. In addition, each counterparty is required to execute a credit support agreement obligating the counterparty to provide collateral to the Company when the fair value of the Company's exposure to the counterparty exceeds specified amounts. Counterparty credit ratings and credit exposure are monitored continuously by National Western's Investment Department with adjustments to collateral levels managed as incurred under the credit support agreements.

The Company is also exposed to credit spread risk related to market prices of investment securities and cash flows associated with changes in credit spreads. Credit spread tightening will reduce net investment income associated with new purchases of fixed debt securities and will increase the fair value of the investment portfolio. Credit spread widening will reduce the fair value of the investment portfolio and will increase net investment income on new

purchases.

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LIQUIDITY AND CAPITAL RESOURCES

Liquidity

Liquidity requirements are met primarily by funds provided from operations. Premium deposits and annuity considerations, investment income, and investment maturities and prepayments are the primary sources of funds while investment purchases, policy benefits in the form of claims, and payments to policyholders and contract holders in connection with surrenders and withdrawals as well as operating expenses are the primary uses of funds. To ensure the Company will be able to pay future commitments, the funds received as premium payments and deposits are invested in high quality investments, primarily fixed income securities. Funds are invested with the intent that the income from investments, plus proceeds from maturities, will meet the ongoing cash flow needs of the Company. The approach of matching asset and liability durations and yields requires an appropriate mix of investments. Although the Company historically has not been put in the position of having to liquidate invested assets to provide cash flow, its investments consist primarily of marketable debt securities that could be readily converted to cash for liquidity needs. Effective October 1, 2018, the Company ("National Western") may also borrow up to \$75 million on its bank line of credit for short-term cash needs. There were no borrowings outstanding under the line of credit at September 30, 2018.

A primary liquidity concern for life insurers is the risk of an extraordinary level of early policyholder withdrawals, particularly with respect to annuity products whose funds tend to move more rapidly with interest rate changes. The Company includes provisions within its annuity and universal life insurance policies, such as surrender and market value adjustments, that help limit and discourage early withdrawals.

The actual amounts paid by product line in connection with surrenders and withdrawals for the three and nine months ended September 30, for each respective year, are noted in the table below.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	2018

(In thousands)

Product Line:

Traditional Life	\$1,152	1,037	2,756	3,400
Universal Life	23,961	28,488	74,870	93,121
Annuities	157,970	122,697	465,435	393,743
Total	\$183,083	152,222	543,061	490,264

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

Cash flows from the Company's insurance operations have historically been sufficient to meet current needs. Cash flows from operating activities were \$222.1 million and \$193.4 million for the nine months ended September 30, 2018 and 2017, respectively. The Company also has significant cash flows from both scheduled and unscheduled

investment security maturities, redemptions, and prepayments. These cash flows totaled \$528.7 million and \$525.5 million for the nine months ended September 30, 2018 and 2017, respectively. Operating and investing activity cash flow items could be reduced if interest rates rise at an accelerated rate in the future. Net cash inflows/(outflows) from the Company's universal life and investment annuity deposit product operations totaled \$(306.5) million and \$(140.1) million during the nine months ended September 30, 2018 and 2017, respectively, reflecting the recent slowdown in annuity sales and slightly higher lapse rate for annuities thus far in 2018 compared to prior periods.

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Capital Resources

The Company relies on stockholders' equity for its capital resources as there is no long-term debt outstanding and the Company does not anticipate the need for any long-term debt in the near future. As of September 30, 2018, the Company had no commitments beyond its normal operating and investment activities.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

It is Company practice to not enter into off-balance sheet arrangements or to issue guarantees to third parties, other than in the normal course of issuing insurance contracts. Commitments related to insurance products sold are reflected as liabilities for future policy benefits. Insurance contracts guarantee certain performances by National Western.

Insurance reserves are the means by which life insurance companies determine the liabilities that must be established to assure that future policy benefits are provided for and can be paid. These reserves are required by law and based upon standard actuarial methodologies to ensure fulfillment of commitments guaranteed to policyholders and their beneficiaries, even though the obligations may not be due for many years. Refer to Note 1 in the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 for a discussion of reserving methods.

The table below summarizes future estimated cash payments under existing contractual obligations.

	Payment Due by Period				
	Total	Less Than 1 Year	1 - 3 Years	3 - 5 Years	More Than 5 Years
	(In thousands)				
Loan commitments	\$ 10,500	10,500	—	—	—
Lease obligations	1,525	359	1,076	90	—
Life claims payable (1)	65,554	65,554	—	—	—
Other long-term reserve liabilities reflected on the balance sheet (2)	10,679,148	978,202	1,855,796	1,638,066	6,207,084
Total	\$ 10,756,727	1,054,615	1,856,872	1,638,156	6,207,084

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

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

Subsequent to acquiring a commercial office building at the end of 2016 through its wholly owned subsidiary Braker P III, LLC ("BP III"), the Company has entered into lease agreements with various tenants for available space not occupied by the Company. Total revenues recorded pertaining to these leases for the three month periods ended September 30, 2018 and 2017 amounted to \$0.9 million and \$0.3 million, respectively, and for the nine month periods then ended amounted to \$2.3 million and \$1.0 million, respectively. Under their respective terms these leases expire at various dates from 2019 through 2025.

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The table below summarizes future estimated cash receipts under all existing lease agreements, including those in addition to the BP III lease agreements discussed above.

Estimated Cash Receipts by Period				
	Less			More
Total	Than	1 - 3	3 - 5	Than
	1	Years	Years	5
	Year			Years
(In thousands)				

Real estate revenue	\$41,121	5,055	12,943	8,839	14,284
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CHANGES IN ACCOUNTING PRINCIPLES AND CRITICAL ACCOUNTING POLICIES

Changes in Accounting Principles

As described in Note 2, in the first quarter of 2018 the Company implemented ASU 2016-01, Recognition and Measurement of Financial Assets and Liabilities. Equity securities are now separately disclosed on the balance sheet and the change in the fair value runs through net investment income. This prospective adjustment resulted in a reclassification of \$4.4 million, net of tax, from other comprehensive income to retained earnings as a change in accounting. There were no other changes in accounting principles during the periods reported in this Form 10-Q.

REGULATORY AND OTHER ISSUES

Statutory Accounting Practices

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

Risk-Based Capital Requirements

The NAIC established risk-based capital ("RBC") requirements to help state regulators monitor the financial strength and stability of life insurers by identifying those companies that may be inadequately capitalized. Under the NAIC's requirements, each insurer must maintain its total capital above a calculated threshold or take corrective measures to achieve the threshold. The threshold of adequate capital is based on a formula that takes into account the amount of risk each company faces on its products and investments. The RBC formula takes into consideration four major areas of risk which are: (i) asset risk which primarily focuses on the quality of investments; (ii) insurance risk which encompasses mortality and morbidity risk; (iii) interest rate risk which involves asset/liability matching issues; and (iv) other business risks. As a result of the change in corporate income tax rates enacted in the Tax Cuts and Job Act of 2017, the NAIC is updating the RBC formula factors. The impact of the formula changes for the corporate tax rate will increase the calculated RBC amount, absent any other factor changes, for all insurers.

Statutory laws prohibit public dissemination of certain RBC information. However, the company's current statutory capital and surplus is significantly in excess of the current threshold RBC requirements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES
ABOUT MARKET RISK

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

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ITEM 4. CONTROLS AND PROCEDURES

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

There were no changes in the Company's internal controls over financial reporting, as defined in Rules 13a-15(f) and 15d-15(e) under the Exchange Act, during the quarter ended September 30, 2018 that materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting. Internal controls over financial reporting change as the Company modifies or enhances its systems and processes to meet business needs. Any significant changes in controls are evaluated prior to implementation to help ensure continued effectiveness of internal controls and the control environment.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 8(A) "Legal Proceedings" of the accompanying Condensed Consolidated Financial Statements included in this Form 10-Q.

ITEM 1A. RISK FACTORS

There have been no substantial changes relative to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

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

Effective August 22, 2008, National Western adopted and implemented a limited stock buy-back program associated with the company's 2008 Incentive Plan which provides Option Holders the additional alternative of selling shares acquired through the exercise of options directly back to the company. This program succeeded a similar buy-back program implemented March 10, 2006 associated with the company's 1995 Stock Option and Incentive Plan. Option Holders may elect to sell such acquired shares back to the company at any time within ninety (90) days after the exercise of options at the prevailing market price as of the date of notice of election. These plans and programs were assumed by National Western Life Group, Inc. from National Western in 2015 pursuant to the terms of the holding company reorganization.

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Purchased shares are reported in the Company's Condensed Consolidated Financial Statements as authorized and unissued. The following table sets forth the Company's repurchase of its Class A common shares from Option Holders for the quarter ended September 30, 2018.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May yet Be Purchased Under the Plans or Programs
July 1, 2018 through July 31, 2018	—	\$ —	N/A	N/A
August 1, 2018 through August 31, 2018	—	\$ —	N/A	N/A
September 1, 2018 through September 30, 2018	—	\$ —	N/A	N/A
Total	—	\$ —	N/A	N/A

At September 30, 2018, there were no stock options vested or unvested and outstanding under these plans.

ITEM 4. Removed and Reserved.

ITEM 6. EXHIBITS

(a) Exhibits

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

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

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

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SIGNATURES

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

NATIONAL WESTERN LIFE GROUP, INC.
(Registrant)

Date: November 7, 2018 /S/ Ross R. Moody
Ross R. Moody
Chairman of the Board, President and
Chief Executive Officer
(Authorized Officer)

Date: November 7, 2018 /S/ Brian M. Pribyl
Brian M. Pribyl
Senior Vice President,
Chief Financial Officer and Treasurer
(Principal Financial Officer)
(Principal Accounting Officer)