NATIONAL WESTERN LIFE INSURANCE CO
Form 10-Q
November 07, 2014

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2014
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to __________

Commission File Number: 2-17039

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

COLORADO	84-0467208
(State of Incorporation)	(I.R.S. Employer Identification Number)
850 EAST ANDERSON LANE	
AUSTIN, TEXAS 78752-1602	(512) 836-1010
(Address of Principal Executive Offices)	(Telephone Number)

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

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

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

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

As of November 6, 2014, the number of shares of Registrant's common stock outstanding was: Class A – 3,436,166 and Class B - 200,000.

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

ASSETS	(Unaudited) September 30, 2014	December 31, 2013
Investments:		
Securities held to maturity, at amortized cost (fair value: $7,195,441 and $6,656,144)	$6,898,038	6,510,320
Securities available for sale, at fair value (cost: $2,576,805 and $2,535,264)	2,724,880	2,651,544
Mortgage loans, net of allowance for possible losses ($650 and $650)	152,740	132,765
Policy loans	63,746	65,969
Derivatives, index options	109,812	169,314
Other long-term investments	29,006	30,991
Total investments	9,978,222	9,560,903
Cash and short-term investments	121,482	120,859
Deferred policy acquisition costs	795,452	785,706
Deferred sales inducements	160,614	169,570
Accrued investment income	100,256	95,367
Federal income tax receivable	5,650	—
Other assets	97,400	98,011
Total assets	$11,259,076	10,830,416

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

Table of Contents

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

LIABILITIES AND STOCKHOLDERS' EQUITY	(Unaudited) September 30, 2014	December 31, 2013
LIABILITIES:		
Future policy benefits:		
Universal life and annuity contracts	$9,267,144	8,987,062
Traditional life reserves	137,501	138,072
Other policyholder liabilities	142,175	142,587
Deferred Federal income tax liability	36,421	7,199
Federal income tax payable	—	10,067
Other liabilities	141,697	97,481
Total liabilities	9,724,938	9,382,468
COMMITMENTS AND CONTINGENCIES (Note 8)		
STOCKHOLDERS' EQUITY:		
Common stock:		
Class A - $1 par value; 7,500,000 shares authorized; 3,436,166 issued and outstanding in 2014 and 3,434,765 in 2013	3,436	3,435
Class B - $1 par value; 200,000 shares authorized, issued, and outstanding in 2014 and 2013	200	200
Additional paid-in capital	38,116	37,767
Accumulated other comprehensive income	47,717	38,080
Retained earnings	1,444,669	1,368,466
Total stockholders' equity	1,534,138	1,447,948
Total liabilities and stockholders' equity	$11,259,076	10,830,416

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

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

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
For the Three Months Ended September 30, 2014 and 2013
(Unaudited)
(In thousands, except per share amounts)

	2014	2013
Premiums and other revenues:		
Universal life and annuity contract charges	$36,602	33,523
Traditional life premiums	4,506	4,159
Net investment income	110,966	141,403
Other revenues	5,377	5,822
Net realized investment gains (losses):		
Total other-than-temporary impairment (“OTTI”) gains (losses)	—	214
Portion of OTTI (gains) losses recognized in other comprehensive income	—	(227)
Net OTTI losses recognized in earnings	—	(13)
Other net investment gains (losses)	2,169	3,298
Total net realized investment gains (losses)	2,169	3,285
Total revenues	159,620	188,192
Benefits and expenses:		
Life and other policy benefits	13,163	16,941
Amortization of deferred policy acquisition costs	23,467	24,244
Universal life and annuity contract interest	59,211	87,486
Other operating expenses	20,451	22,675
Total benefits and expenses	116,292	151,346
Earnings before Federal income taxes	43,328	36,846
Federal income taxes	14,862	12,064
Net earnings	$28,466	24,782
Basic earnings per share:		
Class A	$8.05	$7.01
Class B	$4.03	$3.51
Diluted earnings per share:		
Class A	$8.05	$7.00
Class B	$4.03	$3.51

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

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
For the Nine Months Ended September 30, 2014 and 2013
(Unaudited)
(In thousands, except per share amounts)

	2014	2013
Premiums and other revenues:		
Universal life and annuity contract charges	$112,824	111,785
Traditional life premiums	13,946	13,241
Net investment income	374,596	451,904
Other revenues	16,351	17,954
Net realized investment gains (losses):		
Total other-than-temporary impairment (“OTTI”) gains (losses)	(32)	524
Portion of OTTI (gains) losses recognized in other comprehensive income	(3)	(776)
Net OTTI losses recognized in earnings	(35)	(252)
Other net investment gains (losses)	6,782	7,451
Total net realized investment gains (losses)	6,747	7,199
Total revenues	524,464	602,083
Benefits and expenses:		
Life and other policy benefits	40,922	48,081
Amortization of deferred policy acquisition costs	79,304	83,900
Universal life and annuity contract interest	224,576	299,224
Other operating expenses	63,414	69,442
Total benefits and expenses	408,216	500,647
Earnings before Federal income taxes	116,248	101,436
Federal income taxes	38,773	33,031
Net earnings	$77,475	68,405
Basic earnings per share:		
Class A	$21.92	$19.35
Class B	$10.95	$9.68
Diluted earnings per share:		
Class A	$21.91	$19.32
Class B	$10.95	$9.68

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

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
For the Three Months Ended September 30, 2014 and 2013
(Unaudited)
(In thousands)

	2014	2013
Net earnings	$28,466	24,782
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	(7,793)	(1,833)
Net unrealized liquidity gains (losses)	(23)	(92)
Reclassification adjustment for net amounts included in net earnings	(958)	(261)
Amortization of net unrealized (gains) losses related to transferred securities	—	—
Net unrealized gains (losses) on securities	(8,774)	(2,186)
Foreign currency translation adjustments	(3)	(38)
Benefit plans:		
Amortization of net prior service cost and net gain (loss)	(176)	373
Other comprehensive income (loss)	(8,953)	(1,851)
Comprehensive income (loss)	$19,513	22,931

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

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Nine Months Ended September 30, 2014 and 2013
(Unaudited)
(In thousands)

	2014	2013
Net earnings	$77,475	68,405
Other comprehensive income, net of effects of deferred costs and taxes:		
Unrealized gains (losses) on securities:		
Net unrealized holding gains (losses) arising during period	14,101	(36,065)
Net unrealized liquidity gains (losses)	28	66
Reclassification adjustment for net amounts included in net earnings	(3,329)	(2,657)
Amortization of net unrealized (gains) losses related to transferred securities	—	—
Net unrealized gains (losses) on securities	10,800	(38,656)
Foreign currency translation adjustments	(636)	555
Benefit plans:		
Amortization of net prior service cost and net gain (loss)	(527)	1,127
Other comprehensive income (loss)	9,637	(36,974)
Comprehensive income	$87,112	31,431

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

Table of Contents

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

	2014	2013
Common stock:		
Balance at beginning of period	$3,635	3,635
Shares exercised under stock option plan	1	—
Balance at end of period	3,636	3,635
Additional paid-in capital:		
Balance at beginning of period	37,767	37,767
Shares exercised under stock option plan	349	—
Balance at end of period	38,116	37,767
Accumulated other comprehensive income:		
Unrealized gains on non-impaired securities:		
Balance at beginning of period	46,693	91,972
Change in unrealized gains (losses) during period, net of tax	10,772	(38,860)
Balance at end of period	57,465	53,112
Unrealized losses on impaired held to maturity securities:		
Balance at beginning of period	(1,287)	(1,426)
Amortization	80	77
Other-than-temporary impairments, non-credit, net of tax	—	90
Additional credit loss on previously impaired securities	—	—
Change in shadow deferred policy acquisition costs	(53)	(149)
Balance at end of period	(1,260)	(1,408)
Unrealized losses on impaired available for sale securities:		
Balance at beginning of period	(2)	(196)
Other-than-temporary impairments, non-credit, net of tax	—	—
Change in shadow deferred policy acquisition costs	(1)	(188)
Recoveries, net of tax	2	374
Balance at end of period	(1)	(10)

Table of Contents

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

	2014	2013
Foreign currency translation adjustments:		
Balance at beginning of period	3,241	2,589
Change in translation adjustments during period	(636)	555
Balance at end of period	2,605	3,144
Benefit plan liability adjustment:		
Balance at beginning of period	(10,565)	(16,153)
Amortization of net prior service cost and net loss, net of tax	(527)	1,127
Balance at end of period	(11,092)	(15,026)
Accumulated other comprehensive income at end of period	47,717	39,812
Retained earnings:		
Balance at beginning of period	1,368,466	1,273,492
Net earnings	77,475	68,405
Stockholder dividends	(1,272)	(1,273)
Balance at end of period	1,444,669	1,340,624
Total stockholders' equity	$1,534,138	$1,421,838

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

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2014 and 2013
(Unaudited)
(In thousands)

	2014	2013
Cash flows from operating activities:		
Net earnings	$77,475	68,405
Adjustments to reconcile net earnings to net cash from operating activities:		
Universal life and annuity contract interest	224,576	299,224
Surrender charges and other policy revenues	(9,531)	(10,450)
Realized (gains) losses on investments	(7,225)	(7,199)
Accretion/amortization of discounts and premiums, investments	(831)	(2,040)
Depreciation and amortization	2,522	3,742
(Increase) decrease in value of derivatives	(49,278)	(126,739)
(Increase) decrease in deferred policy acquisition and sales inducement costs	(16,197)	(15,433)
(Increase) decrease in accrued investment income	(4,889)	(3,792)
(Increase) decrease in other assets	28	(20,271)
Increase (decrease) in liabilities for future policy benefits	3,956	8,960
Increase (decrease) in other policyholder liabilities	(412)	11,261
Increase (decrease) in Federal income taxes	7,691	(14,151)
Increase (decrease) in other liabilities	1,848	2,390
Other, net	1	—
Net cash provided by operating activities	229,734	193,907
Cash flows from investing activities:		
Proceeds from sales of:		
Securities held to maturity	—	1,980
Securities available for sale	19,511	10,246
Other investments	3,247	10,520
Proceeds from maturities and redemptions of:		
Securities held to maturity	591,536	1,028,476
Securities available for sale	213,260	191,833
Derivatives, index options	164,059	109,816
Purchases of:		
Securities held to maturity	(933,997)	(1,380,732)
Securities available for sale	(275,751)	(247,375)
Derivatives, index options	(53,174)	(45,629)
Other investments	(376)	(15)
Principal payments on mortgage loans	14,112	30,649
Cost of mortgage loans acquired	(33,985)	(5,271)
Decrease (increase) in policy loans	2,223	3,242
Other, net	(1)	(2)
Net cash used in investing activities	(289,336)	(292,262)

Continued on Next Page

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, (continued)
For the Nine Months Ended September 30, 2014 and 2013
(Unaudited)
(In thousands)

	2014	2013
Cash flows from financing activities:		
Deposits to account balances for universal life and annuity contracts	715,705	732,745
Return of account balances on universal life and annuity contracts	(655,195)	(665,048)
Issuance of common stock under stock option plan	350	—
Net cash provided by (used in) financing activities	60,860	67,697
Effect of foreign exchange	(635)	555
Net increase (decrease) in cash and short-term investments	623	(30,103)
Cash and short-term investments at beginning of period	120,859	124,561
Cash and short-term investments at end of period	$121,482	$94,458

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

	2014	2013
Cash paid during the period for:		
Interest	$30	$40
Income taxes	$30,515	$48,658
Noncash operating activities:		
Deferral of sales inducements	$(6,066)	$1,261

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

Table of Contents

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

(1) CONSOLIDATION AND BASIS OF PRESENTATION

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

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

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

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

Affected Line Item in the Statements of Earnings	Amount Reclassified From Accumulated Other Comprehensive Income			
	Three Months Ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Other net investment gains (losses)	$1,474	413	5,156	4,247
Net OTTI losses recognized in earnings	—	(12)	(35)	(160)
Earnings before Federal income taxes	1,474	401	5,121	4,087

Federal income taxes	516	140	1,792	1,430
Net earnings	$958	261	3,329	2,657

Table of Contents

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

(2) NEW ACCOUNTING PRONOUNCEMENTS

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

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

In June 2014, the FASB issued guidance that applies to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. It requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition and follows existing accounting guidance for the treatment of performance conditions. The standard will be effective for annual periods and interim periods within those annual periods beginning after December 15, 2015, with early adoption permitted. The Company’s current employee share-based plans do not require performance targets and the adoption of this guidance is not expected to have a material impact on the Company’s financial position or results of operations.
Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the American Institute of Certified Pubic Accountants ("AICPA"), and the SEC did not, or are not believed by management to, have a material impact on the Company’s present or future condensed consolidated financial statements.

(3) STOCKHOLDERS' EQUITY

The Company is restricted by state insurance laws as to dividend amounts which may be paid to stockholders without prior approval from the Colorado Division of Insurance. The restrictions are based on the greater of statutory earnings from operations excluding capital gains or 10% of statutory capital and surplus of the Company. The maximum dividend payment which may be made without prior approval in 2015 is $112.3 million.

The Company did declare a cash dividend on August 22, 2014 payable December 4, 2014 to stockholders on record as of October 31, 2014. The dividends declared were $0.36 per common share to Class A stockholders and $0.18 per common share to Class B stockholders. A dividend in the same amounts per share on Class A and Class B common stock was declared in August, 2013 and paid in December of 2013.

14

Table of Contents

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

(4) EARNINGS PER SHARE

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

	Three Months Ended September 30,			
	2014		2013	
	Class A	Class B	Class A	Class B
	(In thousands except per share amounts)			
Numerator for Basic and Diluted Earnings Per Share:				
Net income	$28,466		24,782	
Dividends - Class A shares	(1,236)		(1,237)	
Dividends - Class B shares	(36)		(36)	
Undistributed income	$27,194		23,509	
Allocation of net income:				
Dividends	$1,236	36	1,237	36
Allocation of undistributed income	26,425	769	22,844	665
Net income	$27,661	805	24,081	701
Denominator:				
Basic earnings per share - weighted-average shares	3,436	200	3,435	200
Effect of dilutive stock options	2	—	4	—
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,438	200	3,439	200
Basic Earnings Per Share	$8.05	4.03	7.01	3.51
Diluted Earnings Per Share	$8.05	4.03	7.00	3.51

Stock options that were outstanding during the three months ended September 30, 2014 and 2013, but were not included in the computation of diluted earnings per share because the effect was anti-dilutive were approximately 22,200 and 23,000, respectively.

Table of Contents

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

	Nine Months Ended September 30,			
	2014		2013	
	Class A	Class B	Class A	Class B
	(In thousands except per share amounts)			
Numerator for Basic and Diluted Earnings Per Share:				
Net income	$77,475		68,405	
Dividends - Class A shares	(1,236)		(1,237)	
Dividends - Class B shares	(36)		(36)	
Undistributed income	$76,203		67,132	
Allocation of net income:				
Dividends	$1,236	36	1,237	36
Allocation of undistributed income	74,048	2,155	65,233	1,899
Net income	$75,284	2,191	66,470	1,935
Denominator:				
Basic earnings per share - weighted-average shares	3,435	200	3,435	200
Effect of dilutive stock options	2	—	5	—
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,437	200	3,440	200
Basic Earnings Per Share	$21.92	10.95	19.35	9.68
Diluted Earnings Per Share	$21.91	10.95	19.32	9.68

Stock options that were outstanding during the nine months ended September 30, 2014 and 2013, but were not included in the computation of diluted earnings per share because the effect was anti-dilutive were approximately 22,200 and 23,000, respectively.

Table of Contents

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

(5) PENSION AND OTHER POSTRETIREMENT PLANS

(A) Defined Benefit Pension Plans

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Service cost	$42	48	126	142
Interest cost	239	218	718	654
Expected return on plan assets	(320)	(284)	(959)	(850)
Amortization of prior service cost	1	1	3	3
Amortization of net loss	106	203	317	609
Net periodic benefit cost	$68	186	205	558

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

The Company's minimum required contribution for the 2014 plan year is $0.0 million. In addition, the Company had a remaining contribution payable for the 2013 plan year of $0.0 million as of September 30, 2014. As of September 30, 2014, the Company had contributed a total of $0.3 million to the plan for the 2014 and 2013 plan years.

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

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

Table of Contents

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Service cost	$74	44	222	133
Interest cost	250	201	752	601
Amortization of prior service cost	15	15	44	44
Amortization of net loss	323	293	970	880
Net periodic benefit cost	$662	553	1,988	1,658

The Company expects to contribute $2.0 million to these plans in 2014. As of September 30, 2014, the Company has contributed $1.3 million to the plans.

(B) Defined Benefit Postretirement Healthcare Plans

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Interest cost	$28	29	83	88
Amortization of prior service cost	26	26	78	77
Amortization of net loss	(1)	9	(3)	25
Net periodic benefit cost	$53	64	158	190

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

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

(6) SEGMENT AND OTHER OPERATING INFORMATION

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

Selected Segment Information:

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
September 30, 2014					
Condensed Consolidated Balance Sheet Items:					
Deferred policy acquisition costs and sales inducements	$61,087	242,124	652,855	—	956,066
Total segment assets	705,156	1,223,571	8,871,276	251,905	11,051,908
Future policy benefits	611,550	944,505	7,848,590	—	9,404,645
Other policyholder liabilities	12,742	12,226	117,207	—	142,175
Three Months Ended September 30, 2014					
Condensed Consolidated Income Statements:					
Premiums and contract revenues	$6,847	29,135	5,126	—	41,108
Net investment income	6,859	8,273	90,835	4,999	110,966
Other revenues	19	20	23	5,315	5,377
Total revenues	13,725	37,428	95,984	10,314	157,451
Life and other policy benefits	3,353	9,672	138	—	13,163
Amortization of deferred acquisition costs	1,166	2,525	19,776	—	23,467
Universal life and annuity contract interest	5,803	6,956	46,452	—	59,211
Other operating expenses	2,314	6,307	7,045	4,785	20,451
Federal income taxes (benefit)	379	4,143	7,681	1,899	14,102
Total expenses	13,015	29,603	81,092	6,684	130,394
Segment earnings (loss)	$710	7,825	14,892	3,630	27,057

Table of Contents

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

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Nine months ended September 30, 2014					
Condensed Consolidated Income Statements:					
Premiums and contract revenues	$22,077	87,906	16,787	—	126,770
Net investment income	24,044	35,902	300,118	14,532	374,596
Other revenues	40	321	63	15,927	16,351
Total revenues	46,161	124,129	316,968	30,459	517,717
Life and other policy benefits	7,268	16,375	17,279	—	40,922
Amortization of deferred acquisition costs	5,346	18,078	55,880	—	79,304
Universal life and annuity contract interest	19,066	32,820	172,690	—	224,576
Other operating expenses	10,585	18,167	19,965	14,697	63,414
Federal income taxes (benefit)	1,295	12,865	17,010	5,241	36,411
Total expenses	43,560	98,305	282,824	19,938	444,627
Segment earnings (loss)	$2,601	25,824	34,144	10,521	73,090

Table of Contents

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

Selected Segment Information:

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
September 30, 2013					
Condensed Consolidated Balance Sheet Items:					
Deferred policy acquisition costs and sales inducements	$50,067	235,922	650,526	—	936,515
Total segment assets	559,824	1,161,517	8,487,915	253,097	10,462,353
Future policy benefits	485,754	899,090	7,549,441	—	8,934,285
Other policyholder liabilities	13,177	16,778	129,867	—	159,822
Three Months Ended September 30, 2013					
Condensed Consolidated Income Statements:					
Premiums and contract revenues	$3,944	28,865	4,873	—	37,682
Net investment income	6,928	10,957	118,521	4,997	141,403
Other revenues	12	60	22	5,728	5,822
Total revenues	10,884	39,882	123,416	10,725	184,907
Life and other policy benefits	4,003	11,040	1,898	—	16,941
Amortization of deferred acquisition costs	1,015	3,287	19,942	—	24,244
Universal life and annuity contract interest	2,261	8,525	76,700	—	87,486
Other operating expenses	2,782	5,987	8,565	5,341	22,675
Federal income taxes (benefit)	268	3,596	5,298	1,751	10,913
Total expenses	10,329	32,435	112,403	7,092	162,259
Segment earnings (loss)	$555	7,447	11,013	3,633	22,648

Table of Contents

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

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Nine months ended September 30, 2013					
Condensed Consolidated Income Statements:					
Premiums and contract revenues	$22,967	87,061	14,998	—	125,026
Net investment income	22,943	43,224	371,704	14,033	451,904
Other revenues	21	211	52	17,670	17,954
Total revenues	45,931	130,496	386,754	31,703	594,884
Life and other policy benefits	8,129	17,910	22,042	—	48,081
Amortization of deferred acquisition costs	5,260	17,000	61,640	—	83,900
Universal life and annuity contract interest	17,320	39,760	242,144	—	299,224
Other operating expenses	11,496	18,820	23,117	16,009	69,442
Federal income taxes (benefit)	1,206	11,982	12,242	5,081	30,511
Total expenses	43,411	105,472	361,185	21,090	531,158
Segment earnings (loss)	$2,520	25,024	25,569	10,613	63,726

Table of Contents

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Premiums and Other Revenues:				
Premiums and contract revenues	$41,108	37,682	126,770	125,026
Net investment income	110,966	141,403	374,596	451,904
Other revenues	5,377	5,822	16,351	17,954
Realized gains (losses) on investments	2,169	3,285	6,747	7,199
Total condensed consolidated premiums and other revenues	$159,620	188,192	524,464	602,083

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Federal Income Taxes:				
Total segment Federal income taxes	$14,102	10,913	36,411	30,511
Taxes on realized gains (losses) on investments	760	1,151	2,362	2,520
Total condensed consolidated Federal income taxes	$14,862	12,064	38,773	33,031

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Net Earnings:				
Total segment earnings	$27,057	22,648	73,090	63,726
Realized gains (losses) on investments, net of taxes	1,409	2,134	4,385	4,679
Total condensed consolidated net earnings	$28,466	24,782	77,475	68,405

Table of Contents

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

	September 30, 2014 (In thousands)	2013
Assets:		
Total segment assets	$11,051,908	10,462,353
Other unallocated assets	207,168	206,115
Total condensed consolidated assets	$11,259,076	$10,668,468

(7) SHARE-BASED PAYMENTS

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

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

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

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

Table of Contents

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

The Company uses the current fair value method to measure compensation cost. As of September 30, 2014 and December 31, 2013, the liability balance was $7.7 million and $5.9 million, respectively. A summary of shares available for grant and activity during the nine months ended September 30, 2014 is detailed below.

		Options Outstanding	
	Shares Available For Grant	Shares	Weighted-Average Exercise Price
Stock Options:			
Balance at January 1, 2014	291,000	36,668	$229.24
Exercised	—	(5,000)	$150.00
Forfeited	—	(500)	$255.13
Expired	—	—	$—
Stock options granted	—	—	$—
Balance at September 30, 2014	291,000	31,168	$241.54

	Stock Appreciation Rights Outstanding	
	Awards	Weighted-Average Exercise Price
Stock Appreciation Rights:		
Balance at January 1, 2014	99,461	$156.93
Exercised	(1,825)	$114.64
Forfeited	(3,350)	$165.46
Granted	—	$—
Balance at September 30, 2014	94,286	$157.45

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

The total intrinsic value of options exercised was $0.8 million and $2.1 million for the nine months ended September 30, 2014 and 2013, respectively. The total share-based liabilities paid were $0.6 million and $2.1 million for the nine months ended September 30, 2014 and 2013, respectively. The total fair value of shares vested during the nine months ended September 30, 2014 and 2013 was $0.7 million and $0.4 million, respectively. For the nine months ended September 30, 2014 and 2013, the total cash received from the exercise of options under the Plans was $0.2 million and $0, respectively.

25

Table of Contents

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

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

	Options/SARs Outstanding		
	Number Outstanding	Weighted-Average Remaining Contractual Life	Number Exercisable
Exercise prices:			
255.13 (options)	22,168	3.6 years	17,815
208.05 (options)	9,000	3.7 years	9,000
236.00 (SARs)	250	3.9 years	200
114.64 (SARs)	26,518	4.4 years	17,761
132.56 (SARs)	31,518	7.2 years	3,600
210.22 (SARs)	36,000	9.2 years	—
Totals	125,454		48,376
Aggregate intrinsic value (in thousands)	$7,471		$3,116

The aggregate intrinsic value in the table above is based on the closing stock price of $247.01 per share on September 30, 2014.

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

	September 30, 2014		December 31, 2013	
Expected term of options	3.6 to 9.2 years		0 to 10 years	
Expected volatility:				
Range	18.16% to 38.35%		21.03% to 42.71%	
Weighted-average	22.24	%	30.50	%
Expected dividend yield	0.15	%	0.16	%
Risk-free rate:				
Range	0.11% to 1.63%		0.12% to 3.93%	
Weighted-average	0.55	%	2.10	%

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

The pre-tax compensation cost recognized in the financial statements related to the two plans defined above was $0.0 million and$2.5 million for the three and nine months ended September 30, 2014 compared to $0.6 million and $4.0 million for the three and nine months ended September 30, 2013. The related tax expense recognized was $0.0 million and $0.8 million for the three and nine months ended September 30, 2014 compared to $0.2 million and $1.4 million for the three and nine months ended September 30, 2013.

As of September 30, 2014, the total compensation cost related to nonvested options not yet recognized was $2.7 million. This amount is expected to be recognized over a weighted-average period of 2.3 years. The Company recognizes compensation cost over the graded vesting periods.

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

(8) COMMITMENTS AND CONTINGENCIES

(A) Legal Proceedings

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

The Company resolved a class action lawsuit pending since June 12, 2006, in the U.S. District Court for the Southern District of California. The case is titled In Re National Western Life Insurance Deferred Annuities Litigation. The complaint asserted claims for RICO violations, Financial Elder Abuse, Violation of Cal. Bus. & Prof. Code 17200, et seq, Violation of Cal. Bus. & Prof. Code 17500, et seq, Breach of Fiduciary Duty, Aiding and Abetting Breach of Fiduciary Duty, Fraudulent Concealment, Cal. Civ. Code 1710, et seq, Breach of the Duty of Good Faith and Fair Dealing, and Unjust Enrichment and Imposition of Constructive Trust. On July 12, 2010 the Court certified a nationwide class of policyholders under the RICO allegation and a California class under all of the remaining causes of action except breach of fiduciary duty. The parties entered into a Settlement and Release Agreement in August of 2013 ("Settlement") which was finally approved by the Court on February 11, 2014. On February 12, 2014, the Court issued a redacted final approval order granting the Motion for Final Approval of Class Action Settlement. The Settlement became final and non-appealable on April 12, 2014. The Settlement Agreement and Plaintiffs' Request for Attorneys' Fees and Costs were approved by the Court, and the Company paid the Court-approved amount of attorneys’ fees and costs in April 2014. The Company also made certain payments to surrendered and annuitized policyholders in June 2014. In addition, the Company agreed to provide bonuses on annuitization for active policyholders who choose a 10-year or a 20-year certain and life settlement option. The Company had held reserves of $6.5 million for the matter which approximated the ultimate settlement amounts described above.

In addition to the class action lawsuit described above, the Company was the named defendant in the case of Sheila Newman vs. National Western Life Insurance Company, which alleged mishandling of policyholder funds by an agent. On February 3, 2010, the 415th Judicial District Court of Parker County in Weatherford, Texas, entered a Final Judgment against the Company of approximately $208,000 including actual damages of $113,000 and amounts for attorney's fees, and prejudgment interest on the actual damages. In addition, the Final Judgment included $150 million for exemplary damages. The Company vigorously defended this case and appealed the Final Judgment to the Court of Appeals Second District of Texas in Fort Worth. The Court of Appeals on August 11, 2011, reversed the trial court judgment in its entirety and rendered a take nothing verdict in favor of National Western. Plaintiffs (Appellees) filed a motion for a rehearing which the Court ruled on October 13, 2011, that the trial court's judgment was still reversed and judgment was still entered that Newman take nothing, all in favor of National Western. The Plaintiffs (Appellees) filed a Motion for Reconsideration En Banc which the Court of Appeals denied on October 27, 2011. The Plaintiffs (Appellees) then filed a Motion for Rehearing of the Court's amended decision, which the Court of Appeals denied on December 22, 2011. On March 21, 2012, Plaintiffs (Appellees) filed a petition for review with the Texas Supreme Court and the Company filed its response on April 20, 2012. The Supreme Court asked the parties for briefs on the issues before deciding on whether to hear the case and both parties submitted their briefs. On February 14, 2013, the Supreme Court denied the Plaintiffs petition for review. On April 3, 2013, Plaintiff filed a Motion for Rehearing. The Supreme Court denied Plaintiff's Motion for Rehearing on June 7, 2013 thus ending the matter.

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

Table of Contents

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

Although there can be no assurances, at the present time, the Company does not anticipate that the ultimate liability arising from such other potential, pending, or threatened legal actions will have a material adverse effect on the financial condition or operating results of the Company.

(B) Financial Instruments

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

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

The Company had $3.0 million of commitments to extend credit relating to mortgage loans at September 30, 2014. The Company evaluates each customer's creditworthiness on a case-by-case basis.

(9) INVESTMENTS

(A) Investment Gains and Losses

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Available for sale debt securities:				
Realized gains on disposal	$1,467	415	5,144	3,739
Realized losses on disposal	—	(3)	(22)	(3)
Held to maturity debt securities:				
Realized gains on disposal	353	2,831	1,167	3,221
Realized losses on disposal	—	—	(17)	(72)
Equity securities realized gains (losses)	7	—	34	511
Real estate gains (losses)	820	55	954	55
Mortgage loans write-downs	—	—	—	—
Other	(478)	—	(478)	—

Totals	$2,169	3,298	6,782	7,451

28

Table of Contents

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

The Company uses the specific identification method in computing realized gains and losses. Approximately 87% of the gains on bonds are due to calls of securities rather than sales. This includes calls out of the Company's available for sale portfolio of debt securities.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Total other-than-temporary impairment gains (losses) on debt securities	$—	214	(4)	538
Portion of loss (gain) recognized in comprehensive income	—	(227)	(3)	(776)
Net impairment losses on debt securities recognized in earnings	—	(13)	(7)	(238)
Equity securities impairments	—	—	(28)	(14)
Totals	$—	(13)	(35)	(252)

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

Table of Contents

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

(B) Debt and Equity Securities

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

	Securities Held to Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
U.S. agencies	$23,069	913	—	23,982
U.S. Treasury	1,918	407	—	2,325
States and political subdivisions	430,243	27,854	(1,051)	457,046
Foreign governments	—	—	—	—
Public utilities	915,761	63,842	(1,558)	978,045
Corporate	3,834,631	181,422	(26,026)	3,990,027
Mortgage-backed	1,667,528	59,881	(13,457)	1,713,952
Home equity	19,348	4,841	—	24,189
Manufactured housing	5,540	335	—	5,875
Totals	$6,898,038	339,495	(42,092)	7,195,441

The table below presents amortized costs and fair values of securities available for sale at September 30, 2014.

	Securities Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
States and political subdivisions	$591	—	(38)	553
Foreign governments	9,937	313	—	10,250
Public utilities	189,636	11,994	(406)	201,224
Corporate	2,296,848	135,520	(8,955)	2,423,413
Mortgage-backed	52,270	4,541	—	56,811
Home equity	11,817	237	(3)	12,051
Manufactured housing	2,877	86	—	2,963
	2,563,976	152,691	(9,402)	2,707,265
Equity public	12,829	5,215	(429)	17,615
Totals	$2,576,805	157,906	(9,831)	2,724,880

Table of Contents

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

The table below presents amortized costs and fair values of securities held to maturity at December 31, 2013.

	Securities Held to Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
U.S. agencies	$23,088	1,700	—	24,788
U.S. Treasury	1,913	434	—	2,347
States and political subdivisions	423,286	13,433	(10,944)	425,775
Foreign governments	9,997	159	—	10,156
Public utilities	864,324	53,222	(9,687)	907,859
Corporate	3,463,521	153,442	(81,760)	3,535,203
Mortgage-backed	1,696,887	54,035	(33,376)	1,717,546
Home equity	20,179	4,738	(32)	24,885
Manufactured housing	7,125	460	—	7,585
Totals	$6,510,320	281,623	(135,799)	6,656,144

The table below presents amortized costs and fair values of securities available for sale at December 31, 2013.

	Securities Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
States and political subdivisions	$594	—	(110)	484
Foreign governments	9,931	—	(156)	9,775
Public utilities	233,788	15,014	(1,397)	247,405
Corporate	2,195,124	124,519	(30,732)	2,288,911
Mortgage-backed	68,799	5,040	—	73,839
Home equity	12,079	245	(7)	12,317
Manufactured housing	3,803	132	—	3,935
	2,524,118	144,950	(32,402)	2,636,666
Equity public	11,146	4,489	(757)	14,878
Totals	$2,535,264	149,439	(33,159)	2,651,544

Table of Contents

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

The following table shows the gross unrealized losses and fair values of the Company's held to maturity investments by investment category and length of time the individual securities have been in a continuous unrealized loss position at September 30, 2014.

	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	$—	—	33,440	(1,051)	33,440	(1,051)
Public utilities	73,039	(231)	68,585	(1,327)	141,624	(1,558)
Corporate	328,940	(1,478)	845,310	(24,548)	1,174,250	(26,026)
Mortgage-backed	67,440	(437)	309,267	(13,020)	376,707	(13,457)
Total temporarily impaired securities	$469,419	(2,146)	1,256,602	(39,946)	1,726,021	(42,092)

The following table shows the gross unrealized losses and fair values of the Company's available for sale investments by investment category and length of time the individual securities have been in a continuous unrealized loss position at September 30, 2014.

	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	$—	—	553	(38)	553	(38)
Public utilities	—	—	18,556	(406)	18,556	(406)
Corporate	180,872	(1,269)	248,901	(7,686)	429,773	(8,955)
Home equity	—	—	4,832	(3)	4,832	(3)
	180,872	(1,269)	272,842	(8,133)	453,714	(9,402)
Equity public	1,997	(116)	3,620	(313)	5,617	(429)
Total temporarily impaired securities	$182,869	(1,385)	276,462	(8,446)	459,331	(9,831)

Unrealized losses for securities held to maturity and securities available for sale decreased during the first nine months of 2014 due primarily to the decline in market interest rates. The Company does not consider investments with unrealized losses to be other-than-temporarily impaired since it does not anticipate selling these securities prior to maturity and expects to receive all amounts due relative to principal and interest.

The Company does not consider securities to be other-than-temporarily impaired when the market decline is attributable to factors such as interest rate movements, market volatility, liquidity, spread widening and credit quality and when recovery of all amounts due under the contractual terms of the security is anticipated. Based on the review and the Company's ability and intent not to sell these securities until maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2014. 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.

Table of Contents

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

During the first quarter of 2014, the Company recorded an other-than-temporary impairment on one asset-backed security. The security had a $7 thousand credit impairment which is reported in the Condensed Consolidated Statements of Earnings and there were minimal liquidity gains which did not affect current earnings. The Company intends to hold the security until recovery of fair market value or maturity.

Debt securities. The gross unrealized losses for debt securities are made up of 259 individual issues, or 19.7% of the total debt securities held by the Company. The market value of these bonds as a percent of amortized cost averages 97.7%. Of the 259 securities, 190, or 71.2%, fall in the 12 months or greater aging category; and 254 were rated investment grade at September 30, 2014.

Equity securities. The gross unrealized losses for equity securities are made up of 17 individual issues. These holdings are reviewed quarterly for impairment. One equity security was other-than-temporarily impaired during the nine months ended September 30, 2014, in accordance with Company policy.

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, 2013.

	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	$128,711	(9,249)	8,080	(1,695)	136,791	(10,944)
Public utilities	260,982	(8,998)	7,821	(689)	268,803	(9,687)
Corporate	1,335,088	(71,330)	117,179	(10,430)	1,452,267	(81,760)
Mortgage-backed	581,373	(32,043)	13,861	(1,333)	595,234	(33,376)
Home equity	—	—	2,617	(32)	2,617	(32)
Total temporarily impaired securities	$2,306,154	(121,620)	149,558	(14,179)	2,455,712	(135,799)

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

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, 2013.

	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	—	—	484	(110)	484	(110)
Foreign governments	$9,775	(156)	—	—	9,775	(156)
Public utilities	20,090	(1,343)	962	(54)	21,052	(1,397)
Corporate	532,310	(26,376)	46,187	(4,356)	578,497	(30,732)
Home equity	4,833	(7)	—	—	4,833	(7)
	567,008	(27,882)	47,633	(4,520)	614,641	(32,402)
Equity public	3,707	(757)	—	—	3,707	(757)
Total temporarily impaired securities	$570,715	(28,639)	47,633	(4,520)	618,348	(33,159)

(C) Transfer of Securities

During the nine months ended September 30, 2014 and 2013, the Company made no transfers to the held to maturity category from securities available for sale.

(D) Mortgage Loans and Real Estate

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

Credit and default risk is minimized through strict underwriting guidelines and diversification of underlying property types and geographic locations. In addition to being secured by the property, mortgage loans with leases on the underlying property are often guaranteed by the lease payments and also by the borrower. This approach has proven 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, 2014 or 2013 and as a result all interest income was recognized at September 30, 2014 or 2013.

Table of Contents

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

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

	September 30, 2014		December 31, 2013	
	Amount (In thousands)	%	Amount (In thousands)	%
Mortgage Loans by Loan-to-Value Ratio (1):				
Less than 50%	$49,514	32.3	$57,445	43.0
50% to 60%	56,530	36.9	23,339	17.5
60% to 70%	18,932	12.3	20,120	15.1
70% to 80%	8,476	5.5	9,723	7.3
80% to 90%	—	—	—	—
Greater than 90%	19,938	13.0	22,788	17.1
Gross balance	153,390	100.0	133,415	100.0
Allowance for possible losses	(650)	(0.4)	(650)	(0.5)
Totals	$152,740	99.6	$132,765	99.5

(1) Loan-to-Value Ratio 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.

The mortgage loans in the greater than 90% category relate to loans made with a long standing borrower. The loans are backed by the investment property, contracted leases, as well as a separate and additional guarantee of the long standing borrower.

The Company does not consider its mortgage loans to be a separate portfolio segment. The Company considers its primary class to be property type and primarily uses loan-to-value as its credit risk quality indicator. All loans within the portfolio 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 would indicate a potential problem are: major tenant vacancies or bankruptcies, late payments, and loan relief/restructuring requests. The mortgage loan portfolio is analyzed for the need for a valuation allowance on any loan that is on the internal watch list, in the process of foreclosure or that currently has a valuation allowance.

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

The following table represents the mortgage loan allowance.

	September 30, 2014	December 31, 2013

	(In thousands)	
Balance, beginning of period	$650	650
Provision	—	—
Releases	—	—
Balance, end of period	$650	650

35

Table of Contents

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

(10) FAIR VALUES OF FINANCIAL INSTRUMENTS

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

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

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

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

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

Table of Contents

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

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

	September 30, 2014			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale	$2,707,265	—	2,707,265	—
Equity securities, available for sale	17,615	16,405	1,210	—
Derivatives, index options	109,812	—	—	109,812
Total assets	$2,834,692	16,405	2,708,475	109,812
Policyholder account balances (a)	$127,622	—	—	127,622
Other liabilities (b)	7,704	—	—	7,704
Total liabilities	$135,326	—	—	135,326

During the three and nine months ended September 30, 2014, the Company had no transfers into or out of Levels 1, 2 or 3.

	December 31, 2013			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale	$2,636,666	—	2,636,666	—
Equity securities, available for sale	14,878	13,802	1,076	—
Derivatives, index options	169,314	—	—	169,314
Total assets	$2,820,858	13,802	2,637,742	169,314
Policyholder account balances (a)	$187,399	—	—	187,399
Other liabilities (b)	5,939	—	—	5,939
Total liabilities	$193,338	—	—	193,338

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

Table of Contents

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

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

	September 30, 2014			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale:				
Priced by third-party vendors	$2,707,265	—	2,707,265	—
Priced internally	—	—	—	—
Subtotal	2,707,265	—	2,707,265	—
Equity securities, available for sale:				
Priced by third-party vendors	17,615	16,405	1,210	—
Priced internally	—	—	—	—
Subtotal	17,615	16,405	1,210	—
Derivatives, index options:				
Priced by third-party vendors	109,812	—	—	109,812
Priced internally	—	—	—	—
Subtotal	109,812	—	—	109,812
Total	$2,834,692	16,405	2,708,475	109,812
Percent of total	100.0 %	0.6 %	95.5 %	3.9 %

	December 31, 2013			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale:				
Priced by third-party vendors	$2,636,666	—	2,636,666	—
Priced internally	—	—	—	—
Subtotal	2,636,666	—	2,636,666	—
Equity securities, available for sale:				
Priced by third-party vendors	14,878	13,802	1,076	—
Priced internally	—	—	—	—
Subtotal	14,878	13,802	1,076	—
Derivatives, index options:				
Priced by third-party vendors	169,314	—	—	169,314
Priced internally	—	—	—	—
Subtotal	169,314	—	—	169,314

Total	$2,820,858	13,802	2,637,742	169,314
Percent of total	100.0 %	0.5 %	93.5 %	6.0 %

38

Table of Contents

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

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

	For the Three Months Ended September 30, 2014				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Balance at July 1, 2014	$—	—	146,514	146,514	171,428
Total realized and unrealized gains (losses):					
Included in net income	—	—	3,479	3,479	4,099
Included in other comprehensive income	—	—	—	—	—
Purchases, sales, issuances and settlements, net			(40,181)	(40,181)	(40,201)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	109,812	109,812	135,326
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	$—	—	747	747	—
Other operating expenses	—	—	—	—	175
Total	$—	—	747	747	175

Table of Contents

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

	For the Three Months ended September 30, 2013				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Balance at July 1, 2013	$—	—	—	—	4,370
Total realized and unrealized gains (losses):					
Included in net income	—	—	—	—	1,010
Included in other comprehensive income	—	—	—	—	—
Purchases, sales, issuances and settlements, net	—	—	—	—	(827)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	—	—	4,553
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	$—	—	—	—	—
Other operating expenses	—	—	—	—	1,601
Total	$—	—	—	—	1,601

	Nine Months Ended September 30, 2014				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Beginning balance, January 1, 2014	$—	—	169,314	169,314	193,338
Total realized and unrealized gains (losses):					
Included in net income	—	—	49,278	49,278	51,529
Included in other comprehensive income	—	—	—	—	—
Purchases, sales, issuances and settlements, net	—	—	(108,780)	(108,780)	(109,541)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	109,812	109,812	135,326
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	$—	—	29,895	29,895	—

Other operating expenses	—	—	—	—	3,266
Total	$—	—	29,895	29,895	3,266

40

Table of Contents

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

	Nine Months Ended September 30, 2013				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Beginning balance, January 1, 2013	$—	—	—	—	2,718
Total realized and unrealized gains (losses):					
Included in net income	—	—	—	—	3,976
Included in other comprehensive income	—	—	—	—	—
Purchases, sales, issuances and settlements, net	—	—	—	—	(2,141)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	—	—	4,553
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	$—	—	—	—	—
Other operating expenses	—	—	—	—	5,343
Total	$—	—	—	—	5,343

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

	September 30, 2014		
	Fair Value	Valuation Technique	Unobservable Input
	(In thousands)		
Derivatives, index options	$109,812	Broker prices	Implied volatility Inputs from broker proprietary models
Total assets	$109,812		
Policyholder account balances	$127,622	Deterministic cash flow model	Projected option cost
Other liabilities	7,704	Black Scholes	Expected term Forfeiture assumptions
Total liabilities	$135,326		

Table of Contents

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

	December 31, 2013 Fair Value (In thousands)	Valuation Technique	Unobservable Input
Derivatives, index options	$169,314	Broker prices	Implied volatility Inputs from broker proprietary models
Total assets	$169,314		
Policyholder account balances	$187,399	Deterministic cash flow model	Projected option cost
Other liabilities	5,939	Black Scholes	Expected term Forfeiture assumptions
Total liabilities	$193,338		

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

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

Table of Contents

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

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

	September 30, 2014				
			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	$6,898,038	7,195,441	—	7,195,441	—
Securities available for sale	2,724,880	2,724,880	16,405	2,708,475	—
Cash and short-term investments	121,482	121,482	121,482	—	—
Mortgage loans	152,740	159,845	—	—	159,845
Policy loans	63,746	63,746	—	—	63,746
Other loans	2,318	2,462	—	—	2,462
Derivatives, index options	109,812	109,812	—	—	109,812
Life interest in Libbie Shearn Moody Trust	—	12,775	—	—	12,775
LIABILITIES					
Deferred annuity contracts	$7,471,884	7,102,374	—	—	7,102,374
Immediate annuity and supplemental contracts	448,892	472,485	—	—	472,485

	December 31, 2013				
			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	$6,510,320	6,656,144	—	6,656,144	—
Securities available for sale	2,651,544	2,651,544	13,802	2,637,742	—
Cash and short-term investments	120,859	120,859	120,859	—	—
Mortgage loans	132,765	138,159	—	—	138,159
Policy loans	65,969	65,969	—	—	65,969
Other loans	2,986	3,143	—	—	3,143
Derivatives, index options	169,314	169,314	—	—	169,314
Life interest in Libbie Shearn Moody Trust	—	12,775	—	—	12,775
LIABILITIES					
Deferred annuity contracts	$7,288,861	6,941,902	—	—	6,941,902
Immediate annuity and supplemental contracts	463,276	483,690	—	—	483,690

43

Table of Contents

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 Sheet. The remaining portions of these policy contracts are considered the host contracts and are recorded separately as fixed annuity or universal life contracts. The host contracts are accounted for under debt instrument type accounting in which future policy benefits are recorded as discounted debt instruments that are accreted, using the effective yield method, to their minimum account values at their projected maturities or termination dates.

The Company purchases over-the-counter index options, which are derivative financial instruments, to hedge the equity return component of its fixed-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.

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.

Table of Contents

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

The tables below present the fair value of derivative instruments as of September 30, 2014 and December 31, 2013, respectively.

	September 30, 2014			
	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
		(In thousands)		(In thousands)
Derivatives not designated as hedging instruments				
Equity index options	Derivatives, Index Options	$109,812		
Fixed-index products			Universal Life and Annuity Contracts	$127,622
Total		$109,812		$127,622

	December 31, 2013			
	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
		(In thousands)		(In thousands)
Derivatives not designated as hedging instruments				
Equity index options	Derivatives, Index Options	$169,314		
Fixed-index products			Universal Life and Annuity Contracts	$187,399
Total		$169,314		$187,399

Table of Contents

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

The table below presents the effect of derivative instruments in the Condensed Consolidated Statements of Earnings for the three months ended September 30, 2014 and 2013.

Derivatives Not Designated As Hedging Instruments	Location of Gain or (Loss) Recognized In Income on Derivatives	September 30, 2014	September 30, 2013
		Amount of Gain or (Loss) Recognized in Income on Derivatives (In thousands)	
Equity index options	Net investment income	$3,479	35,615
Fixed-index products	Universal life and annuity contract interest	(4,033)	(36,857)
		$(554)	(1,242)

The table below presents the effect of derivative instruments in the Condensed Consolidated Statement of Earnings for the nine months ended September 30, 2014 and 2013.

Derivatives Not Designated As Hedging Instruments	Location of Gain or (Loss) Recognized In Income on Derivatives	September 30, 2014	September 30, 2013
		Amount of Gain or (Loss) Recognized in Income on Derivatives (In thousands)	
Equity index options	Net investment income	$49,278	126,739
Fixed-index products	Universal life and annuity contract interest	(49,003)	(129,625)
		$275	(2,886)

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

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

There have been no changes in the Company's internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(e) under the Exchange Act) during the quarter ended September 30, 2014 that have 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.

Table of Contents

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

FORWARD-LOOKING STATEMENTS

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

Management's discussion and analysis of the financial condition and results of operations (“MD&A”) of National Western Life Insurance Company for the three and nine months ended September 30, 2014 follows. This discussion should be read in conjunction with the Company's condensed consolidated financial statements and related notes beginning on page 3 of this report and with the 2013 Annual Report filed on Form 10-K with the SEC.

Overview

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

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

- the level of sales and premium revenues collected
- persistency of policies and contracts
- returns on investments sufficient to produce acceptable spread margins over interest crediting rates
- investment credit quality which minimizes the risk of default or impairment
- levels of policy benefits and costs to acquire business
- the level of operating expenses
- effect of interest rate changes on revenues and investments including asset and liability matching
- maintaining adequate levels of capital and surplus
- actual levels of surrenders, withdrawals, claims and interest spreads
- 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 in 2014, incorporating required disclosures in accordance with the rules and regulations of the Securities and Exchange Commission.

Table of Contents

Insurance Operations - Domestic

The Company is currently licensed to do business in all states and the District of Columbia except for New York. Products marketed are annuities, universal life insurance, 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 as tax qualified or nonqualified products. At September 30, 2014, the Company maintained approximately 139,100 annuity contracts in force and 56,200 domestic life insurance policies in force representing $3.0 billion in face amount of coverage.

National Western markets and distributes its domestic products primarily through independent national marketing organizations ("NMOs"). These NMOs assist the Company in recruiting, contracting, and managing independent agents. The Company's agents are independent contractors who are compensated on a commission basis. The Company currently has approximately 17,900 domestic independent agents contracted. Roughly 15% of these contracted agents have submitted policy applications to the Company in the past twelve months.

Insurance Operations - International

The Company's international clientèle consists mainly of foreign nationals in upper socioeconomic classes. Insurance products are issued primarily to residents of countries in Central and South America, the Caribbean, Eastern Europe, Asia and the Pacific Rim based upon applications received in the Company's home office in Austin, Texas. Issuing policies to residents of countries in these different regions provides diversification that helps to minimize large fluctuations that could arise due to various economic, political, and competitive pressures that may occur from one country to another. Products issued to international residents are almost entirely universal life and traditional life insurance products. However, certain annuity and investment contracts are also available. At September 30, 2014, the Company had approximately 70,800 international life insurance policies in force representing approximately $19.7 billion in face amount of coverage.

International applications are submitted by independent contractor consultants and broker-agents. The Company has approximately 2,200 independent international consultants and brokers currently contracted, 43% of which have submitted policy applications to the Company in the past twelve months.

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

Table of Contents

SALES

Life Insurance

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
International:				
Universal life	$935	1,143	3,135	3,366
Traditional life	854	731	2,724	2,298
Equity-index life	3,785	5,452	10,327	11,051
	5,574	7,326	16,186	16,715
Domestic:				
Universal life	23	42	89	201
Traditional life	(38)	12		