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

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2009

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

For the transition period from __________ to __________

Commission File Number: 2-17039

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

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes þ 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 þ 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 þ

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

TABLE OF CONTENTS

2

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

See accompanying notes to condensed consolidated financial statements.

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
For the Three Months Ended September 30, 2009 and 2008
(Unaudited)
(In thousands, except per share amounts)

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

Class B	$	(0.16)	(1.39)

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
For the Nine Months Ended September 30, 2009 and 2008
(Unaudited)
(In thousands, except per share amounts)

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

Class B	$	4.65	3.23

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

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

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

Continued on next page

Table of Contents

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

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

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

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

(Continued on next page)

Table of Contents

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

		2009	2008
Cash flows from financing activities:			
Deposits to account balances for universal life			
and annuity contracts	$	611,163	346,119
Return of account balances on universal life			
and annuity contracts		(430,243)	(441,195)
Issuance of common stock under stock option plan		-	448
Net cash provided by (used in) financing activities		180,920	(94,628)
Effect of foreign exchange		(14)	(412)
Net decrease in cash and short-term investments		(32,127)	(10,355)
Cash and short-term investments at beginning of period		67,796	45,206
Cash and short-term investments at end of period	$	35,669	34,851
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the period for:			
Interest	$	30	30
Income taxes		22,757	10,504
Noncash operating activities:			
Net change in deferral of sales inducements		15,984	13,148

See accompanying notes to condensed consolidated financial statements.

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”) as of September 30, 2009, and the results of its operations and its cash flows for the three and nine months ended September 30, 2009 and 2008. The results of operations for the nine months ended September 30, 2009 and 2008 are not necessarily indicative of the results to be expected for the full year. It is recommended that these condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 accessible free of charge through the Company's internet site at www.nationalwesternlife.com or the Securities and Exchange Commission internet site at www.sec.gov. The condensed consolidated balance sheet at December 31, 2008, has been derived from the audited consolidated financial statements as of that date. Certain amounts in the prior year condensed consolidated financial statements have been reclassified to conform to the current year presentation.

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

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

(2) NEW ACCOUNTING PRONOUNCEMENTS

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

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

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

Continued on Next Page

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

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

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

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

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

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

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

On April 9, 2009 the FASB issued new guidance to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. It was effective for the Company as of June 30, 2009 and did not have a significant impact on the consolidated financial position or results of operations. See Note 10 for additional disclosures.

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

Continued on Next Page

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

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

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

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

(3) STOCKHOLDERS' EQUITY

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

Change in Accounting Principles

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

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

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

Continued on Next Page

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

Continued on Next Page

Table of Contents

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

Earnings per Share (continued)

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

Continued on Next Page

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 comply with the minimum funding provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). On October 19, 2007, the Company's Board of Directors approved an amendment to freeze the Pension Plan as of December 31, 2007. The freeze ceased future benefit accruals to all participants and closed the Plan to any new participants. In addition, all participants became immediately 100% vested in their accrued benefits as of that date. Fair values of plan assets and liabilities are measured as of the prior December 31 for each respective year. The following summarizes the components of net periodic benefit cost.

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

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

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

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

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

Continued on Next Page

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

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

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

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

(B) Defined Contribution Pension Plans

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

(C) Defined Benefit Postretirement Plans

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

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

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

Continued on Next Page

Table of Contents

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

Selected Segment Information:

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

Continued on Next Page

Table of Contents

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

Selected Segment Information (continued):

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

Continued on Next Page

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

Selected Segment Information (continued):

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

Continued on Next Page

Table of Contents

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

Selected Segment Information (continued):

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

Continued on Next Page

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, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
	(In thousands)			
Premiums and Other Revenue:				
Premiums and contract revenues	$ 41,390	36,942	127,343	111,271
Net investment income	116,276	69,582	280,625	201,290
Other income	5,086	3,056	12,187	9,348
Realized gains (losses) on investments	57	(21,620)	(5,122)	(21,931)
Total consolidated premiums and other revenue	$ 162,809	87,960	415,033	299,978

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

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

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

Continued on Next Page

Table of Contents

(7) SHARE-BASED PAYMENTS

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

All of the employees of the Company and its subsidiaries are eligible to participate in the two Plans. In addition, directors of the Company are eligible to receive the same types of awards as employees except that they are not eligible to receive incentive stock options. Company directors, including members of the Compensation and Stock Option Committee, are eligible for nondiscretionary stock options. The directors' grants vest 20% annually following one full year of service to the Company from the date of grant. The employees' grants vest 20% annually following three full years of service to the Company from the date of grant. All grants issued expire after ten years. On February 19, 2009, the Company awarded 29,393 stock appreciation rights to Company officers and 9,000 stock appreciation rights to Company directors at a market value price of $114.64. During the third quarter of 2008, 2,750 stock appreciation rights were awarded to specified Company officers. Quantities awarded and market value prices on the dates of award are: (1) August 21, 2008, 1,250 awards at $236.00 (2) September 2, 2008, 1,000 awards at $251.49; and, (3) September 22, 2008, 500 awards at $256.00.

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

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

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

		Options Outstanding	
	Shares Available For Grant	Shares	Weighted-Average Exercise Price

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

Continued on Next Page

Table of Contents

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

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

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

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

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

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

Continued on Next Page

Table of Contents

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

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

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

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

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

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

(8) COMMITMENTS AND CONTINGENICES

(A) Legal Proceedings

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

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

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

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

Continued on Next Page

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

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

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

(9) INVESTMENTS

(A) Investment Gains and Losses

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

		Three months ended September 30,		Nine months ended September 30,	
		2009	2008	2009	2008
		(In thousands)			
Available for sale debt securities:					
Realized gains on disposal	$	63	106	209	992
Realized losses on disposal		-	-	(180)	-
Held to maturity debt securities:					
Realized gains on disposal		87	4	201	154
Realized losses on disposal		-	-	(19)	-
Equity securities realized gains		1	39	63	118
Real estate writedown		-	-	(52)	-
Mortgage loans writedowns		-	-	(12)	(4)
Other		-	(134)	69	(106)
Totals	$	151	15	279	1,154

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

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

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

Continued on Next Page

Table of Contents

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

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

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

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

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

Continued on Next Page

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 cost and fair values of securities held to maturity at September 30, 2009.

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

Continued on Next Page

Table of Contents

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

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

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

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

Continued on Next Page

Table of Contents

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

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

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

Continued on Next Page

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

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

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

Continued on Next Page

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

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

	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:						
U.S. Agencies	$ -	-	-	-	-	-
U.S. Treasury	-	-	-	-	-	-
State and political subdivisions	5,087	22	2,785	26	7,872	48
Foreign governments	-	-	-	-	-	-
Public utilities	6,965	50	22,128	820	29,093	870
Corporate bonds	91,530	548	291,240	31,585	382,770	32,133
Mortgage-backed	-	-	59,076	2,749	59,076	2,749
Home equity	3,419	331	14,466	6,890	17,885	7,221
Manufactured housing	1,431	146	7,340	1,103	8,771	1,249
Total	$ 108,432	1,097	397,035	43,173	505,467	44,270

Continued on Next Page

Table of Contents

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

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

		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:						
U. S. Agencies	$ -	-	-	-	-	-
U.S. Treasury	-	-	-	-	-	-
State and political subdivisions	-	-	19,676	965	19,676	965
Foreign governments	-	-	-	-	-	-
Public utilities	-	-	23,340	789	23,340	789
Corporate bonds	31,850	2,554	252,247	21,686	284,097	24,240
Mortgage-backed	-	-	22,608	4,175	22,608	4,175
Home equity	-	-	8,964	4,835	8,964	4,835
Manufactured housing	-	-	202	1	202	1
Total debt securities	31,850	2,554	327,037	32,451	358,887	35,005
Equity securities - public	1,931	105	743	183	2,674	288
Total	$ 33,781	2,659	327,780	32,634	361,561	35,293

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

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

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

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

Continued on Next Page

Table of Contents

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

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

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

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

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

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

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

		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:							
U.S. Agencies	$	-	-	-	-	-	-
U.S. Treasury		-	-	-	-	-	-
State and political subdivisions		9,687	631	2,635	170	12,322	801
Foreign governments		-	-	-	-	-	-

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

Continued on Next Page

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

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

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

Continued on Next Page

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

(C) Transfer of Securities

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

(10) FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the Company adopted FASB guidance which defines fair value, establishes a framework for measuring fair value under GAAP, and requires additional disclosures about fair value measurements.

In compliance with FASB ASC 820, the Company has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three level hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure fair value fall within different levels of the hierarchy, the category level is based on the lowest priority level input that is significant to the fair value measurement of the instrument.

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

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

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

Level 3: Fair value is based on significant unobservable inputs which reflect the entity's or third party pricing service assumptions about the assumptions market participants would use in pricing an asset or liability. The Company's Level 3 assets include certain equity securities and certain less liquid or private fixed maturity debt securities where significant valuation inputs cannot be corroborated with observable market data. The Company's Level 3 liabilities consist of share-based compensation obligations. Valuations are estimated based on non-binding broker prices or internally developed valuation models or methodologies, discounted cash flow models and other similar techniques.

Continued on Next Page

Table of Contents

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

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

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

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

(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.

Continued on Next Page

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

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

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

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

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

Continued on Next Page

Table of Contents

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

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

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

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

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

Realized gains (losses) on debt and equity securities are reported in the consolidated statements of earnings as net investment gains (losses), unrealized gains (losses) on available for sale debt and equity securities are reported as other comprehensive income (loss) within stockholders' equity.

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

Continued on Next Page

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

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

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

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

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

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

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

Continued on Next Page

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

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

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

(11) RELATED PARTY TRANSACTIONS

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

(12) DERIVATIVE INVESTMENTS

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

The Company purchases over-the-counter index options, which are derivative financial instruments, to hedge the equity return component of its fixed-indexed annuity and life products. The index options act as hedges to match closely the returns on the underlying index or indices. The amounts which may be credited to policyholders are linked, in part, to the returns of the underlying index or indices. As a result, changes to policyholders' liabilities are substantially offset by changes in the value of the options. Cash is exchanged upon purchase of the index options and no principal or interest payments are made by either party during the option periods. Upon maturity or expiration of the options, cash may be paid to the Company depending on the underlying index or indices performance and terms of the contract.

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

Continued on Next Page

Table of Contents

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

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

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

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

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

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

Continued on Next Page

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 statement of earnings for the nine months ended September 30, 2009.
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Derivatives Not Designated as Hedging Instruments Under SFAS No. 133	Location of Gain or (Loss) Recognized In Income on Derivatives		Amount of Gain or (Loss) Recognized In Income on Derivatives (In thousands)
Equity index options	Net investment income	$	23,766
Fixed-indexed products	Universal life and annuity contract interest		(35,762)
		$	(11,996)

(13) SUBSEQUENT EVENTS

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

Table of 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 ("Company") or its subsidiaries is or may be viewed as forward-looking. Although the Company has taken appropriate care in developing any such information, forward-looking information involves risks and uncertainties that could significantly impact actual results. These risks and uncertainties include, but are not limited to, matters described in the Company's SEC filings such as exposure to market risks, anticipated cash flows or operating performance, future capital needs, and statutory or regulatory related issues. However, the Company, as a matter of policy, does not make any specific projections as to future earnings, nor does it endorse any projections regarding future performance that may be made by others. Whether or not actual results differ materially from forward-looking statements may depend on numerous foreseeable and unforeseeable events or developments. Also, the Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future developments, or otherwise.

Management's discussion and analysis of financial condition and results of operations ("MD&A") of National Western Life Insurance Company for the three and nine months ended September 30, 2009 follows. This discussion should be read in conjunction with the Company's condensed consolidated financial statements and related notes beginning on page 3 of this report.

Overview

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

Due to the business of accepting funds to pay future obligations in later years, the underlying economics and relevant factors affecting the life insurance industry include the following:

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

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

Insurance Operations - Domestic

The Company is currently licensed to do business in all states except for New York. Products marketed are annuities, universal life insurance, fixed-indexed annuities and fixed-indexed universal life, and traditional life insurance, which include both term and whole life products. The Company's domestic sales have historically been more heavily weighted toward annuity products, which include single and flexible premium deferred annuities, single premium immediate annuities, and fixed-indexed annuities. Most of these annuities can be sold as tax qualified or nonqualified products. At September 30, 2009, the Company maintained approximately 119,000 annuity policies in force.

Table of Contents

The Company markets and distributes its domestic products primarily through independent national marketing organizations ("NMOs"). These NMOs assist the Company in recruiting, contracting, and managing independent agents. The Company currently has approximately 6,500 independent agents contracted. Roughly 29% of these contracted agents have submitted policy applications to the Company in the past twelve months.

Insurance Operations - International

The Company's international operations focus on foreign nationals in upper socioeconomic classes. Insurance products are issued primarily to residents of countries in Central and South America, the Caribbean, Eastern Europe, Asia and the Pacific Rim. Issuing policies to residents of countries in these different regions provides diversification that helps to minimize large fluctuations that could arise due to various economic, political, and competitive pressures that may occur from one country to another. Products issued to international residents are almost entirely universal life and traditional life insurance products. However, certain annuity and investment contracts are also available. At September 30, 2009, the Company had approximately 71,900 international life insurance policies in force representing approximately $15.8 billion in face amount of coverage.

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

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

SALES

Life Insurance

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

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

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

47

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

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

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

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

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

The Company's international life business consists of applications submitted from residents in various regions outside of the United States, the volume of which typically varies based upon changes in the socioeconomic climates of these regions. Historically, the Company has experienced a simultaneous combination of rising and declining sales from residents in various countries; however, the appeal of the Company's dollar-denominated life insurance products overcomes many of the local and national difficulties. In the “financial crisis” economic climate of the past 18 to 24 months, individuals in countries outside of the United States have become increasingly leery of the U.S. economy and the stability of financial institutions and markets. These concerns have manifested in the past several quarters via reduced international sales.

Applications submitted from residents of Latin America and the Pacific Rim perennially have comprised the majority of the Company's international life insurance sales. Over the past few years, new sales efforts were directed toward the sale of a traditional endowment form of life insurance product for residents of Eastern European and the Commonwealth of Independent States (former Soviet Union). While these territories initially demonstrated solid growth potential recent activity has been more muted. As noted previously, the Company’s international sales by geographic market tend to fluctuate with the socio and economic climates in these regions. The Company’s mix of international sales by geographic region is as follows.

Table of Contents

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

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

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

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

Annuities

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

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

Totals	$	237,612	89,462	575,320	293,611

Table of Contents

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

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

The Company's mix of annuity sales tends to shift with interest rate levels and the relative performance of the equity market. Over the past several years, sales of fixed-indexed products have consistently accounted for more than one-half of all annuity sales and were 62% of annuity activity during the first nine months of 2009. For all fixed-indexed products, the Company purchases over the counter options to hedge the equity return feature. The options are purchased relative to the issuance of the annuity contracts in such a manner to minimize timing risk. Generally, the index return during the indexing period (if the underlying index increases) becomes a component in a formula (set forth in the annuity), the result of which is credited as interest to contract holders electing the index formula crediting method at the beginning of the indexing period. The formula result can never be less than zero with these products. The Company does not deliberately mismatch or under hedge for the equity feature of the products. Fixed-indexed products also provide the contractholder the alternative to elect a fixed interest rate crediting option. With the performance of the equity markets over the past two years, an increasing percentage of fixed-indexed contractholders have elected this crediting option.

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

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

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

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

Table of Contents

Critical Accounting Policies

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

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

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

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

Deferred Sales Inducements. Costs related to sales inducements offered on sales to new customers, principally on investment type contracts and primarily in the form of additional credits to the customer’s account value or enhancements to interest credited for a specified period, which are beyond amounts currently being credited to existing contracts, are deferred and recorded as other assets. All other sales inducements are expensed as incurred and included in interest credited to contract holders' funds. Deferred sales inducements are amortized to income using the same methodology and assumptions as DAC, and are included in interest credited to contract holders' funds. Deferred sales inducements are periodically reviewed for recoverability.

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

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

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

Pension Plans and Other Postretirement Benefits. The Company sponsors a qualified defined benefit pension plan, covering substantially all employees, which was frozen effective December 31, 2007, and three nonqualified defined benefit plans covering certain senior officers. In addition, the Company has postretirement health care benefits for certain senior officers. The freeze of the qualified benefit pension plan ceased future benefit accruals to all participants and closed the Plan to any new participants. In addition, all participants became immediately 100% vested in their accrued benefits as of that date. In accordance with prescribed accounting standards, the Company annually reviews plan assumptions.

The Company annually reviews its pension benefit plans assumptions which include the discount rate, the expected long-term rate of return on plan assets, and the compensation increase rate. The assumed discount rate is set based on the rates of return on high quality long-term fixed income investments currently available and expected to be available during the period to maturity of the pension benefits. The assumed long-term rate of return on plan assets is generally set at the rate expected to be earned based on the long-term investment policy of the plans, the various classes of the invested funds, based on the input of the plan’s investment advisors and consulting actuary, and the plan’s historic rate of return. The compensation rate increase assumption is generally set at a rate consistent with current and expected long-term compensation and salary policy, including inflation. These assumptions involve uncertainties and judgment, and therefore actual performance may not be reflective of the assumptions.

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

Table of Contents

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

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

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

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

Impact of Recent Business Environment

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

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

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

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

Table of Contents

RESULTS OF OPERATIONS

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

Consolidated Operations

Revenues. The following details Company revenues.

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

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

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

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

Table of Contents

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

	Three Months Ended September 30,		Nine Months Ended September 30,
	2009	2008	2009