KANSAS CITY LIFE INSURANCE CO
Form 10-K
February 28, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012 or
¨ 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 1-33348
KANSAS CITY LIFE INSURANCE COMPANY
(Exact name of registrant as specified in its charter)

Missouri	44-0308260
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3520 Broadway, Kansas City, Missouri	64111-2565
(Address of principal executive offices)	(Zip Code)

816-753-7000
Registrant's telephone number, including area code
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
$1.25 par value common stock	NASDAQ Capital Market LLC

Securities registered pursuant to section 12(g) of the Act:
None
(Title of class)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x

Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes ¨ No x

At December 31, 2012, 11,032,857 shares of Kansas City Life Insurance Company's common stock par value $1.25 were outstanding, and the aggregate market value of the common stock (based upon the average of bid and ask price according to Company records) on June 30, 2012 of Kansas City Life Insurance Company held by non-affiliates was approximately $107,694,760.

Documents incorporated by reference: Portions of the registrant's definitive proxy statement relating to its 2013 annual meeting of shareholders (the “2013 Proxy Statement”) are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated. The 2013 Proxy Statement will be filed with the U.S. Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates.

Table of Contents

KANSAS CITY LIFE INSURANCE COMPANY

TABLE OF CONTENTS

Table of Contents

PART I

Item 1. Business

Amounts are stated in thousands, except share data, or as otherwise noted.

General

Kansas City Life Insurance Company (Kansas City Life) was incorporated under the assessment laws of Missouri in 1895 as the Bankers Life Association. In 1900, its present corporate title was adopted and it was reorganized as a stock life insurance company in 1903. Kansas City Life operates in 48 states and the District of Columbia.

Kansas City Life, the parent company, and wholly owned insurance subsidiaries Sunset Life Insurance Company of America (Sunset Life) and Old American Insurance Company (Old American), comprise the consolidated entity (the Company). The Company offers investment and broker-dealer services through its subsidiary Sunset Financial Services (SFS) for both proprietary and non-proprietary variable insurance products, mutual funds and other securities. The Company also has several non-insurance subsidiaries that individually and collectively are not material.

In 1974, the Company acquired Sunset Life in a stock acquisition transaction. Sunset Life is a life insurance company that was organized in 1937 that marketed and sold business in the western region of the United States. In 2006, the Sunset Life sales force was integrated into the Kansas City Life sales force by appointing Sunset Life agents as agents of Kansas City Life. All of Sunset Life's operations, administration, and accounting are consolidated as part of the Company's home office operations. Sunset Life maintains its closed block of business, but does not solicit new sales. Sunset Life is included in the Individual Insurance segment and its individual insurance products include traditional life, immediate annuity, and interest sensitive products, including universal life and fixed deferred annuity products. Sunset Life operates in 43 states and the District of Columbia.

In 1991, the Company acquired Old American in a stock acquisition transaction. Old American is a life insurance company that was organized in 1939. Old American sells final expense traditional life insurance products primarily to the senior market, as well as a term product targeted at younger individuals. These products are marketed nationwide through a general agency system with exclusive territories, using direct response marketing to supply agents with leads. Old American's administrative and accounting operations are part of the Company's home office, but it operates and maintains a separate and independent field force and is identified as a separate segment. Old American operates in 47 states and the District of Columbia.

In 1997, the Company entered into a coinsurance assumption and servicing agreement with another insurer to acquire a block of traditional life and universal life products. Under this agreement, the Company assumed the policy liabilities as defined in the contract. Investments equal to the policy reserves are held in a trust to secure payment of the estimated liabilities relating to the policies. This closed block of policies continues to make a significant contribution to the Company's results, which are included in the Individual Insurance segment.

In 2003, the Company acquired GuideOne Life Insurance Company (GuideOne). GuideOne principally marketed traditional life and annuity products, as well as universal life and fixed deferred annuity products. In addition, the Company entered into a marketing arrangement with GuideOne Mutual Insurance Company, which allows GuideOne Mutual's agents to sell the Company's various traditional, interest sensitive, and variable life and annuity products. Subsequent to the purchase, the Company merged GuideOne into Kansas City Life as a closed block of policies.

In 2006, the Company entered into a Master General Agent and Marketing Agreement which enables American Republic Insurance Company (American Republic) agents to market Kansas City Life's insurance products. This agreement offers the Company additional distribution opportunities, while offering American Republic's agents competitive life and annuity products to strengthen their portfolio of available products in which to serve their clients.

Business Segments

The Company has three reportable business segments, which are generally defined based on the nature of the products and services offered: Individual Insurance, Group Insurance, and Old American.

The Individual Insurance segment consists of individual insurance products for both Kansas City Life and Sunset Life. The Individual Insurance segment generated approximately 49% of consolidated insurance revenues for the year ended December 31, 2012, compared to 48% and 54% for the years ended December 31, 2011 and 2010, respectively.

The Group Insurance segment is operated as part of Kansas City Life and its administrative and accounting operations are part of the Company's home office. This segment generated 21% of consolidated insurance revenues for the year ended December 31, 2012 compared to 22% and 20% for the years ended December 31, 2011 and 2010, respectively.

Table of Contents

The Old American segment accounted for 30% of consolidated insurance revenues for the years ended December 31, 2012 and 2011, compared to 26% for the year ended December 31, 2010.

For more information concerning the Company's business segments, please see Note 18 - Segment Information in the Notes to Consolidated Financial Statements and the Operating Results by Segment Section in Management's Discussion and Analysis of Financial Condition and Results of Operations.

Products, Marketing and Distribution

The Company markets individual life insurance and annuity products, including traditional, interest sensitive, and variable products through its sales force and third-party marketing arrangements, as identified below. The interest sensitive products are universal life, variable universal life, fixed deferred annuities, and variable annuities. The group products marketed by the Company include life, dental, vision, and long-term and short-term disability. The Company offers investment products and broker-dealer services through SFS for both proprietary and non-proprietary variable life insurance and annuity products, mutual funds, and other securities.

The following table details the Company's gross premiums and deposits by product for the years ended December 31.

	2012	% of Total		2011	% of Total	
Individual life insurance	$117,834	28	%	$115,316	27	%
Immediate annuities	12,497	3	%	7,151	2	%
Group life insurance	10,971	3	%	10,701	3	%
Group accident & health insurance	51,030	12	%	50,507	12	%
Other	1,060	—	%	1,335	—	%
Total premiums	193,392	46	%	185,010	44	%
Universal life insurance	96,776	23	%	95,946	23	%
Variable universal life insurance	10,984	3	%	11,682	3	%
Fixed deferred annuities	93,432	22	%	100,646	24	%
Variable annuities	26,640	6	%	25,681	6	%
Total deposits	227,832	54	%	233,955	56	%
Total	$421,224	100	%	$418,965	100	%

The following table provides the geographic distribution of gross premiums and deposits by state greater than 5% of the total for the years ended December 31.

	2012			2011	
Missouri	8	%	Missouri	9	%
Texas	7	%	Texas	7	%
California	6	%	Kansas	6	%
Kansas	6	%	California	6	%
Colorado	6	%	Colorado	5	%
Florida	5	%	All others	67	%
All others	62	%	Total	100	%
Total	100	%			

Individual Insurance

The Individual Insurance segment is comprised of sales of non-group products from Kansas City Life and the closed blocks of Sunset Life, GuideOne Life, and the reinsurance transaction originated in 1997. This segment also includes sales from third-party marketing arrangements, including American Republic and GuideOne Mutual. This segment offers an array of traditional whole life, term life, and universal life products, along with fixed deferred and immediate annuity products, and variable universal life and annuity products.

Products are marketed through a nationwide sales force of independent general agents, agents, and third-party marketing arrangements. These general agents and agents are contracted individually and are not exclusive with Kansas City Life. The

Table of Contents

Company does not restrict general agents or agents to designated sales territories. Kansas City Life provides commissions and allowances based on sales results. In addition, the Company has had selected occasions to use additional third-party arrangements for product specific or market niche sales opportunities.

Kansas City Life offers a portfolio of life insurance products for individuals. Universal life products have the ability to deliver flexibility in coverage and competitive long-term cash values or premiums that guarantee coverage for a desired period or through the insured's lifetime. Kansas City Life also offers variable universal life products that allow the policyholder to participate in the equity markets. Variable universal life combines the advantages of a range of investment options with life insurance. In addition, Kansas City Life offers traditional whole life products, products geared towards juveniles that offer additional coverage as the child ages, and term life insurance products for a wide range of ages and coverage.

Kansas City Life offers multiple fixed deferred annuity products. In addition, Kansas City Life offers immediate annuity products with a broad variety of payout options, including guaranteed specified amounts and life contingencies. Kansas City Life also offers variable annuity products which allow the policyholder to participate in equity market growth potential. These options include either single or flexible-premium contracts combined with the advantages of a range of investment options and the advantages of an annuity.

Finally, in both the individual life insurance products and annuity products, selected riders are also available for added coverage and protection.

The following table details gross premiums and deposits by product for the Individual Insurance segment for the years ended December 31.

	2012	% of Total		2011	% of Total	
Individual life insurance	$46,262	16	%	$46,597	16	%
Immediate annuities	12,497	4	%	7,151	3	%
Other	285	—	%	405	—	%
Total premiums	59,044	20	%	54,153	19	%
Universal life insurance	96,776	34	%	95,946	33	%
Variable universal life insurance	10,984	4	%	11,682	4	%
Fixed deferred annuities	93,432	33	%	100,646	35	%
Variable annuities	26,640	9	%	25,681	9	%
Total deposits	227,832	80	%	233,955	81	%
Total	$286,876	100	%	$288,108	100	%

The following table provides the geographic distribution of gross premiums and deposits by state greater than 5% of the total for the Individual Insurance segment for the years ended December 31.

	2012			2011	
California	7	%	Missouri	9	%
Missouri	7	%	Kansas	7	%
Colorado	7	%	Colorado	7	%
Florida	7	%	California	7	%
Kansas	6	%	Texas	6	%
Texas	6	%	Washington	5	%
Washington	5	%	Iowa	5	%
All others	55	%	All others	54	%
Total	100	%	Total	100	%

Table of Contents

Closed Blocks

The Company has closed blocks of business that are primarily from three sources. First, the Company has sizeable blocks of business obtained through the acquisition of certain companies such as Sunset Life and GuideOne. Second, the Company completed a sizeable reinsurance assumption transaction as described previously. Third, the Company may determine that it no longer intends to actively market selected products or to continue to remain active in certain niche markets. These closed blocks of business decline in premiums and deposits and insurance in force over time. However, the Company seeks to actively conserve this business. The types of products included in the Company's closed blocks are traditional life, immediate annuities, universal life, fixed deferred annuities, and individual accident and health. At December 31, 2012, 6% of total premiums and 17% of total deposits were from closed blocks.

Group Insurance

Kansas City Life offers a range of group products. The group portfolio has two primary markets, groups with two to nine employees and groups with ten or more employees. This segment's marketing focus is to create a range of products in the group life, dental, long-term and short-term disability areas, as well as vision products. This segment primarily uses two marketing approaches. The first is to market business using Kansas City Life's internal sales representatives and an independent general agent and agent field force. The second is through independent third-party arrangements, whereby business sold through these arrangements is primarily administered by the third parties.

The Group Insurance segment tailors products and services to employees' needs depending upon such factors as the following:

- Employer contributions towards the cost of coverage;
- Employee participation levels;
- Benefits desired versus product cost;
- Number of employees; and
- Plan design features, such as coinsurance percentages, deductibles, waiting periods, plan maximums, and more.

This segment also assists employers using its flexible plan design for its group life product, which can include many features such as:

- Spouse and dependent benefits;
- Annual enrollments;
- Accidental death and dismemberment and waiver of premium benefit coverage; and
- Policy conversion and portability privileges.

The following table details gross premiums by product for the Group Insurance segment for the years ended December 31.

	2012	% of Total		2011	% of Total	
Group life insurance	$10,971	18	%	$10,701	18	%
Group dental insurance	27,194	44	%	28,497	47	%
Group disability insurance	21,819	35	%	19,882	32	%
Other group insurance	2,017	3	%	2,128	3	%
Total	$62,001	100	%	$61,208	100	%

The following table provides the geographic distribution of gross premiums by state greater than 5% of the total for the Group Insurance segment for the years ended December 31.

	2012			2011	
Missouri	10	%	Missouri	10	%
Texas	8	%	Texas	9	%
North Carolina	7	%	North Carolina	7	%
Indiana	6	%	Georgia	6	%
All others	69	%	Indiana	5	%
Total	100	%	Pennsylvania	5	%
			All others	58	%
			Total	100	%

Table of Contents

Old American

Old American sells final expense traditional life insurance products. This segment is marketed through a nationwide general agency sales force with exclusive territories, using direct response marketing to supply agents with leads. The Company manages the territories based upon production and directly supports and subsidizes general agent managers and agents with marketing leads and allowances based upon sales results. The Old American segment consists of individual insurance products designed primarily as final expense products for the senior market. Agents primarily market to individuals in the age range of 50 to 85, principally through final arrangements planning.

Old American offers several products geared primarily towards supporting policyholders' final expense needs. This segment offers final expense products, including preferred products with guaranteed level death benefits for individuals in good health, and sub-standard products with graded or increasing benefits for those individuals who cannot qualify for standard or preferred risk due to health issues. Old American also offers a juvenile product designed for parents or grandparents to insure children of ages up to 15 and a term life insurance product to individuals ages from 20 to 65. Old American also offers several riders, including accidental death and dismemberment and waiver of premium. All of Old American's products are traditional individual life insurance products.

Old American has focused on expanding its sales territories, recruiting, and agent productivity for its general agencies in order to effectively meet the sales goals of the Company. Furthermore, this segment seeks to expand its target market to include younger individuals by offering additional insurance products, as described above. Finally, a main driving force behind Old American's sales efforts is the approach to support its field force through its lead generation efforts.

The following table provides the geographic distribution of gross premiums by state greater than 5% of the total for the Old American segment for the years ended December 31.

	2012			2011	
Texas	7	%	Missouri	7	%
Missouri	7	%	Texas	7	%
California	6	%	Illinois	6	%
Illinois	6	%	California	5	%
All others	74	%	Kansas	5	%
Total	100	%	All others	70	%
			Total	100	%

Reinsurance

Consistent with the general practice of the life insurance industry, the Company enters into traditional agreements of indemnity reinsurance with other insurance companies to support sales of new products and the in force business. The reinsurance arrangements have taken various forms over the years. The Company has reinsurance in force on all of the following bases: automatic and facultative; yearly renewable term (YRT) and coinsurance; and excess and quota share basis. For additional information pertaining to the Company's significant reinsurers, along with additional information pertaining to reinsurance, please see Note 15 - Reinsurance in the Notes to Consolidated Financial Statements.

Currently, new sales of traditional life and universal life products are reinsured on a YRT basis in excess of the Company's retention limits, while sales of certain term life insurance products are reinsured on a quota share (a portion of each policy is reinsured) coinsurance basis. Sales of group disability income products are reinsured on a quota share coinsurance basis. New group life sales are reinsured on an excess of retention basis, with the accidental death and dismemberment benefits being 100% reinsured. During 2012, the Company's maximum retention limit was five hundred thousand dollars on individual life products and one hundred thousand dollars on group life business. During 2011, the Company's maximum retention limit on individual life insurance products was three hundred fifty thousand dollars and one hundred thousand dollars on group life business.

In addition to reinsurance coverage for new business, the Company has also engaged in various reinsurance arrangements for in force blocks of business:

•

In 1991, the Company purchased Old American Insurance Company. Old American had an existing coinsurance agreement in place that ceded on a 100% coinsurance basis certain whole life policies issued by Old American prior to December 1, 1986. These policies had life insurance in force of $29.6 million at December 31, 2012 (2011 - $32.9 million) with a ceded reserve for future policy benefits under this agreement of $16.7 million (2011 - $18.3 million).

Table of Contents

- In 1997, the Company acquired a block of traditional life and universal life products by way of a coinsurance and servicing agreement with another insurer. Investments equal to the statutory policy reserves are held in a trust to secure payment of the estimated liabilities relating to the policies. At December 31, 2012, the block had $1.2 billion of life insurance in force (2011 - $1.3 billion) and a reserve of $198.2 million (2011 - $208.0 million).

- In 1998, Old American executed a coinsurance agreement ceding 100% of its retained risk on a closed block of individual accident and health business. At December 31, 2012, the reserve credit on these policies was $9.1 million (2011 - $11.2 million).

- In 2002, Sunset Life entered into a yearly renewal term bulk reinsurance agreement whereby it ceded 80% of its retained mortality risk on traditional and universal life policies. This was accomplished through a reinsurance pool involving four primary reinsurers. In June, 2012, Sunset Life recaptured approximately 9% of the outstanding bulk reinsurance agreement. The net impact of this recapture event to the Consolidated Statements of Comprehensive Income was less than $0.5 million. At December 31, 2012, the ceded insurance in force was approximately $1.1 billion (2011 - $1.3 billion) with reserves of $4.0 million (2011 - $4.7 million).

Governmental Regulations

The Company is subject to state regulations in its states of domicile and in the states in which it does business. Although the federal government generally does not regulate the business of insurance, federal initiatives often have an impact on the business in a variety of ways, including the taxation of insurance companies and the tax treatment of insurance products. In addition, the Company is a stock life insurance company and is subject to the rules and regulations of the United States Securities and Exchange Commission (SEC). SFS is a registered broker-dealer, which is regulated by the Financial Industry Regulatory Authority (FINRA) and the SEC.

State Regulation

State insurance laws establish extensive regulation and supervisory agencies with broad regulatory authority, including the power to:

- Grant and revoke licenses to companies to transact business and to license agents;
- Regulate and supervise trade practices and market conduct;
- Establish guaranty associations which levy mandatory fees used for insurers with solvency issues;
- Approve policy forms, advertising, and marketing materials;
- Establish reserve requirements;
- Prescribe the form and content of required financial statements and reports;
- Determine the reasonableness and adequacy of statutory capital and surplus;
- Perform financial, market conduct, and other examinations;
- Define acceptable accounting principles for statutory reporting purposes;
- Regulate the type and amount of permitted investment activity; and
- Limit the amount of dividends that can be paid without prior regulatory approval.

The Company's life insurance entities are subject to periodic examinations by state regulatory authorities. Financial statements are prepared and examined on a basis other than U.S. generally accepted accounting principles (GAAP), namely statutory accounting principles. The most recently completed examination performed by the State of Missouri occurred as of December 31, 2009 for Kansas City Life, Sunset Life, and Old American. There were no adjustments recommended to any of the insurance companies as a result of that examination.

The National Association of Insurance Commissioners (NAIC) has received regulatory authority by the respective state departments of insurance. Accordingly, the NAIC has been able to establish more consistency for insurers with regard to financial reporting requirements. In one such measure, the NAIC has adopted risk-based capital (RBC) guidelines to assist in the evaluation of the adequacy of statutory capital and surplus in relation to an insurance company's risks. RBC requirements are intended to be used by insurance regulators as an early warning tool to identify deteriorating or weakly capitalized insurance companies for the purpose of initiating regulatory action. RBC guidelines consist of target statutory surplus levels based on the relationship of statutory capital and surplus to the sum of weighted risk exposures. At December 31, 2012 and 2011, the statutory capital and surplus of each of the Company's insurance entities was substantially above the required levels. The NAIC continues to assess solvency issues and makes recommendations to enhance the existing guidelines, such as solvency modernization and own risk and solvency assessment (ORSA). While the Company is not subject to these regulations, it continues to monitor them for ongoing developments.

Table of Contents

The Company and its insurance subsidiaries have received inquiries from a number of state regulatory authorities regarding its use of the U.S. Social Security Administration's Death Master File ("Death Master File") and its compliance with state unclaimed property and escheatment laws. Certain states have proposed, and many other states are considering, new legislation and regulations related to unclaimed life insurance benefits and the use of the Death Master File in the claims process. It is possible that audits and/or the enactment of new state laws could result in identifying payments to beneficiaries more quickly than under the current legislative and regulatory standards established for life insurance claims or may provide for additional escheatment of funds deemed abandoned under state laws. The audits could also result in administrative penalties. Given the legal and regulatory uncertainty in this area, it is also possible that life insurers, including the Company, may be subject to claims concerning their business practices. West Virginia, for example, has initiated litigation against a large number of life insurance companies.

Under insurance solvency or guaranty laws in most states in which the Company operates, insurers doing business can be assessed for policyholder losses related to insolvencies of other insurance companies. The amount and timing of any future assessments on the Company under these laws cannot be reasonably estimated and are beyond the control of the Company. For the three years ended December 31, 2012, the Company's assessments, net of related premium tax credits, were not material.

Federal Regulation

The federal government does not directly regulate the business of insurance. However, the federal government does regulate through legislation and administrative policies several aspects of the business including but not limited to:

- The Sarbanes-Oxley Act (SOX) regarding financial reporting internal controls;
- Pension regulations and other qualified retirement plans such as 401(k) plans;
- Certain employer hiring considerations, specifically including but not limited to race, age, and sexual discrimination;
- The sale of securities and investment-related products;
- Corporate and individual taxation;
- Prescribe the form and content of required financial statements and reports;
- Define acceptable accounting principles for reporting purposes;
- Health care reform; and
- Other federal initiatives.

In addition, legislation which has been passed and is also being contemplated could result in the federal government assuming some role in the regulation or oversight of insurance companies. Specifically, the Dodd-Frank Wall Street Reform and Consumer Protection Act may enhance and expand the federal government's role in insurance company regulation.

As a publicly traded stock life insurance entity, the Company is also subject to the SEC's regulations for such items as financial reporting requirements, accounting rules, public disclosure of accounting practices and policies, internal control regulations as defined under SOX, a wide variety of governance considerations promulgated under proxy statements and proxy disclosure related matters, and other items as may be enacted by legislation. These regulations place an expanded burden on insurance companies both in financial aspects as well as the timely filing and reporting of items covered under each of these requirements. In addition, future enactments may have a material impact on the Company, depending upon the regulation and its requirements.

Life insurance companies are taxed under the life insurance company provisions of the Internal Revenue Code of 1986, as amended (the Code). Provisions of the Code have various impacts on the Company and changes to the Code that may be enacted in the future could also negatively impact the Company's net income and stockholders' equity.

Certain securities policies, contracts, and annuities offered through SFS are subject to regulation under the federal securities laws administered by the SEC and FINRA. Federal securities laws contain regulatory restrictions and criminal, administrative, and private remedial provisions related to the offering of these products. From time to time, the SEC and FINRA examine or investigate the activities of broker-dealers and investment advisors. These examinations often focus on the activities of registered principals, registered representatives and registered investment advisors doing business through that entity. It is possible that the results of any examination may lead to changes in systems or procedures, payments of fines and penalties, payments to customers, or a combination thereof.

Competition and Ratings

The Company operates in the life insurance sector of the financial services industry in the United States. This industry is highly competitive with respect to products, pricing, selection of products, and quality of service. No single competitor or any small group of competitors dominates any of the markets in which the Company operates. General economic conditions may affect future results. Many of the Company's competitors are considerably larger and have substantially greater financial resources, have higher ratings from rating agencies, have broader and more diversified product lines, and have more agency relationships.

Table of Contents

The Company's insurance products compete with a wide variety of other products, including products from other insurance companies, financial intermediaries, and other institutions. In addition, competition arises from a number of features, including crediting rates, policy terms and conditions, service provided to distribution channels and policyholders, ratings reputation, and agent compensation. Insurance products also compete with products offered from mutual funds; traditional bank investments; and other investment and retirement funding alternatives offered by asset managers, banks, and broker-dealers.

The sales agents for the Company's products use the financial strength ratings assigned to an insurer by independent rating agencies as one factor in their sales materials. The market has generally been influenced by those insurers with the highest ratings. However, the degree to which ratings and changes in ratings affect sales and persistency cannot be definitively measured.

Following is a summary of the Company's insurance ratings and outlook for the three insurance companies, as assigned by the A. M. Best Company, which is an independent rating agency.

	2012	2011	2010
Kansas City Life	A (Excellent) Stable	A (Excellent) Stable	A (Excellent) Stable
Sunset Life	A- (Excellent) Stable	A- (Excellent) Stable	A (Excellent) Stable
Old American	B++(Good) Stable	B++(Good) Positive	B++(Good) Positive

Financial strength ratings generally involve quantitative and qualitative evaluations by rating agencies of a company's financial condition and operating performance. Generally, rating agencies base their ratings upon information furnished to them by the insurer and upon their own investigations, studies, and assumptions. Ratings are based upon factors of concern to policyholders, agents, and intermediaries and are not directed toward the protection of investors and are not recommendations to buy, sell, or hold securities.

In addition to the financial strength ratings, rating agencies use an "outlook statement" to indicate a medium or long-term trend which, if continued, may lead to a rating change. A positive outlook indicates a rating may be raised and a negative outlook indicates a rating may be lowered. A stable outlook is assigned when ratings are not likely to be changed. Outlook statements should not be confused with expected stability of the issuer's financial or economic performance. A rating may have a stable outlook to indicate that the rating is not expected to change, but a stable outlook does not preclude a rating agency from changing a rating at any time without notice.

A. M. Best Company ratings currently range from "A++" (Superior) to "F" (In Liquidation), and include 16 separate ratings categories. Within these categories, "A++" (Superior) and "A+" (Superior) are the highest, followed by "A" (Excellent) and "A-" (Excellent), then followed by "B++" (Good) and "B+" (Good). A. M. Best Company reviews its ratings of insurance companies from time to time. There can be no assurance that any particular rating will continue or that it will not be changed or withdrawn entirely if, in its judgment, circumstances so warrant.

Employees

The Company had 443 full-time employees at December 31, 2012. The Company experienced no work stoppages or strikes and considers relations with its employees to be good. None of the Company's employees are represented by a union.

Access to Public Filings

Additional information about the Company beyond what is included in this Form 10-K is available at the Company's website: www.kclife.com. You may also read and copy these materials at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549, or obtain them by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet website that contains reports, proxy and other information statements and other information regarding issuers that file electronically with the SEC at www.sec.gov. You may also access the SEC website through a link on the Company's website. The Company will provide a copy of any of those reports free of charge upon request.

None of the information on the Company's website that is not otherwise expressly set forth or incorporated by reference in the Form 10-K is a part of this Form 10-K.

Table of Contents

Item 1A. Risk Factors

The operating results of life insurance companies have historically been subject to significant fluctuations. The factors which could affect the Company's future results include, but are not limited to, general economic conditions and the known trends and uncertainties which are discussed more fully below.

Strategic, Product, and Operational Risks:

The Company operates in a mature, highly competitive industry, which could limit its ability to grow sales or maintain its position in the industry and negatively affect profitability.

Life insurance is a mature and highly competitive industry. The Company encounters significant competition in all lines of business from other insurance companies, many of which have greater financial resources, a greater market share, a broader range of products, lower product prices, better name recognition, greater actual or perceived financial strength, higher claims-paying ratings, the ability to assume a greater level of risk, lower operating or financing costs, or lower profitability expectations.

Changes in competition and the business environment could negatively affect the Company's ability to maintain or increase its profitability.

In recent years, there has been substantial consolidation and convergence among companies in the financial services industry, resulting in increased competition from large, well-capitalized financial services firms. Furthermore, many of these larger competitors may have lower operating costs and an ability to absorb greater risk while maintaining their financial strength ratings, thereby allowing them to price their products more competitively. The Company expects consolidation to continue, thereby increasing competitive pressures.

Changes in demographics, particularly the aging of the population and the decline in the number of agents in the industry, affect the demand for life insurance products. Also, as technology evolves, customers and agents may be able to compare products of any particular company with any other, which could lead to increased competition as well as changes in agent or customer behavior, including persistency that differs from past behavior.

The Company may be unable to attract agencies and sales representatives.

The Company sells insurance and annuity products through independent agents and agencies. These agencies and sales representatives are not captive and may sell products of the Company's competitors. The Company's ability to compete is dependent upon, among other things, its ability to attract agents and agencies to market its insurance products, its ability to develop competitive and profitable products, its ability to control unit cost growth, and its maintenance of strong financial strength ratings. Sales and the results of operations and financial condition could be adversely affected if the Company is unsuccessful in attracting agencies and sales representatives.

The Company's ability to retain agents and sales representatives is dependent upon a number of factors including: the ability of the Company to maintain a competitive compensation system while also offering products with competitive features and benefits for policyholders; the ability to maintain a level of service and support activities that effectively support the agent and sales representative needs; and the ability to approve and monitor agent and sales representative sales and business practices that are consistent with regulatory requirements and expectations of the Company.

The Company's ability to maintain competitive unit costs is dependent upon the level of new sales.

The Company's ability to maintain competitive unit costs is dependent upon a number of factors, such as the level of new sales, persistency (continuation or renewal) of existing business, and expense management. A decrease in sales or the amount of total existing business or deterioration in the profitability of the existing business without a corresponding reduction in expenses may result in higher unit costs, which would affect the Company's operating results.

The Company's policy claims fluctuate from period to period, resulting in earnings volatility.

The Company's financial results may fluctuate from period to period due to fluctuations in policy claims incurred by the Company. However, the Company reinsures a significant amount of the mortality risk on fully underwritten and newly issued individual life insurance contracts. The Company regularly reviews retention limits for continued appropriateness and these limits may be changed in the future. If the Company was to experience significant adverse mortality or morbidity experience, it is expected that a significant portion of that expense would be reimbursed by reinsurers.

11

Table of Contents

The Company's results may be negatively affected should actual experience differ from management's assumptions and estimates.

The Company makes certain assumptions regarding mortality, persistency, expenses, interest rates, tax liability, business mix, policyholder behavior, or other factors appropriate for the type of business results it expects to experience in future periods. These assumptions are also used to estimate the amounts of deferred acquisition costs (DAC), value of business acquired (VOBA), policy reserves and accruals, future earnings, and various components of the Company's Consolidated Balance Sheets. These assumptions are used in the operations of the Company's business in making decisions crucial to the success of the Company, including the pricing of products and expense structures relating to products. The Company's actual experience and changes in estimates are reflected in the Company's financial statements. The Company's actual experience may vary from period to period and from established assumptions, potentially resulting in variability in the financial statements.

Assumptions and estimates involve judgment and are subject to changes and revision over time.

The calculations the Company uses to estimate various components of its financial statements are complex and involve analyzing and interpreting large quantities of data. The Company employs various techniques for such calculations and, from time to time, will develop and implement more sophisticated systems and procedures to facilitate calculations and improve estimates. Accordingly, the Company's results may be affected, positively or negatively, by actual results differing from assumptions, by changes in estimates, and by changes resulting from implementing new administrative systems and procedures.

The Company's reserves for future policy benefits may prove to be inadequate.

The Company establishes and carries a reserve liability based on estimates of how much will be needed to pay for future benefits and claims. The assumptions and estimates used in connection with establishing and carrying reserves are inherently uncertain and in some cases are mandated by regulators. If actual experience is significantly different from assumptions or estimates or if regulators decide to increase or change regulations, reserves may prove to be inadequate in relation to estimated future benefits and claims. As a result, a charge to earnings would be incurred in the quarter in which the Company increases reserves.

The amortization of DAC and VOBA may change, impacting both the level of the asset and the timing of the Company's net income.

Amortization of DAC and VOBA depends on the actual and expected profits generated by the lines of business that incurred the costs. Expected profits are dependent on assumptions regarding a number of factors, including investment returns, benefit payments, expenses, mortality, and policy lapse. Due to the nature of the business, the Company cannot anticipate the exact pattern of profit emergence. As a result, amortization of DAC and VOBA will vary from period-to-period as actual profits replace expected profits and future expected profits are re-projected based on management's best estimates as of the reporting dates. To the extent that actual experience emerges less favorably than expected or expectations for future profits decrease, the DAC and VOBA assets may be reduced. This would likely result in increased amortization and reduced profitability in the current period.

The Company is dependent on the performance of others.

The Company's results may be affected by the performance of others because the Company has entered into various arrangements involving other parties. For example, most of the Company's products are sold through independent distribution channels, and variable universal life and annuity deposits are invested in funds managed by third parties. Additionally, the Company's operations are dependent on various technologies, some of which are provided by other parties.

As with all financial services companies, the Company's ability to conduct business is dependent upon consumer confidence in the industry and its products. Actions of competitors and financial difficulties of other companies in the industry could undermine consumer confidence and adversely affect retention of existing business and future sales of the Company's insurance and investment products.

Risk management policies and procedures may leave the Company exposed to unidentified or unanticipated risk, which could negatively affect business or result in losses.

The Company has devoted significant resources to develop risk management policies and procedures and will continue to do so in the future. However, the Company's policies and procedures used to identify, monitor, and manage risks may not be fully effective. Many of the methods of managing risk and exposures are based upon the use of observed historical policyholder and market behavior or statistics based on historical models. As a result, these methods may not effectively identify or evaluate the magnitude of existing or future exposures, which could be significantly greater than the historical measures indicate. An example of such risks includes the risk of pandemics, which could cause a large number of deaths. Other risk management methods depend upon the evaluation of information regarding markets, agents, clients, catastrophe occurrence, or other matters that are publicly available or otherwise accessible to us. This information may not always be accurate, complete, up-to-date, or properly evaluated.

Management of operational, legal, and regulatory risks requires, among other things, policies and procedures to record properly and verify a large number of transactions and events, and these policies and procedures may not be fully effective. Additional risks and uncertainties not currently known or that the Company currently deems to be immaterial may adversely affect the business, financial condition, and/or operating results.

A rating downgrade could adversely affect the Company's ability to compete and increase the number or value of policies surrendered.

The Company's financial strength rating, which is intended to measure its ability to meet policyholder obligations, is an important factor affecting public confidence in most of the Company's products and, as a result, the Company's competitiveness. Rating organizations periodically review the financial performance and condition of insurers, including the Company, and downgrades of insurance companies occur frequently.

A downgrade in the Company's rating could adversely affect the Company's ability to sell its products, retain existing business, and compete for attractive acquisition opportunities. Rating organizations assign ratings based upon several factors. While most of the factors relate to the rated company, some of the factors relate to the views of the rating organization, general economic conditions, and circumstances outside the rated company's control. In addition, rating organizations use various models and formulas to assess the strength of a rated company, and from time to time rating organizations have, in their discretion, altered the models. Changes to the models could impact the rating organizations' judgment of the rating to be assigned to the rated company. The Company cannot predict what actions rating organizations may take or what actions the Company may be required to take in response to the actions of the rating organizations, which could adversely affect the Company.

The Company may be unable to complete additional acquisitions.

One of the Company's growth strategies is to acquire other life insurance companies and/or blocks of business. The Company's previous acquisitions have increased earnings by allowing the Company to realize certain operating efficiencies or increase sales. There can be no assurance, however, that suitable acquisitions presenting opportunities for continued growth and operating efficiencies will continue to be available to the Company. Further, sufficient capital to fund acquisitions may not be available at the time opportunities become available.

The Company may not realize its anticipated financial results from its acquisitions.

The completion of an acquisition may be more costly or take longer than expected. There may be unforeseen liabilities that arise in connection with businesses that the Company acquires. Additionally, in connection with its acquisitions, the Company assumes or otherwise becomes responsible for the obligations of policies and liabilities of other insurers. Any regulatory, legal, financial, or other adverse development affecting the other insurer could also have an adverse effect on the Company.

Investment and Asset/Liability Management Risks:

The Company's investments are subject to market and credit risks.

The Company's invested assets, primarily including fixed income securities, are subject to customary risks of credit defaults and changes in fair value. The value of the Company's commercial mortgage loan and real estate portfolios also depend on the financial condition of the tenants occupying the properties which the Company has financed. Factors that may affect the overall default rate on and fair value of the Company's invested assets include interest rate levels and changes, availability and cost of liquidity, financial market performance, and general economic conditions, as well as particular circumstances affecting the businesses of individual borrowers and tenants.

Interest rate fluctuations could negatively affect the Company's spread income or otherwise impact its business.

Interest rate fluctuations or sustained low interest rate environments could negatively affect earnings because the profitability of certain products depends in part on interest rate spreads. These products include fixed annuity, interest-sensitive whole life, universal life, and the fixed portion of variable universal life insurance business. Changes in interest rates or sustained low interest rate environments may reduce both the profitability and the return on invested capital.

Some of the Company's products, principally fixed annuities, interest-sensitive whole life, universal life, and the fixed portion of variable universal life insurance have interest rate guarantees that expose the Company to the risk that changes in interest rates will reduce the spread, or the difference between the amounts the Company is required to credit to policyholder contracts and the amounts earned by the Company on general account investments. Declines in spread or instances where the returns on the general account investments are not sufficient to support the interest rate guarantees on these products could have a material adverse effect on the results of operations. In periods of increasing interest rates, the Company may not be able to replace the assets in the general account with higher yielding assets needed to fund the higher crediting rates that may be necessary to keep interest sensitive

Table of Contents

products competitive. The Company, therefore, may have to accept a lower spread and profitability or face a decline in sales, loss of existing contracts from non-renewed maturities, early withdrawals, or surrenders. In periods of declining interest rates, the Company has to reinvest the cash received from interest or return of principal on investments in lower yielding instruments then available. Moreover, issuers of fixed-income investment securities and borrowers related to the Company's commercial mortgage investments may prepay these obligations in order to borrow at lower market rates, which may exacerbate the risk for the Company of having to reinvest at lower rates. The Company is entitled to reset the interest rates it credits on fixed-rate annuities. Because many of the Company's policies have guaranteed minimum interest or crediting rates, spreads could decrease and potentially become negative.

Increases in interest rates may cause increased surrenders and withdrawals of insurance products. In periods of increasing interest rates, policy loans and surrenders and withdrawals of life insurance policies and annuity contracts may increase as policyholders seek to buy products with higher returns. These outflows may require investment assets to be sold at a time when the prices of those assets are lower because of the increase in market interest rates, which may result in realized investment losses.

Changes in interest rates may also impact the business in other ways. Lower interest rates may result in lower sales of certain of the Company's insurance products. Higher interest rates may create a less favorable environment for the origination of mortgage loans. Higher interest rates may also result in lower sales of variable products. Further, higher interest rates may result in significant unrealized losses on investments, which could cause changes in agent and policy retention and new product sales.

While the Company develops and maintains asset/liability management programs and procedures designed to mitigate the effect on spread income in rising or falling interest rate environments, no assurance can be given that changes in interest rates will not affect such spreads. Additionally, the Company's asset/liability management programs incorporate assumptions about the relationship between short-term and long-term interest rates (i.e., the slope of the yield curve) and relationships between risk-adjusted and risk-free interest rates, market liquidity, and policyholder behavior in periods of changing interest rates and other factors. The effectiveness of the Company's asset/liability management programs and procedures may be negatively affected whenever actual results differ from these assumptions.

Prolonged periods of low interest rates can affect policyholder behavior and negatively impact earnings.

As interest rates decline, policyholders may become more likely to extend the retention or duration of fixed-rate products previously purchased and may seek alternatives to fixed-rate products for new purchases. Many of the products sold in earlier periods may have minimum guaranteed interest crediting rates or other features that are greater than those being offered in the current low interest rate environment. Additionally, cash flows from existing investments, including interest and principal payments, may be reinvested at lower interest rates relative to prior periods. As a result, a prolonged low interest rate environment can result in significant changes to cash flows, lower investment income, compressed product spreads, reduced earnings, and increased surplus strain. In addition, the Company may change its risk profiles in regards to selecting investment opportunities to reduce the impact on earnings.

The change from a low interest rate environment to an environment of increasing interest rates can affect policyholder behavior and negatively impact earnings.

The change from a period of low interest rates to a period of significantly higher and increasing interest rates may cause policyholders to surrender policies or to make early withdrawals in order to maximize their returns. Accordingly, the Company may become more susceptible to increased surrenders and withdrawals on policies as surrender charges and other features that help protect the Company from increased or unexpected policyholder withdrawals or lapses. Increases in policyholder surrenders, withdrawals, or lapses could negatively affect the Company's operating results.

The Company's valuation of fixed maturity and equity securities may include methodologies, estimations, and assumptions and could result in changes to investment valuations that may have a material adverse effect on the results of operations or financial condition.

Fixed maturity securities, equity securities, and short-term investments are reported at fair value in the Consolidated Balance Sheets and represent the majority of total cash and invested assets. Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820 establishes a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The level in the fair value hierarchy is based on the priority of the inputs to the respective valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and lowest priority to unobservable inputs (Level 3). An asset or liability’s classification within the fair value hierarchy is based on the lowest level of input that is significant to its valuation.

Table of Contents

During periods of market disruption, including periods of significantly rising or high interest rates, rapidly widening credit spreads or illiquidity, it may be difficult to value certain securities if trading becomes less frequent and/or market data becomes less observable. There may be certain asset classes that were previously acquired and valued in active markets with significant observable data that are now valued in illiquid markets with little observable data. In such cases, more securities may be classified in Level 3 and, therefore, require more subjectivity and management judgment. As such, valuations may include inputs and assumptions that are less observable or require greater estimation as well as valuation methods which are more complex or require increased estimation, thereby resulting in values which may have greater variance from the value at which the investments may or could be ultimately sold. Further, rapidly changing credit and equity market conditions could materially impact the valuation of securities as reported in the consolidated financial statements, and the period-to-period changes in value could vary significantly. Decreases in value could have a material adverse effect on the Company's results of operations or financial condition.

Equity market volatility could negatively impact the Company's profitability.

The Company is exposed to equity market volatility in the following ways:

- The Company has exposure to equity price risk through investments, but this exposure is limited due to the relatively small equity portfolio held during the periods presented.
- The Company earns investment management fees and mortality and expense fee income based upon the value of assets held in the Company's separate accounts. Revenues from these sources fluctuate with changes in the fair value of the separate accounts.
- Volatility in equity markets may discourage purchasers of variable universal life and annuity products that have returns linked to the performance of the equity markets and may also result in existing customers withdrawing cash values or reducing investments in those products.
- The Company has equity price risk to the extent that it may affect the liability recognized under guaranteed minimum death benefits and guaranteed minimum withdrawal benefit provisions of the variable contracts. Periods of significant and sustained downturns in equity markets, increased equity volatility or reduced interest rates could result in an increase in the valuation of the future policy benefit or policyholder account balance liabilities associated with such products, which ultimately results in a reduction to net income.
- The amortization of DAC relating to variable products can fluctuate with changes in the performance of the underlying separate accounts.

The determination of the amount of realized and unrealized impairments and allowances established on the Company's investments is highly subjective and could materially impact results of operations or financial position.

The determination of the amount of impairments and allowances varies by investment type and is based upon the Company's evaluation and assessment of known and inherent risks associated with the respective asset class. Such evaluations and assessments are revised as conditions change and new information becomes available. There can be no assurance that the assumptions, methodologies, and judgments employed in these evaluations and assessments will be accurate or sufficient in later periods. As a result, additional impairments may need to be realized or allowances provided in future periods. Further, historical trends may not be indicative of future impairments or allowances. Additionally, the Company considers a wide range of factors about security issuers and uses its best judgment in evaluating the cause of the decline in the fair value of the security and in assessing the prospects for recovery. Inherent in management's evaluation of the security are assumptions and estimates about the operations of the issuer, its future earnings potential, and the ability and timeliness of the security's recovery in fair value.

The Company could be forced to sell investments at a loss to meet policyholder withdrawals.

Many of the products offered by the Company allow policyholders and contract holders to withdraw their funds under defined circumstances. The Company manages liabilities and attempts to align the investment portfolio so as to provide and maintain sufficient liquidity to support anticipated withdrawal demands, contract benefits, and maturities. While the Company owns a significant amount of liquid assets, a certain portion of investment assets are relatively illiquid. If the Company experiences unanticipated withdrawal or surrender activity, the Company could exhaust all other sources of liquidity and be forced to liquidate assets, perhaps on unfavorable terms. If the Company is forced to dispose of assets on unfavorable terms, it could have an adverse effect on the Company's results of operations and financial condition.

15

Table of Contents

The Company invests in certain low income housing real estate properties specifically to generate state and federal tax credits. These tax credits have become targets of regulatory bodies to reduce the available tax credits. Additionally, economic forces may negatively impact the ongoing performance of these investments.
In recent periods, both the state and federal governments have offered selected tax credits for low income housing real estate properties. These tax credits have become the targets of certain regulators to either reduce or to eliminate the available credits that companies can receive. The willingness of regulators to reduce or eliminate these available credits could have a negative impact on the Company’s tax strategy. In addition, the economic environment may negatively impact the operating performance of these properties and result in either losses for these properties or tax credit recapture to the holders of these credits. Accordingly, these items may negatively impact or impair the value of the properties or the current or future ability to realize or maintain tax credits previously recognized or tax credits to be realized in the future.
The Company's mortgage loan investments are subject to default and volatility in performance.
As an asset class, mortgage loans have experienced heightened delinquency and default risk in certain historical periods due to difficult economic conditions. These conditions may result in a negative impact on the performance of the underlying collateral, resulting in declining values and volatility in the ability of the holders to repay these instruments. An increase in defaults on the Company's mortgage loan investments could have an adverse effect on the Company's results of operations and financial condition.
The Company may be exposed to environmental liability from its commercial loan and real estate investments.
The Company customarily conducts environmental assessments prior to making commercial mortgage loans secured by real estate and before taking title to real estate. Based on the Company’s environmental assessments made through the date of the financial statements, the Company believes that any compliance costs associated with environmental laws and regulations or any remediation of affected properties would not have a material adverse effect on the Company’s results of operations or financial condition. However, no assurance can be provided that material compliance costs will not be incurred by the Company in future periods.
The Company’s mortgage loan investments in the Pacific region of the United States may subject it to losses resulting from certain natural catastrophes in this area.
The Company has a sizeable concentration of commercial mortgage loans in the Pacific region of the United States. This concentration exposes the Company to potential losses resulting from certain natural catastrophes, such as earthquakes and fires, which may occur in the region. While the Company diversifies its commercial mortgage loan portfolio in this region by both location and type of property in an effort to reduce catastrophic exposure, such diversification does not eliminate the risk of such losses, which could have a material adverse effect on the Company’s business, financial position, results of operations or cash flows.
The Company’s mortgage loan investments in regions with significant concentration may subject it to losses resulting from the impact of the economic downturn in that region.
The Company has a sizeable concentration of commercial mortgage loans in certain regions of the United States. Severe adverse economic conditions in these regions could have a material adverse effect on the Company’s business, financial position, results of operations, or cash flows.
Liquidity and Capital Resources Risks:
Adverse capital and credit market conditions may significantly affect the Company’s ability to meet liquidity needs, as well as access to capital and cost of capital.
The capital and credit markets can experience extreme volatility and disruption. The volatility and disruption can exert downward pressure on availability of liquidity and credit for certain sectors and issuers. Although the Company has not issued new equity or debt securities in recent years, including 2012 and 2011, the Company’s results of operations, financial condition, cash flows, and statutory capital position could be materially adversely affected by future disruptions in the capital and credit markets.
The Company’s level of cash and investments, along with expected cash inflows from investments and operations, is believed to be adequate to meet anticipated short-term and long-term policyholder and operational obligations. However, withdrawal and surrender levels may differ from anticipated levels for a variety of reasons, such as changes in economic conditions, changes in policyholder behavior, changes in agent practices, or changes in the Company’s

claims-paying ability or financial strength ratings. Any of these occurrences could adversely affect the Company’s profitability and financial condition. In the event that the Company’s current internal sources of liquidity do not satisfy these needs, additional financing may be required and, in such case, the Company may not be able to successfully obtain additional financing on favorable terms, or at all. The availability of additional financing will depend on a variety of factors, such as market conditions, the general availability of credit, the volume of trading activities,

Table of Contents

the overall availability of credit to the financial services industry, the Company's credit ratings and credit capacity, as well as the possibility that customers or lenders could develop a negative perception of long- or short-term financial prospects if the Company incurs large realized or unrealized investment losses or if the level of business activity is decreased due to a market downturn. Similarly, access to funds may be impaired if regulatory authorities or rating agencies take negative actions against the Company.

Disruptions, uncertainty, or volatility in the capital and credit markets may also limit the Company's access to external sources of liquidity, which could be required to operate its business. Such market conditions could limit the Company's ability to replace maturing liabilities in a timely manner; satisfy capital requirements; fund redemption requests on insurance or other financial products; generate fee income and market-related revenue; meet liquidity needs; and access the capital necessary to grow the business. As such, the Company could be forced to delay raising capital, utilize available internal resources, or bear an unattractive cost of capital, which could decrease the Company's profitability and significantly reduce financial flexibility and liquidity.

The Company's ability to grow depends in large part upon the continued availability of capital.

The Company deploys significant amounts of capital to support its sales and acquisition efforts. Although the Company believes it has sufficient capital to fund its immediate growth and capital needs, the amount of capital available could vary in the future due to a variety of circumstances, some of which are neither predictable nor foreseeable, nor within the Company's control. A lack of sufficient capital could impair the Company's ability to grow.

Regulatory Risks:

Insurance companies are highly regulated and are subject to numerous legal restrictions and regulations.

The Company is subject to government regulation in each of the states in which business is conducted. Such regulation is vested in state agencies having broad administrative and, in some instances, discretionary power dealing with many aspects of the Company's business. This may include, among other things, premium rates and increases thereto, reserve requirements, marketing practices, advertising, privacy, policy forms, reinsurance reserve requirements, acquisitions, mergers, and capital adequacy. Government regulation of insurers is concerned primarily with the protection of policyholders and other customers rather than shareholders. Interpretations of regulations by regulators may change and statutes, regulations, and interpretations may be applied with retroactive impact, particularly in areas such as accounting or reserve requirements.

The Company cannot predict whether or in what manner regulatory reforms will be enacted and, if so, whether the enacted reforms will positively or negatively affect the Company or whether any effects will be material. The NAIC generally formulates and promulgates statutory-based insurance regulations. However, each state is independent and must separately enact these financial regulations and guidelines. As such, insurers follow the interpretations and legal approvals of their respective states of domicile.

Other types of regulation that could affect the Company include insurance company investment laws and regulations, state statutory accounting practices, state escheatment practices, anti-trust laws, minimum solvency requirements, state securities laws, federal privacy laws, insurable interest laws, federal money laundering, and anti-terrorism laws. Further, because the Company owns and operates real property, state, federal, and local environmental laws could affect the Company. The Company cannot predict what form any future changes in these or other areas of regulation affecting the insurance industry might take or what effect, if any, such proposals might have on the Company if enacted into law.

The Company is also subject to various government regulations at the federal level. As a result of economic and market conditions in recent years, the federal government has become increasingly more active in issuing and enforcing regulations. The implementation of these legislative or regulatory requirements may make it more expensive for the Company to conduct its business, may have a material adverse effect on the overall business climate, and could materially affect the profitability of the results of operations and financial condition of financial institutions. The Company is uncertain as to all of the impacts that new legislation will have and cannot provide assurance that it will not adversely affect its results of operations and financial condition.

Publicly held companies in general and the financial services industry, in particular, are sometimes the target of law enforcement investigations and the focus of increased regulatory scrutiny.

The financial services industry has become the focus of increased scrutiny by regulatory and law enforcement authorities relating to allegations of improper special payments, price-fixing, bid-rigging, and other alleged misconduct, including payments made by insurers and other financial services providers to brokers and the practices surrounding the placement of insurance business and sales of other financial products.

Table of Contents

New accounting rules or changes to existing accounting rules could negatively impact the Company.
Like all publicly traded companies, the Company is required to comply with GAAP. A number of organizations are instrumental in the development and interpretation of GAAP, such as the SEC, the FASB, and the American Institute of Certified Public Accountants (AICPA).
GAAP is subject to constant review by these organizations and others in an effort to address emerging accounting issues and develop interpretative accounting guidance on a continual basis. The implementation of new accounting guidance could result in substantial costs and or changes in assumptions or estimates, which could negatively impact the results of operations for the Company. Accordingly, the Company can give no assurance that future changes to GAAP or the required adherence to International Financial Reporting Standards (IFRS) will not have a negative impact on the Company.
In addition, the Company is required to comply with statutory accounting principles (SAP). SAP and various components of SAP, such as statutory actuarial reserving methodology, are subject to constant review by the NAIC, NAIC taskforces and committees, as well as state insurance departments to address emerging issues and otherwise improve or modify financial reporting. Various proposals are typically pending before committees and taskforces of the NAIC. If enacted, some of these may negatively affect the Company and some could positively impact the Company. The NAIC also typically works to reform state regulation in various areas, including reforms relating to life insurance reserves and the accounting for such reserves. The Company cannot predict whether or in what manner reforms will be enacted and, if so, whether the enacted reforms will positively or negatively affect the Company. Although states generally defer to the interpretation of the insurance department of the state of domicile with regards to regulations and guidelines, neither the action of the domiciliary state nor action of the NAIC is binding on a state. Accordingly, a state could choose to follow a different interpretation. The Company can give no assurance that future changes to SAP or components of SAP will not have a negative impact on the Company.
Changes to tax law or interpretations of existing tax law could adversely affect the Company and its ability to compete with non-insurance products or could reduce the demand for certain insurance products.
Under the Internal Revenue Code of 1986, as amended (the Code), income tax payable by policyholders on investment earnings is deferred during the accumulation period of certain life insurance and annuity products. This favorable tax treatment may give certain of the Company’s products a competitive advantage over other non-insurance products. To the extent that the Code is revised to reduce the tax-deferred status of life insurance and annuity products or to increase the tax-deferred status of competing products, all life insurance companies, including the Company, would be adversely affected with respect to their ability to sell such products. Further, depending upon grandfathering provisions, life insurance companies would be affected by the surrenders of existing annuity contracts and life insurance policies. Changes in tax law, which have reduced the federal income tax rates on corporate dividends in certain circumstances, could make the tax advantages of investing in certain life insurance or annuity products less attractive. Additionally, changes in tax law based on proposals to establish new tax-advantaged retirement and life savings plans, if enacted, could reduce the tax advantage of investing in certain life insurance or annuity products. The Company cannot predict what changes to tax law or interpretations of existing tax law may ultimately be enacted or whether such changes could adversely affect the Company.
Litigation Risk:
Financial services companies are frequently the targets of litigation, including class action litigation, which could result in substantial judgments.
A number of civil jury verdicts have been returned against insurers, broker-dealers, and other providers of financial services involving sales or claims practices; alleged agent misconduct; failure to properly supervise representatives; relationships with agents or other persons with whom the insurer does business; and other matters. Often these lawsuits have resulted in the award of substantial judgments that are disproportionate to the actual damages, including material amounts of punitive non-economic compensatory damages. In some states, juries, judges, and arbitrators have substantial discretion in awarding punitive and non-economic compensatory damages, which creates the potential for unpredictable material adverse judgments or awards in any given lawsuit or arbitration. Arbitration awards are subject to very limited appellate review. In addition, in some class actions and other lawsuits, companies have made material settlement payments.

The Company, like other financial services companies, is involved in litigation and arbitration in the ordinary course of business. Although the Company makes every effort to appropriately accrue liability for litigation and other legal proceedings, the outcome of such matters (including any amount of settlement, judgment or fine) is inherently difficult to predict. As a result, an adverse development or an increase in associated legal fees could have a negative impact on the financial condition of the Company.

Catastrophic Event Risk:

The Company is exposed to the risks of climate change, natural disasters, pandemics, or other acts that could adversely affect the Company’s operations.

While the Company has implemented risk management and contingency plans and taken preventive measures and other precautions, no predictions of specific scenarios can be made nor can assurance be given that there are not scenarios that could have an adverse effect on the Company. Climate change, a natural disaster, a pandemic, or an outbreak of an easily communicable disease could adversely affect the mortality or morbidity experience of the Company or its reinsurers. A pandemic could also have an adverse effect on lapses and surrenders of existing policies, as well as sales of new policies. In addition, a pandemic could result in large areas being subject to quarantine, with the result that economic activity slows or ceases, adversely affecting the marketing or administration of the Company’s business. These effects, in turn, could have an adverse financial effect on the Company. The possible macroeconomic effects of climate change, natural disasters, or pandemics could also adversely affect the Company’s asset portfolio, as well as many other variables.

Information Technology Risk:

Unauthorized disclosure of sensitive or confidential corporate or customer information through social media outlets or through a breach of the Company’s computer systems may not be prevented by the Company’s cybersecurity controls.

As part of the Company’s normal course of business, it collects, processes, and retains sensitive and confidential corporate and customer information. In addition, the Company uses third-party vendors and cloud technology on a limited basis for storage, processing, and data support of certain activities. Despite the cybersecurity measures the Company has in place, its facilities and systems may be vulnerable to security breaches, acts of vandalism, computer viruses, misplaced or lost data, programming and/or human error, or other similar events. Any security breach involving the misappropriation, loss, or other unauthorized disclosure of confidential information by the Company could severely damage its reputation, expose it to an increase in the risk of litigation, disrupt its operations, incur significant technical, legal, and operating expenses, or otherwise harm its business.

While the Company has limited social media content, it recognizes that social media outlets are independent of the Company and its security measures. Inaccurate presentations based upon incorrect information or assumptions could be distributed via social media outlets and could harm the Company and its reputation.

Reinsurance Risks:

Significant adverse mortality experience may result in the loss of, or higher prices for, reinsurance.

Prolonged or severe adverse mortality or morbidity experience could result in increased reinsurance costs, and ultimately, reinsurers not being willing to offer coverage. If the Company was unable to maintain its current level of reinsurance or purchase new reinsurance protection in amounts considered sufficient, the Company would either have to be willing to accept an increase in net exposures or revise pricing to reflect higher reinsurance premiums. If this were to occur, the Company may be exposed to reduced profitability and cash flow strain or may not be able to price new business at competitive rates.

The Company’s reinsurers could fail to meet assumed obligations or be subject to adverse developments that could affect the Company.

The Company follows the insurance practice of reinsuring a portion of the risks under the policies written by the Company (known as ceding). The Company cedes significant amounts of insurance to other insurance companies through reinsurance. This reinsurance makes the assuming reinsurer liable to the Company for the reinsured portion of the risk. However, reinsurance does not discharge the Company from its primary obligation to pay policyholders for losses insured under the policies that are issued. Therefore, the Company is subject to the credit risk of reinsurers and the failure of one or more of the Company’s reinsurers could negatively impact the Company’s earnings and financial position.

The Company’s ability to compete is dependent on the availability of reinsurance, cost of reinsurance, or other substitute capital market solutions.

Premium rates charged by the Company are based, in part, on the assumption that reinsurance will be available at a certain cost. Under certain reinsurance agreements, the reinsurer may increase the rate it charges the Company for the reinsurance. Therefore, if the cost of reinsurance were to increase for existing business, or if reinsurance were to become unavailable for new business, or if alternatives to reinsurance were not available, the Company could be adversely affected.

Recently, access to reinsurance has become more costly for the Company, as well as the insurance industry in general. In recent years, the number of life reinsurers has decreased as the reinsurance industry has consolidated. The decreased number of participants in the life reinsurance market results in increased concentration risk for insurers, including the Company. If the reinsurance market further contracts, the Company's ability to continue to offer its products on terms favorable to the Company could be adversely impacted.

The use of reinsurance introduces variability in the Company's financial statements.

The timing of premium payments to and receipt of expense allowances from reinsurers may differ from the Company's receipt of customer premium or deposit payments and incurrence of expenses. Reinsurance may introduce variability in certain components of the Company's financial statements.

Table of Contents

Item 1B. Unresolved Staff Comments
None.
Item 2. Properties
The Company's home office is located at 3520 Broadway in Kansas City, Missouri. The Company owns and wholly occupies two five-story buildings on an eight-acre site.
The Company owns various other properties held for investment.
Item 3. Legal Proceedings
The life insurance industry, including the Company and its subsidiaries, has been subject to an increase in litigation in recent years. Such litigation has been pursued on behalf of purported classes of insurance purchasers, often questioning the conduct of insurers in the marketing of their products.
Similarly, the Company's retail broker-dealer subsidiary is in an industry that also involves substantial risks of liability. In recent years, litigation and arbitration proceedings involving actions against registered representatives and securities products (including mutual funds, variable annuities, and alternative investments, such as real estate investment products and oil and gas investments) have continued to be significant. Given the significant decline in the major market indices beginning in 2008, the generally poor performance of investments that have historically been considered safe and conservative, and the continued volatility in the market, there is the potential for an increase in the number of proceedings to which a broker-dealer may be named as a party.
In addition to the above, the Company and its subsidiaries are defendants in, or subject to, other claims or legal actions related to insurance and investment products. Some of these claims and legal actions are in jurisdictions where juries are given substantial latitude in assessing damages, including punitive damages.
Although no assurances can be given and no determinations can be made at this time, management believes that the ultimate liability, if any, with respect to these other claims and legal actions would not have a material effect on the Company's business, results of operations, or financial position.
Item 4. Mine Safety Disclosures
Not applicable.

Table of Contents

PART II
Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities
Stockholder Information
Corporate Headquarters
Kansas City Life Insurance Company
3520 Broadway
Post Office Box 219139
Kansas City, Missouri 64121-9139
Telephone: (816) 753-7000
Fax: (816) 753-4902
Internet: www.kclife.com
E-mail: kclife@kclife.com
Notice of Annual Meeting
The annual meeting of stockholders will be held at 9 a.m. on Thursday, April 18, 2013 at Kansas City Life's corporate headquarters.
Transfer Agent
Janice Poe, Stock Agent and Assistant Secretary
Kansas City Life Insurance Company
Post Office Box 219139
Kansas City, Missouri 64121-9139
10-K Request
Stockholders may request a free copy of Kansas City Life's Form 10-K, as filed with the Securities and Exchange Commission, by writing to Secretary, Kansas City Life Insurance Company.
Security Holders
At January 31, 2013, Kansas City Life had approximately 3,355 security holders, including individual participants in security position listings.

Table of Contents

Stock and Dividend Information

The following table presents the high and low prices for the Company’s common stock for the periods indicated and the dividends declared per share and paid during such periods. The Company’s common stock is traded on the NASDAQ Capital Market under the symbol “KCLI.”

	High	Low	Dividends Paid
2012:			
First quarter	$34.54	$31.29	$0.27
Second quarter	34.94	30.82	0.27
Third quarter	38.84	34.31	0.27
Fourth quarter*	39.36	34.61	0.54
			$1.35
2011:			
First quarter	$34.45	$29.70	$0.27
Second quarter	32.35	28.48	0.27
Third quarter	31.57	28.37	0.27
Fourth quarter	36.07	30.16	0.27
			$1.08

*In the fourth quarter, the Company declared and paid two dividends. The first was for $0.27 per share, which was declared in October 2012 and paid in November 2012. The second dividend was a special dividend of $0.27 per share, which was declared and paid in December 2012.

A quarterly dividend of $0.27 per share was paid February 13, 2013.

NASDAQ market quotations are compiled according to Company records and may reflect inter-dealer prices, without markup, markdown, or commission and may not necessarily represent actual transactions.

The Company has determined at this time that all compensation shall be paid in cash. As a result, the Company currently offers no equity compensation or equity compensation plan to its employees.

Table of Contents

Performance Comparison

The following graph provides a comparison of the cumulative total return on Kansas City Life's common stock over the last five fiscal years to the S&P 500 Index (“S&P 500”) and to a peer comparison group (“Peer Group”). The graph assumes that $100 was invested on December 31, 2007, and that all dividends were reinvested on the last day of each quarter. Points on the graph represent performance as of the last business day of each of the years indicated.

Comparison of 5 Year Cumulative Total Return
Among Kansas City Life, the S&P 500, and a Peer Group

	2007	2008	2009	2010	2011	2012
Kansas City Life	$100.00	$101.88	$72.42	$83.21	$85.54	$103.21
S&P 500	$100.00	$63.06	$79.70	$91.68	$93.63	$108.55
Peer Group	$100.00	$66.73	$65.60	$97.81	$97.09	$114.55

The Peer Group index weights individual company returns for stock market capitalization. The companies included in the Peer Group index are shown in the following table.

American Equity Investment Life Holding Co.	Primerica, Inc.
FBL Financial Group, Inc.	Protective Life Corporation
Horace Mann Educators Corp.	StanCorp Financial Group, Inc.
Kemper Corporation	Symetra Financial Corporation
National Western Life Insurance Co.	Torchmark Corporation
The Phoenix Companies, Inc.	United Fire and Casualty
Presidential Life Corporation	Universal American Corp.

The Peer Group index has changed during the five-year period. Nationwide Financial Services, Inc. was removed in 2009 due to being fully acquired. Unitrin, Inc. changed its name to Kemper Corporation in 2011. Delphi Financial Group, Inc. and Harleysville Group Inc. were removed in 2012 due to being acquired, and they were replaced with Symetra Financial Corporation and Primerica, Inc. Due to data availability, the starting date for the total return calculation for both Symetra Financial Corporation and Primerica, Inc. is March 31, 2010. Presidential Life Corporation was acquired in 2012, and the total return period ended December 28, 2012. The chart above only includes the data from the current peer group member companies listed above.

Table of Contents

The companies in the Peer Group index include many of the same companies used by the Compensation Committee in evaluating compensation. The group of companies used by the Compensation Committee can be found in the Compensation Disclosure and Analysis section of the Company's Proxy Statement.

The disclosure set forth above under the caption “Performance Comparison” shall not be deemed to be soliciting material and is not incorporated by reference into any of the Company's prior filings under the Securities Act of 1933 or the Securities Exchange Act of 1934, as amended, that incorporated future filings or portions thereof.

Table of Contents

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased Open Market/ Benefit Plans		Average Purchase Price Paid per Share	Total Number of Shares Purchased as a Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
1/1/12 - 1/31/12	—	1	$—	—	1,000,000
	2,464	2	33.53		
2/1/12 - 2/29/12	—	1	—	—	1,000,000
	1,675	2	34.33		
3/1/12 - 3/31/12	—	1	—	—	1,000,000
	407	2	32.37		
4/1/12 - 4/30/12	13,047	1	31.76	13,047	986,953
	2,870	2	32.13		
5/1/12 - 5/31/12	42,382	1	32.21	42,382	944,571
	3,060	2	32.24		
6/1/12 - 6/30/12	16,697	1	32.19	16,697	927,874
	223	2	33.39		
7/1/12 - 7/31/12	—	1	—	—	927,874
	21	2	35.19		
8/1/12 - 8/31/12	—	1	—	—	927,874
	—	2	—		
9/1/12 - 9/30/12	—	1	—	—	927,874
	94	2	35.40		
10/1/12 - 10/31/12	—	1	—	—	927,874
	—	2	—		
11/1/12 - 11/30/12	16,944	1	36.54	16,944	910,930
	—	2	—		
12/1/12 - 12/31/12	7,627	1	37.56	7,627	903,303
	—	2	—		
Total	107,511			96,697	

[1] On January 23, 2012, the Company's Board of Directors authorized the repurchase of up to 1,000,000 shares of its common stock. Under this program in 2012, the Company acquired 96,697 shares at an average price of $33.32. The Company purchased 157,182 shares in 2011

26

Table of Contents

at an average price of $30.66. The 2012 repurchase authorization expired January 27, 2013. On January 28, 2013, the Company's Board of Directors authorized the repurchase of up to 1,000,000 shares of its common stock through January 27, 2014.

[2] Included in this column are: 1) the total shares purchased from the employee stock ownership (ESOP) plan sponsored by the Company during the consecutive months of January through December 2012; 2) the total shares purchased from a former participant of the ESOP plan during September 2012; and 3) the total shares purchased attributable to the Company's deferred compensation plans during the consecutive months of January through June 2012.

Table of Contents

Item 6. Selected Financial Data

Amounts in thousands, except per share data.

	Year Ended December 31				
	2012	2011	2010	2009	2008
Income Statement Data:					
Revenues:					
Insurance revenues	$235,983	$228,399	$245,830	$242,802	$236,173
Net investment income	176,154	177,228	175,859	177,428	177,419
Realized investment gains (losses)	18,436	3,142	535	(10,076)	(52,271)
Other revenues	9,354	10,274	9,139	10,491	13,005
Total revenues	$439,927	$419,043	$431,363	$420,645	$374,326
Net income (loss)	$39,867	$26,133	$22,302	$10,732	$(17,050)
Per Common Share Data:					
Net income (loss), basic and diluted	$3.59	$2.29	$1.95	$0.93	$(1.47)
Cash dividends to stockholders	$1.35	$1.08	$1.08	$1.08	$1.08
Stockholders’ equity	$68.02	$62.84	$59.25	$54.33	$46.11

	December 31				
	2012	2011	2010	2009	2008
Balance Sheet Data:					
Assets	$4,525,745	$4,398,242	$4,333,102	$4,175,981	$3,967,091
Notes payable	—	—	—	—	2,900
Stockholders’ equity	750,401	710,705	679,472	628,363	527,107
Life insurance in force	28,701,373	29,202,126	29,708,102	30,683,571	30,300,286

Table of Contents

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations
Amounts are stated in thousands, except share data, or as otherwise noted.
Management’s Discussion and Analysis of Financial Condition and Results of Operations for the three years ended December 31, 2012 is intended to provide in narrative form the perspective of the management of Kansas City Life Insurance Company (the Company) on its financial condition, results of operations, liquidity, and certain other factors that may affect its future results. This discussion should be read in conjunction with the consolidated financial statements and accompanying notes included in this document.

Overview

Kansas City Life Insurance Company is a financial services company that is predominantly focused on the underwriting, sales, and administration of life insurance and annuity products. The consolidated entity (the Company) primarily consists of three life insurance companies. Kansas City Life Insurance Company (Kansas City Life) is the parent company. Sunset Life Insurance Company of America (Sunset Life) and Old American Insurance Company (Old American) are wholly-owned subsidiaries.

Kansas City Life markets individual insurance products, including traditional, interest sensitive, and variable products through a nationwide sales force of independent general agents and third-party marketing arrangements. Kansas City Life also markets group insurance products, which include life, dental, vision, and disability products through its sales force of independent general agents, group brokers, and third-party marketing arrangements. Kansas City Life operates in 48 states and the District of Columbia.

Sunset Life is a life insurance company that maintains its current block of business, but does not solicit new sales. Sunset Life is included in the Individual Insurance segment and its individual insurance products include traditional and interest sensitive products. Sunset Life operates in 43 states and the District of Columbia.

Old American focuses on selling final expense life insurance products to the senior market. Old American markets its products nationwide through a general agency system, with exclusive territories, using direct response marketing to supply agents with leads. Old American’s administrative and accounting operations are part of the Company’s home office but it operates and maintains a separate marketing function and independent field force. Old American operates in 47 states and the District of Columbia.

The Company offers investment products and broker-dealer services through its subsidiary Sunset Financial Services, Inc. (SFS) for both proprietary and non-proprietary variable insurance products, mutual funds, and other securities.

The Company operates in the life insurance sector of the financial services industry in the United States. This industry is highly competitive with respect to pricing, selection of products, and quality of service. No single competitor or any small group of competitors dominates any of the markets in which the Company operates.

The Company earns revenues primarily from premiums received from the sale of life insurance, immediate annuities, and accident and health policies; from earnings on its investment portfolio; and from the sale of investment assets. Insurance revenues from the sale of traditional life insurance, immediate annuity products, and accident and health products are reported as premium income for financial statement purposes. Considerations for supplementary contracts with life contingencies are reported as other revenues. However, deposits received from the sale of interest sensitive products, namely universal life insurance products, fixed deferred annuities, variable universal life, variable annuities, and supplementary contracts without life contingencies, are not reported as premium revenues. These are instead reported as additions to the policyholders’ account balances and are reflected as deposits in Financing Activities section of the Consolidated Statements of Cash Flows. Accordingly, insurance revenues on these products are recognized over time in the form of contract charges assessed against policyholder account balances, charges assessed on the early surrender of policyholder account balances, and other charges deducted from policyholder balances.

The Company’s profitability depends on many factors, which include but are not limited to:

- The sale of life, interest sensitive, annuity, and accident and health products;
- The rate of mortality, lapse, and surrenders of future policy benefits and policyholder account balances;
- The rate of morbidity, disability, and incurrence of other policyholder benefits;
- Persistency of existing insurance policies;

- Interest rates credited to policyholders;
- The effectiveness of reinsurance programs;
- The amount of investment assets under management;
- The ability to maximize investment returns and minimize risks such as interest rate risk, credit risk, and equity risk;
- Timely and cost-effective access to liquidity; and
- Management of distribution costs and operating expenses.

Table of Contents

Strong sales competition, highly competitive products, and a challenging economic environment present significant challenges to the Company from a new sales perspective. The Company's primary emphasis is on expanding sales of individual life insurance products. The Company's continued focus is on delivering competitive products for a reasonable cost, prompt customer service, excellent financial strength, and effective sales and marketing support to the field force.

The Company generates cash largely through premiums collected from the sale of insurance products, deposits through the sale of universal life-type and deposit-type products, and through investment activity. The principal uses of cash are for the insurance operations, including the purchase of investments, payment of insurance benefits and other withdrawals from policyholder accounts, operating expenses, premium taxes, and costs related to acquiring new business. In addition, cash is used to pay income taxes and stockholder dividends, as well as to fund potential acquisition opportunities.

General economic conditions may affect future results. Market fluctuations, often extreme in nature, have significantly impacted the financial markets and the Company's investments, revenues, and policyholder benefits in recent periods. The sustained low interest rate environment and volatile equity markets have presented significant challenges to the financial markets as a whole and specifically to companies invested in fixed maturity and equity securities. These conditions may continue and the stressed economic and market environment may persist into the future, affecting the Company's revenue, net income, and financial position.

Business Changes

The Company did not have any significant business changes in the three years ended December 31, 2012.

Cautionary Statement on Forward-Looking Information

This report reviews the Company's financial condition and results of operations, and historical information is presented and discussed. Where appropriate, factors that may affect future financial performance are also identified and discussed. Certain statements made in this report include "forward-looking statements" that fall within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include any statement that may predict, forecast, indicate or imply future results, performance, or achievements rather than historical facts and may contain words like "believe," "expect," "estimate," "project," "forecast," "anticipate," "plan," "will," "shall," and other words, expressions with similar meaning.

Forward-looking statements are subject to known and unknown risks, uncertainties, and other factors that may cause actual results to differ materially from those contemplated by the forward-looking statements. Factors that could cause the Company's future results to differ materially from expected results include, but are not limited to:

- Changes in general economic conditions, including the performance of financial markets and interest rates;
- Increasing competition and changes in consumer behavior, which may affect the Company's ability to sell its products and retain business;
- Increasing competition in the recruiting of new agents and agent practices;
- Customer and agent response to new products, distribution channels, and marketing initiatives;
- Fluctuations in experience regarding current mortality, morbidity, persistency, and interest rates relative to expected amounts used in pricing the Company's products;
- Changes in assumptions related to DAC and VOBA;
- Regulatory, accounting, or tax changes that may affect the cost of, or the demand for, the Company's products or services; and
- Unanticipated changes in industry trends and ratings assigned by nationally recognized rating organizations.

The Company cannot give assurances that such statements will prove to be correct. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

Critical Accounting Policies

The preparation of the financial statements requires management to use a variety of assumptions and estimates. Actual results may differ from these estimates under different assumptions or conditions. The profitability of life insurance and annuity products is dependent on actual experience, and differences between actual experience and pricing assumptions may result in variability of net income in amounts which may be material. On an ongoing basis, the

Company evaluates the estimates, assumptions, and judgments based on historical experience and other information that the Company believes to be relevant under the circumstances. A detailed discussion of significant accounting policies is provided in Note 1 – Nature of Operations and Significant Accounting Policies in the Notes to Consolidated Financial Statements.

Table of Contents

Valuation of Investments and Impairments

Securities

Fixed maturity and equity securities, which are classified as available for sale, are carried at fair value in the Company's Consolidated Balance Sheets, with unrealized gains or losses recorded in accumulated other comprehensive income. The Company's fair value of fixed maturity and equity securities is derived from external pricing services, brokers, and internal matrices and calculations. At December 31, 2012, approximately 96% of the carrying value of these investments was from external pricing services and 4% was derived from brokers and internal matrices or calculations.

The Company monitors the various markets in which its investments are traded. The Company utilizes a primary independent third-party pricing service to determine the majority of its fair values. The Company uses a second independent third-party pricing service to validate the fair market values provided by the primary pricing service. The Company also uses the second pricing service to determine the fair value of certain securities for which the primary pricing service is unable to provide. The Company evaluates individual price fluctuations provided by the pricing services and reviews overall data provided by the pricing services for consistency and reasonableness. The Company reviews values received from independent pricing sources for validity. In addition, the Company tests a limited number of securities from each pricing service each reporting period to further validate reliance on the fair values provided. These tests occur in two forms. First, the Company validates a representative sample of securities from each pricing service, reviewing and evaluating methodologies and assumptions used by the pricing services for reasonableness. Second, the Company independently calculates fair values for a sample set of securities and then compares results to those provided by the pricing services.

When fair values are not available from external service providers, where possible, the Company utilizes quotes from brokers who are believed to have expertise in the markets in which the subject securities are traded. The Company reviews the prices received from brokers for reasonableness. When the Company cannot obtain reliable broker pricing, a fair value is determined based upon an assessment of several factors appropriate for the specific issue, including but not limited to: the issuer's industry; liquidity; cash flows; marketability, ratings, and the ability of the issuer to satisfy the obligation; government intervention or regulations; fair value of comparable securities in actively traded or quoted markets; or other factors. The Company creates a matrix of factors from which to calculate an estimable value. However, all factors may not be known or publicly available from which to determine a value and, as such, the fair value used by the Company may not be truly indicative of the actual value available in an active market or an actual exit price if the Company were to sell the security in the current market.

See further discussion of the valuation techniques and processes identified in Notes 4 and 5 to the Consolidated Financial Statements.

The Company has a policy and process in place to identify securities that could potentially have an impairment that is other-than-temporary. This process involves monitoring market events and other items that could impact issuers. The evaluation includes, but is not limited to, such factors as the issuer's stated intent and ability to make all principal and interest payments when due, near-term business prospects, cash flow and liquidity, credit ratings, business climate, management changes, and litigation and government actions. This process also involves monitoring late payments, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts, asset quality, and cash flow projections as indicators of credit issues.

All securities are reviewed to determine whether impairments should be recorded. This process includes an assessment of the credit quality of each investment in the entire securities portfolio. Additional reporting and review procedures are conducted for those securities where fair value is less than 90% of amortized cost. Further, detailed analysis is performed for each issue or issues having experienced a formal restructuring or where the security has experienced material deterioration in fair value or where the fair value is less than 80% of amortized cost for six months or more.

The Company considers relevant facts and circumstances in evaluating whether the impairment of a security is other-than-temporary. Please refer to Note 1 for information concerning these factors.

There are a number of significant risks and uncertainties inherent in the process of monitoring impairments, determining if an impairment is other-than-temporary, and determining the portion of an other-than-temporary impairment that is due to credit. Please refer to Note 1 for a description of these risks and uncertainties.

The Company may selectively determine that it no longer intends to hold a specific issue to its maturity. If the Company makes this determination and the fair value is less than the cost basis, an analysis of the fair value of the investment is performed and the investment is written down to the fair value and an other-than-temporary impairment is recorded on this particular position. Subsequently, the Company seeks to obtain the best possible outcome available for this specific issue and records an investment gain or loss at the disposal date.

The evaluation of loan-backed and similar asset-backed securities, particularly including residential mortgage-backed securities, with significant indications of potential other-than-temporary impairment requires considerable use of estimates and judgment. Specifically, the Company performs discounted cash flow projections on these securities to evaluate whether the value of the

Table of Contents

investment is expected to be fully realized. If the present value of the expected future cash flows is determined to be below the Company's carrying value, the Company recognizes an other-than-temporary impairment on the portion of the carrying value that exceeds the projected expected future cash flows. To the extent that the loan-backed or other asset-backed securities were high quality investments at the time of acquisition, and they remain high quality investments and do not otherwise demonstrate characteristics of impairment, the Company performs other initial evaluations to determine whether other-than-temporary cash flow evaluations need to be performed.

Mortgage Loans

Mortgage loans are stated at cost, net of an allowance for potential future losses. Loans in foreclosure, loans considered impaired, or loans past due 90 days or more are placed on a non-accrual status. If a mortgage loan is determined to be in non-accrual status, the Company does not accrue interest income. The loan is independently monitored and evaluated as to potential impairment or foreclosure. This evaluation includes assessing the probability of receiving future cash flows, along with consideration of many of the factors described in Note 6 - Financing Receivables. If delinquent payments are made and the loan is brought current, then the Company returns the loan to active status and accrues income accordingly.

The allowance for potential future losses on mortgage loans is maintained at a level believed by management to be adequate to absorb estimated credit losses. Management's periodic evaluation and assessment of the adequacy of the reserve is based on known and inherent risks in the portfolio, historical and industry data, current economic conditions, and other relevant factors. The Company evaluates the amount it maintains in the mortgage loan allowance through an assessment of what the Company believes are relevant factors at both the macro-environmental level and specific loan basis, which are detailed in Note 6. Generally, the Company establishes the allowance for potential future losses using a collective impairment methodology at an overall portfolio level that relies on monitoring certain metrics such as debt service coverage and loan-to-value, as well as other qualitative factors. If the Company determines through its evaluation that a loan has an elevated specific risk profile or it does not expect to collect all contractual cash flows, it then individually assesses the loan's risk profile and assigns a specific allowance value.

To the extent the Company's review and valuation determines a loan is impaired, that amount is charged to the allowance for loss and the loan balance is reduced. In the event that a property is foreclosed upon, the carrying value is written down to the lesser of the current fair value or book value of the property with a charge to the allowance for potential future losses and a corresponding reduction to the mortgage loan asset.

Deferred Acquisition Costs (DAC) and Value of Business Acquired (VOBA)

DAC, principally agent commissions and other selling, selection and issue costs, which are related directly to the successful acquisition of new or renewal insurance contracts, are capitalized as incurred. These costs for life insurance products are generally deferred and amortized over the premium paying period. Policy acquisition costs that relate to interest sensitive and variable insurance products are deferred and amortized in relation to the estimated gross profits to be realized over the lives of the contracts.

Historically, when a new block of business was acquired or when an insurance company was purchased, a portion of the purchase price was allocated to a separately identifiable intangible asset, called VOBA. VOBA is established as the actuarially determined present value of future gross profits of the business acquired and is amortized with interest in proportion to future premium revenues or the expected future profits, depending on the type of business acquired. For additional information pertaining to DAC and VOBA, please see Note 1.

Table of Contents

The following table reflects the estimated pre-tax impact to DAC on universal life, variable universal life, and fixed and variable deferred annuity products that could occur in a twelve-month period for an unlocking adjustment due to potential changes in significant assumptions. Changes in assumptions of the same magnitude in the opposite direction would have an impact of a similar magnitude but opposite direction of the examples provided.

Critical Accounting Estimate	Determination Methodology	Potential One-Time Effect on DAC and Related Items
Mortality Experience	Based on Company mortality experience. Industry experience and trends are also considered.	A 2.5% increase in expected mortality experience for all future years would result in a reduction in DAC and an increase in current period amortization expense of $2.3 million.
Surrender Rates	Based on Company surrender experience. Industry experience and trends are also considered.	A 10% increase in expected surrender rates for all future years would result in a reduction in DAC and an increase in current period amortization expense of $1.3 million.
Interest Spreads	Based on expected future investment returns and expected future crediting rates applied to policyholder account balances; future crediting rates include constraints imposed by policy guarantees.	A 10 basis point reduction in future interest rate spreads would result in a reduction in DAC and an increase in current period amortization expense of $2.6 million.
Maintenance Expenses	Based on Company experience using an internal expense allocation methodology.	A 10% increase in future maintenance expenses would result in a reduction in DAC and an increase in current period amortization expense of $1.8 million.

The following table reflects the estimated pre-tax impact to VOBA on universal life and fixed deferred annuity products that could occur in a twelve-month period for an unlocking adjustment due to reasonably likely changes in significant assumptions. Changes in assumptions of the same magnitude in the opposite direction would have an impact of a similar magnitude but opposite direction of the examples provided.

Critical Accounting Estimate	Determination Methodology	Potential One-Time Effect on VOBA and Related Items
Mortality Experience	Based on Company mortality experience. Industry experience and trends are also considered.	A 2.5% increase in expected mortality experience for all future years would result in a reduction in VOBA and an increase in current period amortization expense of $1.2 million.
Surrender Rates	Based on Company surrender experience. Industry experience and trends are also considered.	A 10% increase in expected surrender rates for all future years would result in a reduction in VOBA and an increase in current period amortization

		expense of $0.7 million.
Interest Spreads	Based on expected future investment returns and expected future crediting rates applied to policyholder account balances; future crediting rates include constraints imposed by policy guarantees.	A 10 basis point reduction in future interest rate spreads would result in a reduction in VOBA and an increase in current period amortization expense of $0.7 million.
Maintenance Expenses	Based on Company experience using an internal expense allocation methodology.	A 10% increase in future maintenance expenses would result in a reduction in VOBA and an increase in current period amortization expense of $0.3 million.

Table of Contents

Reinsurance

A variety of reinsurance arrangements are currently in use, including individual and bulk arrangements on both coinsurance and mortality/morbidity-only basis. Reinsurance is an actively managed tool for the Company that supports several objectives, including managing statutory capital and reducing volatility and surplus strain. At the customer level, reinsurance increases the Company's capacity, provides access to additional underwriting expertise, and generally makes it possible for the Company to offer products at competitive levels that could not otherwise be made available.

The Company remains contingently liable if the reinsurer should be unable to meet obligations assumed under the reinsurance contract. The Company monitors the relative financial strength and viability of its reinsurance partners. Reinsurance recoverables include amounts related to paid benefits and estimated amounts related to unpaid policy and contract claims, future policy benefits, and policyholder account balances.

Liabilities for reinsurance are calculated on an actuarial present value method consistent with the risks being transferred.

Future Policy Benefits

The Company establishes liabilities for amounts payable under insurance policies, including traditional life insurance, immediate annuities with life contingencies, supplementary contracts with life contingencies, and accident and health insurance. Generally, amounts are payable over an extended period of time. Liabilities for future policy benefits of traditional life insurance have been computed using a net level premium method based upon estimates at the time of issue for investment yields, mortality, and withdrawals. These estimates include provisions for experience less favorable than initially expected. Mortality assumptions are based on Company experience expressed as a percentage of standard mortality tables. The 2001 Valuation Basic Table and the 1975-1980 Select and Ultimate Basic Table serve as the basis for most mortality assumptions.

Liabilities for future policy benefits of immediate annuities and supplementary contracts with life contingencies are computed by calculating an actuarial present value of future policy benefits, based upon estimates for investment yields and mortality at the time of issue. Liabilities for future policy benefits of immediate annuities and supplementary contracts with life contingencies are also computed by a net level premium method, based upon estimates at the time of issue for investment yields and mortality.

Liabilities for future policy benefits of accident and health insurance represent estimates of payments to be made on reported insurance claims, as well as claims incurred but not yet reported. These liabilities are estimated using actuarial analyses and case basis evaluations that are based upon past claims experience, claim trends, and industry experience.

Policyholder Account Balances

Policyholder account balances include universal life insurance, fixed deferred annuity contracts, and investment-type contracts. Liabilities for these policyholder account balances are included without reduction for potential surrender charges and deferred front-end contract charges. The account balances for these types of contracts are equal to cumulative deposits, less contract charges and withdrawals, plus interest credited. Front-end contract charges are deferred and amortized over the term of the policies. Policyholder benefits incurred in excess of related policyholder account balances are charged to policyholder benefits expense. Interest on policyholder account balances is credited as earned.

On an ongoing basis, the Company performs testing and analysis on its blocks of business to ensure the assumptions made when the Company purchases a block of business or sells new policies remain viable. The Company also periodically performs sensitivity testing on these blocks of business to ensure it maintains the capacity to meet an increase in demand in policyholder benefits, namely increased surrenders, policy loans, or other policyholder elective withdrawals, especially when financial markets become volatile.

Pensions and Other Postretirement Benefits

The measurement of pension and other postretirement benefit obligations and costs depends on a variety of assumptions. Changes in the valuation of pension obligations and assets supporting this obligation can significantly impact the funded status. Assumptions are made regarding the discount rate, expected long-term rate of return on plan assets, health care claim costs, heath care cost trends, retirement rates, and mortality. The discount rate and the

expected return on plan assets have the most significant impact on the level of cost. See Note 13 – Pensions and Other Postretirement Benefits in the Notes to Consolidated Financial Statements for further details.
The Kansas City Life Cash Balance Pension Plan was amended effective December 31, 2010 to provide that participants' accrued benefits were frozen at, and that no further benefits or accruals will be earned after, December 31, 2010. However, the cash balance account will continue to earn annual interest.

Table of Contents

Recognition of Revenues

Premiums for traditional life insurance products are reported as revenue when due. Premiums on accident and health, disability, vision, and dental insurance are reported as earned ratably over the contract period in proportion to the amount of insurance protection provided. A reserve is provided for the portion of premiums written which relates to unexpired terms of coverage.

Deposits related to universal life, fixed deferred annuity contracts, and investment-type products are credited to policyholder account balances. Revenues from such contracts consist of amounts assessed against policyholder account balances for mortality, policy administration, and surrender charges, and are recognized in the period in which the benefits and services are provided as contract charges in the Consolidated Statements of Comprehensive Income. The cash flows from deposits are credited to policyholder account balances. Deposits are not recorded as revenue. Instead, deposits are included as a financing activity in the Consolidated Statements of Cash Flows.

The Company measures its sales or new business production with two components: new premiums recorded and new deposits received. Premiums and deposits are also identified by general product type. New premiums and new deposits are considered to be first year and single receipts. Premiums and deposits are subdivided into two categories: new and renewal. New premiums and deposits are measures of sales or new business production. Renewal premiums and deposits occur as continuing business from existing customers.

Income Taxes

Deferred income taxes are recorded based on the differences between the tax bases of assets and liabilities and the amounts at which they are reported in the consolidated financial statements. Recorded amounts are adjusted to reflect changes in income tax rates and other tax law provisions as they become enacted. Deferred income tax assets are subject to ongoing evaluation of whether such assets will be realized. The ultimate realization of deferred income tax assets generally depends on the reversal of deferred tax liabilities and the generation of future taxable income and realized gains during the periods in which temporary differences become deductible. Deferred income taxes include future deductible differences relating to unrealized losses on investment securities. The Company evaluates the character and timing of unrealized gains and losses to determine whether available future taxable amounts are sufficient to offset future deductible amounts. A valuation allowance against deferred income tax assets may be required if future taxable income is believed to be insufficient to fully realize the assets.

Consolidated Results of Operations

Summary of Results

The Company earned net income of $39.9 million in 2012 compared to $26.1 million in 2011 and $22.3 million in 2010. Net income per share was $3.59 in 2012 versus $2.29 in 2011 and $1.95 in 2010. The following table presents year-over-year variances in results for the two years ended December 31, 2012 and 2011.

	2012 Versus 2011	2011 Versus 2010
Insurance and other revenues	$6,664	$(16,296)
Net investment income	(1,074)	1,369
Net realized investment gains	15,294	2,607
Policyholder benefits and interest credited to policyholder account balances	(2,962)	29,687
Amortization of deferred acquisition costs	5,924	(6,933)
Operating expenses	(4,049)	(5,495)
Income tax expense	(6,063)	(1,108)
Total variance	$13,734	$3,831

Net income increased $13.7 million in 2012 compared to 2011. Contributing to this improvement were increases in net realized investment gains and insurance revenues, along with lower amortization of deferred acquisition costs. Partially offsetting these were increases in policyholder benefits and operating expenses, along with lower net investment income. Additional information on these items is presented below.

Sales

The Company measures sales in terms of new premiums and deposits. Sales of traditional life insurance, immediate annuities, and accident and health products are reported as premium income for financial statement purposes. Deposits received from the sale of interest sensitive products, including universal life insurance, fixed deferred annuities, variable universal life, variable annuities, and supplementary contracts without life contingencies are reflected as deposits in the Consolidated Statements of Cash Flows.

Table of Contents

The Company’s marketing plan for individual products focuses on three main aspects: providing financial security with respect to life insurance, the accumulation of long-term value, and future retirement income needs. The primary emphasis is on the growth of individual life insurance business, including new premiums for individual life products and new deposits for universal life and variable universal life products.

Sales of the Company's products are primarily made through the Company’s existing sales force. The Company emphasizes growth of the sales force with the addition of new general agents and agents. The Company believes that increased sales will result through both the number and productivity of general agents and agents. The Company also places an emphasis on training and direct support to the field force to assist new agents in their start-up phase. In addition, the Company provides support to existing agents to stay abreast of the ever-changing regulatory environment and to introduce agents to new products and enhanced features of existing products. The Company also selectively utilizes third-party marketing arrangements to enhance its sales objectives. This allows the Company the flexibility to identify niches or pursue unique opportunities in the existing markets and to react quickly to take advantage of opportunities when they occur.

The Company also markets a series of group products. These products include group life, dental, disability, and vision products. The primary growth strategies for these products include increased productivity of the existing group representatives; planned expansion of the group distribution system; and to selectively utilize third-party marketing arrangements. Further, growth is to be supported by the addition of new products to the portfolio.

The following table presents gross premiums on new and renewal business, less reinsurance ceded, as included in insurance revenues, for the three years ended December 31. New premiums are also detailed by product.

	2012	% Change	2011	% Change	2010
New premiums:					
Individual life insurance	$17,560	2 %	$17,222	4 %	$16,494
Immediate annuities	12,470	82 %	6,860	(69)%	22,313
Group life insurance	2,459	26 %	1,951	(14)%	2,280
Group accident and health insurance	11,681	(10)%	12,978	3 %	12,606
Total new premiums	44,170	13 %	39,011	(27)%	53,693
Renewal premiums	149,222	2 %	145,999	3 %	141,094
Total premiums	193,392	5 %	185,010	(5)%	194,787
Reinsurance ceded	(57,303)	(1)%	(57,672)	5 %	(54,976)
Net premiums	$136,089	7 %	$127,338	(9)%	$139,811

Consolidated total premiums increased $8.4 million or 5% in 2012 compared to 2011, as total new premiums increased $5.2 million and total renewal premiums increased $3.2 million or 2%. The largest contributor to the increase in new premiums was a $5.6 million or 82% increase in new immediate annuity premiums. Immediate annuity receipts can have sizeable fluctuations, as receipts from policyholders largely result from one-time premiums rather than recurring premiums. The increase in immediate annuity receipts was partially offset by a $1.3 million or 10% decrease in new group accident and health premiums. This reflected a $2.2 million decline in the short-term disability line. This change was partially offset by a $0.5 million increase in new dental premiums. The increase in renewal premiums reflected a $2.2 million or 2% increase in individual life insurance premiums, largely from the Old American segment. In addition, group accident and health renewal premiums increased $1.8 million or 5%. This increase was largely from the short-term disability line.

Consolidated total premiums decreased $9.8 million or 5% in 2011 compared to 2010, as total new premiums decreased $14.7 million or 27% and total renewal premiums increased $4.9 million or 3%. The decrease in new premiums was due to a $15.5 million or 69% decline in immediate annuity sales. This decrease was largely the result of elevated sales of this product in 2010 due to the heightened preference of guaranteed benefits by consumers at that time. In addition to the sizeable fluctuations mentioned above, the decrease in new immediate annuity sales can also be attributed to lower interest rates during 2011 and increased competition from alternative products. Partially offsetting the decrease in immediate annuities, new individual life insurance premiums increased, largely from the Old American segment. The increase in renewal premiums reflected a $2.1 million or 2% increase in individual life insurance renewal premiums and a $2.5 million or 7% increase in group accident and health renewal premiums. The increase in individual life insurance renewal premiums largely resulted from the Old American segment. The increase in group accident and health renewal premiums reflected growth in short-term disability and dental premiums.

The following table reconciles deposits with the Consolidated Statements of Cash Flows and provides detail by new and renewal deposits for the three years ended December 31. New deposits are also detailed by product.

Table of Contents

	2012	% Change	2011	% Change	2010
New deposits:					
Universal life insurance	$12,388	11 %	$11,159	(16)%	$13,330
Variable universal life insurance	563	(32)%	834	(32)%	1,226
Fixed deferred annuities	56,788	(8)%	62,060	(8)%	67,709
Variable annuities	18,039	11 %	16,291	(10)%	18,121
Total new deposits	87,778	(3)%	90,344	(10)%	100,386
Renewal deposits	140,054	(2)%	143,611	4 %	137,827
Total deposits	$227,832	(3)%	$233,955	(2)%	$238,213

Total new deposits decreased from the prior year by $2.6 million or 3% in 2012, following a $10.0 million or 10% decrease in 2011. The decrease in 2012 was largely due to a $5.3 million decrease in new fixed deferred annuity deposits. This was partially offset by a $1.7 million or 11% increase in new variable annuity deposits and a $1.2 million or 11% increase in new universal life deposits. The decline in 2011 was largely due to a decrease in new fixed deferred annuities, as well as declines in new universal life and variable annuity deposits.

Total renewal deposits decreased from the prior year by $3.6 million or 2% in 2012 following a $5.8 million or 4% increase in 2011. The decline in 2012 was largely attributable to a decrease in fixed deferred annuity renewal deposits. The improvement in 2011 was due to an increase in renewal fixed deferred annuity deposits.

Insurance Revenues

Insurance revenues consist of premiums, net of reinsurance, and contract charges. Insurance revenues are affected by the level of new sales, the type of products sold, the persistency of policies, general economic conditions, and competitive forces. The Company strives to provide a portfolio of products with safety and competitive return objectives. The Company offers a broad range of products, including variable insurance products, which allow policyholders to participate in both the equity and fixed income markets. Interest sensitive and traditional insurance products combine safety of principal with competitive interest returns.

Contract charges consist of cost of insurance, expense loads, amortization of unearned revenues, and surrender charges on policyholder account balances. The cost of insurance and expense loads are earned over time by the continued persistency of these products. Surrender charges result from charges levied for withdrawals of policies during time frames defined in the policy contract. Finally, a component of contract charges is the recognition over time of the deferred revenue liability (DRL) from certain fixed and variable universal life policies. This liability arises from front-end loads on such policies and is recognized in concert with the future expected gross profits, similar to the amortization of DAC. Unlocking or other events may also have an impact on future expected gross profits on products and policies. If it is determined that it is appropriate to change the assumptions of future experience, then an unlocking adjustment is recognized for the block of business being evaluated. Certain assumptions, such as interest spreads and surrender rates, may be interrelated. As such, unlocking adjustments often reflect revisions to multiple assumptions. In addition, the Company may also consider refinements in estimates for other unusual or one-time occurrences for events such as administrative or actuarial system upgrades. These items are applied to the appropriate financial statement line items similar to unlocking adjustments.

Total contract charges charges declined $1.2 million or 1% in 2012 and $5.0 million or 5% in 2011, relative to the same periods one year earlier. The decline in 2012 was due to several factors including a decrease in cost of insurance charges, largely due to the runoff of closed blocks; a decrease in expense loads that resulted from increased sales of products with lower expense loads in 2012 relative to the prior year; and a decline in surrender charges, reflecting lower surrenders on universal life products. Partially offsetting these, the amortization of deferred revenue increased due to improved reinsurance modeling capabilities resulting from a system upgrade during 2011. The decline in 2011 primarily resulted from factors including lower amortization of deferred revenue due to unlocking, as discussed below; a decline in cost of insurance charges, largely due to the runoff of closed blocks; and a decline in surrender charges, reflecting reduced surrenders of universal life and variable universal life products in the ongoing blocks of business.

Included in total contract charges are groups of policies and companies that the Company considers to be closed blocks. Total contract charges on these closed blocks equaled 35% of total consolidated contract charges during 2012, compared to 36% in 2011. Total contract charges on closed blocks declined 3% from $35.9 million in 2011 to $34.8 million in 2012, reflecting the runoff of this business. Total contract charges on open blocks of business were essentially flat in 2012 compared to 2011.

At least annually, a review is performed regarding the assumptions related to future expected gross profits on products and policies consistent with those performed for DAC and VOBA. If it is determined that the assumptions should be revised, an adjustment may be recorded to the deferred revenue component of contract charges in the current period as an unlocking adjustment. The

Table of Contents

Company had unlocking in the DRL in both 2012 and 2011. In 2012, unlocking due to changes in the interest and mortality margins resulted in a decrease to the deferred revenue liability and a $1.8 million increase to contract charges. In 2011, the unlocking was the result of several factors, the largest of which was associated with future mortality experience. This included the use of a new industry mortality table and the corresponding impact of reinsurance. The impact of the unlocking in 2011 was an increase in the DRL liability and a reduction in contract charges in the amount of $1.9 million.

The Company uses reinsurance as a means to mitigate its risks and to reduce the earnings volatility from claims. Reinsurance ceded premiums decreased $0.4 million to $57.3 million in 2012 from $57.7 million in 2011. In 2010, reinsurance ceded was $55.0 million. The decrease in 2012 was largely the result of two factors, including an increase in retention limit on new business effective January 1, 2012. This reduced the amount of reinsurance on new business written in 2012. The Company also recaptured a block of reinsurance in its individual life insurance business on a closed block of business, which reduced the overall ceded premiums in 2012 by $0.4 million.

Investment Revenues

Gross investment income is largely composed of interest, dividends and other earnings on fixed maturity securities, equity securities, short-term investments, mortgage loans, real estate, and policy loans. Gross investment income decreased $1.1 million or 1% in 2012 compared to 2011, as an increase in average invested assets was more than offset by lower yields earned. Gross investment income increased $1.7 million or 1% in 2011 compared to 2010, as an increase in average invested assets was partially offset by lower yields.

Fixed maturity securities provided a majority of the Company’s investment income during 2012. Approximately 75% of the Company's investments were in fixed maturity securities at December 31, 2012. Gross investment income from these investments declined $4.0 million compared to 2011. This decrease was primarily the result of lower yields available in the marketplace and a lower average balance of fixed maturity assets.

The Company has significantly increased its holdings in commercial mortgage loans in recent periods. The Company owned $674.0 million in mortgage loans at December 31, 2012, up from $601.9 million at December 31, 2011 and $559.2 million at December 31, 2010. Over this time, mortgage loan investment income increased from 17% of gross investment income to 20% in 2012. It is anticipated that the increased allocation to mortgage loans will provide a favorable impact on investment portfolio yields.

Investment income from real estate properties provided $9.5 million or 5% of gross investment income in 2012 compared to $7.7 million or 4% in 2011. This increase was largely the result of a change in the mix of real estate investments and improved occupancy in certain properties.

In addition, the increase in the fair value of an alternative investment fund, resulted in an increase in investment income of $1.5 million in 2012 compared to 2011.

The Company realizes investment gains and losses from several sources, including write-downs of investments and sales of investment securities and real estate. Many securities purchased by the Company contain call provisions, which allow the issuer to redeem the securities at a particular price. Depending upon the terms of the call provision and price at which the security was purchased, a gain or loss may be realized.

Table of Contents

The following table provides detail concerning realized investment gains and losses for the three years ended December 31.

	2012	2011	2010
Gross gains resulting from:			
Sales of investment securities	$2,670	$3,945	$2,545
Investment securities called and other	3,806	3,519	2,139
Sales of real estate	18,884	—	—
Total gross gains	25,360	7,464	4,684
Gross losses resulting from:			
Sales of investment securities	(2,651)	(1,666)	(67)
Investment securities called and other	(865)	(376)	(253)
Mortgage loans	(220)	(3)	—
Impairment losses on real estate	(838)	—	—
Total gross losses	(4,574)	(2,045)	(320)
Change in allowance for potential future losses on mortgage loans	(497)	102	—
Amortization of DAC and VOBA	(135)	(370)	(9)
Net realized investment gains, excluding other-than-temporary impairment losses	20,154	5,151	