KANSAS CITY LIFE INSURANCE CO
Form 10-Q
July 30, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2014 or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 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
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 o
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 o Accelerated filer x
Non-accelerated filer o Smaller reporting company o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock: $1.25 par	10,967,987 shares
Class	Outstanding June 30, 2014

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KANSAS CITY LIFE INSURANCE COMPANY

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Part I. Financial Information
Item 1. Financial Statements
Amounts in thousands, except share data, or as otherwise noted
Kansas City Life Insurance Company
Consolidated Balance Sheets

	June 30 2014 (Unaudited)	December 31 2013
ASSETS		
Investments:		
Fixed maturity securities available for sale, at fair value	$2,762,031	$2,618,620
Equity securities available for sale, at fair value	24,732	23,116
Mortgage loans	572,831	629,256
Real estate	142,102	142,536
Policy loans	83,223	83,518
Short-term investments	35,660	40,712
Other investments	7,526	12,517
Total investments	3,628,105	3,550,275
Cash	8,566	8,197
Accrued investment income	34,160	33,795
Deferred acquisition costs	245,728	256,386
Reinsurance recoverables	193,765	191,055
Property and equipment	17,295	17,524
Other assets	58,967	64,018
Separate account assets	410,700	393,416
Total assets	$4,597,286	$4,514,666
LIABILITIES		
Future policy benefits	$926,526	$910,228
Policyholder account balances	2,091,954	2,096,212
Policy and contract claims	37,545	36,783
Other policyholder funds	161,865	160,421
Other liabilities	203,832	192,202
Separate account liabilities	410,700	393,416
Total liabilities	3,832,422	3,789,262
STOCKHOLDERS' EQUITY		
Common stock, par value $1.25 per share		
Authorized 36,000,000 shares, issued 18,496,680 shares	23,121	23,121
Additional paid in capital	40,998	40,989
Retained earnings	831,443	823,408
Accumulated other comprehensive income	45,637	14,170
Treasury stock, at cost (2014 - 7,528,693 shares; 2013 - 7,527,841 shares)	(176,335)	(176,284)
Total stockholders’ equity	764,864	725,404
Total liabilities and stockholders’ equity	$4,597,286	$4,514,666

See accompanying Notes to Consolidated Financial Statements

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Kansas City Life Insurance Company
Consolidated Statements of Comprehensive Income

	Quarter Ended June 30		Six Months Ended June 30	
	2014 (Unaudited)	2013	2014 (Unaudited)	2013
REVENUES				
Insurance revenues:				
Net premiums	$41,334	$43,350	$83,121	$97,766
Contract charges	30,834	30,611	59,632	54,959
Total insurance revenues	72,168	73,961	142,753	152,725
Investment revenues:				
Net investment income	41,351	42,878	82,042	85,288
Net realized investment gains, excluding other-than-temporary impairment losses	784	1,732	2,449	2,178
Net impairment losses recognized in earnings:				
Total other-than-temporary impairment losses	(243)	(272)	(456)	(459)
Portion of impairment losses recognized in other comprehensive income (loss)	136	41	187	99
Net other-than-temporary impairment losses recognized in earnings	(107)	(231)	(269)	(360)
Total investment revenues	42,028	44,379	84,222	87,106
Other revenues	2,343	2,558	4,676	4,791
Total revenues	116,539	120,898	231,651	244,622
BENEFITS AND EXPENSES				
Policyholder benefits	50,153	47,585	102,907	108,733
Interest credited to policyholder account balances	19,260	19,865	38,206	39,528
Amortization of deferred acquisition costs	12,529	10,904	21,357	19,769
Operating expenses	22,113	26,504	48,733	53,008
Total benefits and expenses	104,055	104,858	211,203	221,038
Income before income tax expense	12,484	16,040	20,448	23,584
Income tax expense	4,027	5,189	6,489	7,545
NET INCOME	$8,457	$10,851	$13,959	$16,039
COMPREHENSIVE INCOME (LOSS), NET OF TAXES				
Change in net unrealized gains on securities available for sale	$18,908	$(53,348)	$38,273	$(43,875)
Change in future policy benefits	(2,929)	6,637	(6,562)	6,924
Change in policyholder account balances	(113)	310	(244)	322
Change in benefit plan obligations	—	5,010	—	5,010
Other comprehensive income (loss)	15,866	(41,391)	31,467	(31,619)
COMPREHENSIVE INCOME (LOSS)	$24,323	$(30,540)	$45,426	$(15,580)

Basic and diluted earnings per share:				
Net income	$0.77	$0.98	$1.27	$1.45

See accompanying Notes to Consolidated Financial Statements

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Kansas City Life Insurance Company
Consolidated Statement of Stockholders' Equity

	Six Months Ended June 30, 2014 (Unaudited)	
COMMON STOCK, beginning and end of period	$23,121	
ADDITIONAL PAID IN CAPITAL		
Beginning of year	40,989	
Excess of proceeds over cost of treasury stock sold	9	
End of period	40,998	
RETAINED EARNINGS		
Beginning of year	823,408	
Net income	13,959	
Stockholder dividends of $0.54 per share	(5,924	)
End of period	831,443	
ACCUMULATED OTHER COMPREHENSIVE INCOME		
Beginning of year	14,170	
Other comprehensive income	31,467	
End of period	45,637	
TREASURY STOCK, at cost		
Beginning of year	(176,284	)
Cost of 1,140 shares acquired	(55	)
Cost of 288 shares sold	4	
End of period	(176,335	)
TOTAL STOCKHOLDERS' EQUITY	$764,864	

See accompanying Notes to Consolidated Financial Statements

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Kansas City Life Insurance Company

Consolidated Statements of Cash Flows

	Six Months Ended June 30	
	2014	2013
	(Unaudited)	
OPERATING ACTIVITIES		
Net income	$13,959	$16,039
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premium and discount	2,097	2,042
Depreciation	2,240	2,094
Acquisition costs capitalized	(17,761)	(18,661)
Amortization of deferred acquisition costs	21,357	19,769
Realized investment gains	(2,180)	(1,818)
Changes in assets and liabilities:		
Reinsurance recoverables	(2,710)	(3,541)
Future policy benefits	6,202	20,303
Policyholder account balances	(8,135)	(15,993)
Income taxes payable and deferred	490	545
Other, net	305	1,092
Net cash provided	15,864	21,871
INVESTING ACTIVITIES		
Purchases:		
Fixed maturity securities	(194,874)	(106,941)
Equity securities	(89)	(13,212)
Mortgage loans	(9,592)	(30,291)
Real estate	(4,120)	(17,549)
Policy loans	(5,751)	(5,670)
Sales or maturities, calls, and principal paydowns:		
Fixed maturity securities	115,230	138,414
Equity securities	15	1,459
Mortgage loans	63,261	51,104
Real estate	4,723	368
Policy loans	6,046	8,005
Other investments	5,000	—
Net sales of short-term investments	5,052	6,751
Acquisition of property and equipment	(605)	(351)
Reinsurance transaction	—	(34,279)
Net cash used	(15,704)	(2,192)

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Kansas City Life Insurance Company
Consolidated Statements of Cash Flows (Continued)

	Six Months Ended June 30	
	2014	2013
	(Unaudited)	
FINANCING ACTIVITIES		
Deposits on policyholder account balances	$129,853	$116,485
Withdrawals from policyholder account balances	(131,261)	(133,369)
Net transfers from (to) separate accounts	3,791	(1,734)
Change in other deposits	3,792	5,156
Cash dividends to stockholders	(5,924)	(5,951)
Net change in treasury stock	(42)	(380)
Net cash provided (used)	209	(19,793)
Increase (decrease) in cash	369	(114)
Cash at beginning of year	8,197	7,026
Cash at end of period	$8,566	$6,912
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$6,000	$7,000

See accompanying Notes to Consolidated Financial Statements

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Kansas City Life Insurance Company
Notes to Consolidated Financial Statements (Unaudited)

1. Nature of Operations and Significant Accounting Policies

Basis of Presentation

The unaudited interim consolidated financial statements and the accompanying notes include the accounts of the consolidated entity (the Company), which 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.

The unaudited interim consolidated financial statements have been prepared on the basis of U.S. generally accepted accounting principles (GAAP) for interim financial reporting with the instructions to Form 10-Q and Regulations S-K, S-X, and other applicable regulations. Accordingly, they do not include all of the disclosures required by GAAP for complete financial statements. As such, these unaudited interim consolidated financial statements should be read in conjunction with the Company's 2013 Form 10-K, as filed with the Securities and Exchange Commission on February 26, 2014. Management believes that the disclosures are adequate to make the information presented not misleading, and all normal and recurring adjustments necessary to present fairly the financial position at June 30, 2014 and the results of operations for all periods presented have been made. The results of operations for any interim period are not necessarily indicative of the Company's operating results for a full year. Significant intercompany transactions have been eliminated in consolidation and certain immaterial reclassifications have been made to prior period results to conform with the current period's presentation.

The preparation of the unaudited interim consolidated financial statements requires management of the Company to make estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the unaudited interim consolidated financial statements, and the reported amounts of revenue and expenses during the period. These estimates are inherently subject to change and actual results could differ from these estimates.

Immaterial Correction of Error

During the third quarter of 2013, the Company identified an immaterial correction of an error in the presentation of net premiums and policyholder benefits that resulted from the incorrect recognition of premiums related to the conversion of fixed deferred annuity contracts to immediate annuities with life contingencies. The impact of the correction was an equal and offsetting increase to both net premiums and policyholder benefits. The error resulted in no impact to net income, earnings per share, stockholders' equity, or cash flows. Related to the immaterial correction, the Company understated the presentation of net premiums and policyholder benefits by $15.7 million in the first quarter of 2013 and $8.4 million in the second quarter of 2013. The numbers reported have been corrected to reflect these adjustments. The error was insignificant to any previous periods presented.

Reinsurance Transaction

In April 2013, the Company acquired a closed block of variable life insurance policies and variable annuity contracts through reinsurance and servicing agreements from American Family Life Insurance Company (American Family) . Under the reinsurance agreement, the Company assumed 100% of the separate account liabilities on a modified coinsurance basis and 100% of the general account liabilities on a coinsurance basis. The transaction also involved ongoing servicing arrangements with American Family during the period that such policies and contracts were transitioned to administration by the Company. This block is included as a component of the Individual Insurance segment. For additional information, please refer to the Company's 2013 Form 10-K.

Significant Accounting Policies

For a full discussion of the Company's significant accounting policies, please refer to the Company's 2013 Form 10-K. No significant updates or changes to these policies occurred during the six months ended June 30, 2014.

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Kansas City Life Insurance Company
Notes to Consolidated Financial Statements–(Continued) (Unaudited)

2. New Accounting Pronouncements

Accounting Pronouncements Issued During 2014, Not Yet Adopted

In January 2014, the Financial Accounting Standards Board (FASB) issued guidance regarding accounting for investments in qualified affordable housing projects. The amendments modify the conditions that a reporting entity must meet to be eligible to use a method other than the equity or cost methods to account for qualified affordable housing project investments. The guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Company is currently evaluating this guidance and its materiality to the consolidated financial statements.

In May 2014, the FASB issued guidance regarding accounting for revenue recognition that identifies the accounting treatment for an entity's contracts with customers. Certain contracts, including insurance contracts, are specifically excluded from this guidance. This guidance is effective for public entities for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating this guidance, but it does not believe that there will be a material impact to the consolidated financial statements.

All other new accounting standards and updates of existing standards issued through the date of this filing were considered by management and did not relate to accounting policies and procedures pertinent to the Company at this time or were not expected to have a material impact to the consolidated financial statements.

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Kansas City Life Insurance Company
Notes to Consolidated Financial Statements–(Continued) (Unaudited)

3. Investments
Fixed Maturity and Equity Securities Available for Sale
Securities by Asset Class
The following table provides amortized cost and fair value of securities by asset class at June 30, 2014.

	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government	$167,934	$9,174	$349	$176,759
Federal agencies [1]	19,762	2,671	—	22,433
Federal agency issued residential mortgage-backed securities [1]	49,654	5,022	3	54,673
Subtotal	237,350	16,867	352	253,865
Corporate obligations:				
Industrial	530,680	35,725	1,566	564,839
Energy	226,948	18,709	986	244,671
Communications and technology	220,565	18,365	267	238,663
Financial	275,267	21,123	996	295,394
Consumer	501,278	31,471	1,521	531,228
Public utilities	232,300	28,101	240	260,161
Subtotal	1,987,038	153,494	5,576	2,134,956
Corporate private-labeled residential mortgage-backed securities	101,715	4,579	110	106,184
Municipal securities	135,153	19,082	15	154,220
Other	93,945	4,814	2,953	95,806
Redeemable preferred stocks	17,490	275	765	17,000
Fixed maturity securities	2,572,691	199,111	9,771	2,762,031
Equity securities	23,714	1,866	848	24,732
Total	$2,596,405	$200,977	$10,619	$2,786,763

[1] Federal agency securities are not backed by the full faith and credit of the U.S. Government.

The following table provides amortized cost and fair value of securities by asset class at December 31, 2013.

	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government	$134,198	$6,653	$1,831	$139,020
Federal agencies [1]	19,756	2,312	—	22,068
Federal agency issued residential mortgage-backed securities [1]	56,738	5,392	2	62,128
Subtotal	210,692	14,357	1,833	223,216
Corporate obligations:				
Industrial	515,395	27,051	7,667	534,779
Energy	211,115	15,462	3,832	222,745
Communications and technology	222,277	12,938	1,672	233,543
Financial	266,693	18,824	2,040	283,477
Consumer	473,627	25,936	5,807	493,756
Public utilities	228,551	24,780	954	252,377
Subtotal	1,917,658	124,991	21,972	2,020,677
Corporate private-labeled residential mortgage-backed securities	114,219	3,179	916	116,482
Municipal securities	138,136	9,488	5	147,619
Other	97,769	4,422	4,317	97,874
Redeemable preferred stocks	15,144	—	2,392	12,752
Fixed maturity securities	2,493,618	156,437	31,435	2,618,620
Equity securities	23,691	1,871	2,446	23,116
Total	$2,517,309	$158,308	$33,881	$2,641,736

[1] Federal agency securities are not backed by the full faith and credit of the U.S. Government.

Contractual Maturities

The following table provides the distribution of maturities for fixed maturity securities available for sale at June 30, 2014. Expected maturities may differ from these contractual maturities since borrowers may have the right to call or prepay obligations.

	Amortized Cost	Fair Value
Due in one year or less	$111,316	$114,061
Due after one year through five years	739,389	815,907
Due after five years through ten years	1,030,927	1,077,725
Due after ten years	454,374	503,032
Securities with variable principal payments	219,195	234,306
Redeemable preferred stocks	17,490	17,000
Total	$2,572,691	$2,762,031

No material derivative financial instruments were held during the first six months of 2014 or 2013.

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Kansas City Life Insurance Company
Notes to Consolidated Financial Statements–(Continued) (Unaudited)

Unrealized Losses on Investments

At the end of each quarter, all securities are reviewed to determine whether impairments exist and whether other-than-temporary impairments should be recorded. This quarterly 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. The Company prepares a formal review document no less often than quarterly of all investments where fair value is less than 80% of amortized cost for six months or more and selected investments that have changed significantly from a previous period and that have a decline in fair value greater than 10% of amortized cost. For additional information on the Company's process and considerations, as well as related accounting when other-than-temporary impairments are identified, please refer to Note 4 - Investments of the Company's 2013 Form 10-K.

The following table provides information regarding fixed maturity and equity security investments available for sale with unrealized losses by length of time at June 30, 2014.

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government	$9,009	$53	$9,779	$296	$18,788	$349
Federal agency issued residential mortgage-backed securities [1]	68	2	287	1	355	3
Subtotal	9,077	55	10,066	297	19,143	352
Corporate obligations:						
Industrial	5,808	5	59,461	1,561	65,269	1,566
Energy	1,996	3	41,439	983	43,435	986
Communications and technology	—	—	14,732	267	14,732	267
Financial	4,960	40	15,941	956	20,901	996
Consumer	12,560	70	57,209	1,451	69,769	1,521
Public utilities	—	—	6,756	240	6,756	240
Subtotal	25,324	118	195,538	5,458	220,862	5,576
Corporate private-labeled residential mortgage-backed securities	15,009	110	—	—	15,009	110
Municipal securities	3,029	15	—	—	3,029	15
Other	1,277	111	38,070	2,842	39,347	2,953
Redeemable preferred stocks	1,009	3	9,374	762	10,383	765
Fixed maturity securities	54,725	412	253,048	9,359	307,773	9,771
Equity securities	11	11	11,455	837	11,466	848
Total	$54,736	$423	$264,503	$10,196	$319,239	$10,619

[1] Federal agency securities are not backed by the full faith and credit of the U.S. Government.

The following table provides information regarding fixed maturity and equity security investments available for sale with unrealized losses by length of time at December 31, 2013.

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government	$44,951	$1,795	$749	$36	$45,700	$1,831
Federal agency issued residential mortgage-backed securities [1]	37	—	288	2	325	2
Subtotal	44,988	1,795	1,037	38	46,025	1,833
Corporate obligations:						
Industrial	146,454	5,718	22,071	1,949	168,525	7,667
Energy	70,015	3,366	5,518	466	75,533	3,832
Communications and technology	43,477	1,672	—	—	43,477	1,672
Financial	25,300	866	4,680	1,174	29,980	2,040
Consumer	136,745	5,807	—	—	136,745	5,807
Public utilities	17,476	575	3,617	379	21,093	954
Subtotal	439,467	18,004	35,886	3,968	475,353	21,972
Corporate private-labeled residential mortgage-backed securities	33,179	916	—	—	33,179	916
Municipal securities	2,044	5	—	—	2,044	5
Other	16,691	726	39,900	3,591	56,591	4,317
Redeemable preferred stocks	12,752	2,392	—	—	12,752	2,392
Fixed maturity securities	549,121	23,838	76,823	7,597	625,944	31,435
Equity securities	9,731	2,404	131	42	9,862	2,446
Total	$558,852	$26,242	$76,954	$7,639	$635,806	$33,881

[1] Federal agency securities are not backed by the full faith and credit of the U.S. Government.

The Company also considers as part of its monitoring and evaluation process the length of time the fair value of a security is below amortized cost. At June 30, 2014, the Company had 96 positions in its investment portfolio of fixed maturity and equity securities with unrealized losses. Included in this total, 22 security positions were below cost for less than one year; 64 security positions were below cost for one year or more and less than three years; and ten security positions were below cost for three years or more. At December 31, 2013, the Company had 195 positions in its investment portfolio of fixed maturity and equity securities with unrealized losses. Included in this total, 173 security positions were below cost for less than one year; twelve security positions were below cost for one year or more and less than three years; and ten security positions were below cost for three years or more. The securities having unrealized losses for three years or more include mortgage-backed securities, where discounted future cash flow calculations are the primary determinant of impairment; asset-backed securities, which continue to perform as expected but are not actively traded and market values are discounted significantly due to illiquidity; and variable-rate securities, where interest rates and spreads to indices are significant factors in market pricing.

The following table provides the distribution of maturities for fixed maturity securities available for sale with unrealized losses at June 30, 2014 and December 31, 2013. Expected maturities may differ from these contractual maturities since borrowers may have the right to call or prepay obligations.

	June 30, 2014		December 31, 2013	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fixed maturity securities available for sale:				
Due in one year or less	$5,252	$41	$—	$—
Due after one year through five years	4,090	14	29,812	268
Due after five years through ten years	218,309	4,902	417,859	20,118
Due after ten years	54,359	3,936	132,018	7,740
Total	282,010	8,893	579,689	28,126
Securities with variable principal payments	15,380	113	33,503	917
Redeemable preferred stocks	10,383	765	12,752	2,392
Total	$307,773	$9,771	$625,944	$31,435

The following table provides a reconciliation of credit losses recognized in earnings on fixed maturity securities held by the Company for which a portion of the other-than-temporary loss was recognized in other comprehensive income (loss).

	Quarter Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Credit losses on securities held at beginning of the period in accumulated other comprehensive income	$16,532	$15,384	$16,375	$15,260
Additions for credit losses not previously recognized in other-than-temporary impairment	—	—	4	27
Additions for increases in the credit loss for which an other-than-temporary impairment was previously recognized when there was no intent to sell the security before recovery of its amortized cost basis	107	231	265	333
Reductions for securities sold during the period	—	—	—	—
Reductions for securities previously recognized in other comprehensive income (loss) because of intent to sell the security before recovery of its amortized cost basis	—	—	—	—
Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security	(5)	(4)	(10)	(9)
Credit losses on securities held at the end of the period in accumulated other comprehensive income	$16,634	$15,611	$16,634	$15,611

Kansas City Life Insurance Company
Notes to Consolidated Financial Statements–(Continued) (Unaudited)

Realized Gains (Losses)

The following table provides detail concerning realized investment gains and losses for the second quarters and six months ended June 30, 2014 and 2013.

	Quarter Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Gross gains resulting from:				
Sales of investment securities	$433	$50	$611	$118
Investment securities called and other	367	1,789	1,662	2,515
Real estate	—	20	339	20
Total gross gains	800	1,859	2,612	2,653
Gross losses resulting from:				
Investment securities called and other	(57)	(178)	(311)	(360)
Sale of real estate and joint venture	—	—	—	(89)
Mortgage loans	(66)	(36)	(90)	(36)
Total gross losses	(123)	(214)	(401)	(485)
Change in allowance for potential future losses on mortgage loans	124	92	296	38
Amortization of DAC and VOBA	(17)	(5)	(58)	(28)
Net realized investment gains, excluding other-than-temporary impairment losses	784	1,732	2,449	2,178
Net impairment losses recognized in earnings:				
Other-than-temporary impairment losses on fixed maturity and equity securities	(243)	(272)	(456)	(459)
Portion of loss recognized in other comprehensive income (loss)	136	41	187	99
Net other-than-temporary impairment losses recognized in earnings	(107)	(231)	(269)	(360)
Net realized investment gains	$677	$1,501	$2,180	$1,818

Proceeds From Sales of Investment Securities

The table below details proceeds from the sale of fixed maturity and equity securities, excluding maturities and calls, for the second quarters and six months ended June 30, 2014 and 2013.

	Quarter Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Proceeds	$8,269	$5,065	$12,643	$9,130

Mortgage Loans

The Company invests in commercial mortgage loans that are secured by commercial real estate and are stated at cost, adjusted for amortization of premium and accrual of discount, less an allowance for potential future losses. This allowance is maintained at a level believed by management to be adequate to absorb estimated credit losses and was $3.0 million at June 30, 2014 and $3.3 million at December 31, 2013. The Company had 16% of its total investments in commercial mortgage loans at June 30, 2014, down from 18% at December 31, 2013. In addition to the subject collateral underlying the mortgage, the Company typically requires some amount of recourse from borrowers as another potential source of repayment. The recourse requirement is determined as part of the underwriting requirements of each loan. The average loan to value ratio for the overall portfolio was 46% at June 30, 2014, compared to 47% at December 31, 2013. These ratios are based upon the current balance of loans relative to the appraisal of value at the time the loan was originated or acquired.

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The following table identifies the gross mortgage loan principal outstanding and the allowance for potential future losses at June 30, 2014 and December 31, 2013.

	June 30 2014	December 31 2013
Principal outstanding	$575,786	$632,507
Allowance for potential future losses	(2,955)	(3,251)
Carrying value	$572,831	$629,256

The following table summarizes the amount of mortgage loans held by the Company at June 30, 2014 and December 31, 2013, segregated by year of origination. Purchased loans are shown in the year acquired by the Company, although the individual loans may have been initially originated in prior years.

	June 30 2014	% of Total	December 31 2013	% of Total
Prior to 2005	$33,748	6 %	$41,324	6 %
2005	26,060	4 %	28,111	4 %
2006	20,004	3 %	24,744	4 %
2007	22,821	4 %	27,009	4 %
2008	26,069	5 %	28,051	4 %
2009	25,681	4 %	37,723	6 %
2010	57,296	10 %	61,236	10 %
2011	96,759	17 %	118,459	19 %
2012	171,559	30 %	184,749	29 %
2013	79,713	14 %	81,101	14 %
2014	16,076	3 %	—	— %
Total	$575,786	100 %	$632,507	100 %

The following table identifies mortgage loans by geographic location at June 30, 2014 and December 31, 2013.

	June 30 2014	% of Total	December 31 2013	% of Total
Pacific	$166,793	29 %	$181,690	29 %
West north central	81,864	14 %	91,687	14 %
West south central	95,826	17 %	101,019	16 %
Mountain	71,140	12 %	78,116	12 %
South Atlantic	61,471	11 %	66,686	11 %
Middle Atlantic	22,615	4 %	31,495	5 %
East north central	50,747	9 %	57,395	9 %
East south central	25,330	4 %	24,419	4 %
Total	$575,786	100 %	$632,507	100 %

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The following table identifies the concentration of mortgage loans by state greater than 5% of total at June 30, 2014 and December 31, 2013.

	June 30 2014	% of Total		December 31 2013	% of Total	
California	$140,309	24	%	$149,065	24	%
Texas	91,527	16	%	95,205	15	%
Minnesota	57,794	10	%	64,464	10	%
Florida	31,276	5	%	34,334	5	%
All others	254,880	45	%	289,439	46	%
Total	$575,786	100	%	$632,507	100	%

The following table identifies mortgage loans by property type at June 30, 2014 and December 31, 2013. The Other category consists largely of apartments and retail properties.

	June 30 2014	% of Total		December 31 2013	% of Total	
Industrial	$303,247	53	%	$328,478	52	%
Office	166,556	29	%	184,529	29	%
Medical	31,389	5	%	39,531	6	%
Other	74,594	13	%	79,969	13	%
Total	$575,786	100	%	$632,507	100	%

The table below identifies mortgage loans by maturity at June 30, 2014 and December 31, 2013.

	June 30 2014	% of Total		December 31 2013	% of Total	
Due in one year or less	$22,260	4	%	$22,464	4	%
Due after one year through five years	135,326	24	%	169,146	27	%
Due after five years through ten years	193,733	33	%	244,667	38	%
Due after ten years	224,467	39	%	196,230	31	%
Total	$575,786	100	%	$632,507	100	%

The Company may refinance commercial mortgage loans prior to contractual maturity as a means of originating new loans that meet the Company's underwriting and pricing parameters. The Company refinanced three loans with an outstanding balance of $3.5 million during the quarter ended June 30, 2014 and one loan with an outstanding balance of $1.4 million during the quarter ended June 30, 2013. The Company refinanced five loans with outstanding balances of $6.7 million during the six months ended June 30, 2014 and five loans with outstanding balances of $7.7 million during the six months ended June 30, 2013.

In the normal course of business, the Company generally commits to fund commercial mortgage loans up to 120 days in advance. These commitments typically have fixed expiration dates. A small percentage of commitments expire due to the borrower's failure to deliver the requirements of the commitment by the expiration date. In these cases, the Company retains the commitment fee. For additional information, please see Note 15 - Commitments.

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4. Fair Value Measurements
Under GAAP, fair value represents the price that would be received to sell an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. It is the Company’s policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements.
The Company categorizes its financial assets and liabilities measured at fair value in three levels, based on the inputs and assumptions used to determine the fair value. These levels are as follows:
Level 1 - Valuations are based upon unadjusted quoted prices for identical instruments traded in active markets.
Level 2 - Valuations are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. Valuations are obtained from third-party pricing services or inputs that are observable or derived principally from or corroborated by observable market data.
Level 3 - Valuations are generated from techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company's assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of discounted cash flow models, spread-based models, and similar techniques, using the best information available in the circumstances.
Following is a description of valuation methodologies used for assets and liabilities recorded at fair value and for estimating fair value for financial instruments not recorded at fair value but for which fair value is disclosed.
Assets
Securities Available for Sale
Fixed maturity and equity securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon unadjusted quoted prices, if available, except as described in the subsequent paragraphs.
Cash and Short-Term Financial Assets
Short-term financial assets include cash and other short-term investments. Cash is categorized as Level 1. Other short-term assets are invested in institutional money market funds. These assets are categorized as Level 2, as the valuation is based upon the net asset value (NAV) of the fund. There are no restrictions on withdrawal of these funds.
Loans
The Company does not record loans at fair value. As such, valuation techniques discussed herein for loans are primarily for estimating fair value for purpose of disclosure.
Fair values of mortgage loans on real estate properties are calculated by discounting contractual cash flows, using discount rates based on current industry pricing or the Company’s estimate of an appropriate risk-adjusted discount rate for loans of similar size, type, remaining maturity, likelihood of prepayment, and repricing characteristics. Mortgage loans are categorized as Level 3 in the fair value hierarchy.
The Company also has loans made to policyholders. These loans cannot exceed the cash surrender value of the policy. Carrying value of policy loans approximates fair value. Policy loans are categorized as Level 3.
Other Invested Assets
Included in other invested assets is an institutional alternative strategies fund that is recorded at fair value. These assets are categorized as Level 2, as the valuation of these funds is based on values provided by the issuer and represent amounts at which the Company could transact with the issuer. Certain redemption restrictions may apply on this fund, including advance written notice to withdraw funds.
Separate Accounts
The separate account assets and liabilities, which are equal, are recorded at fair value based upon NAV of the underlying investment holdings as derived from closing prices on a national exchange or as provided by the issuer. This is the value at which a policyholder could transact with the issuer on the date. Separate accounts are categorized as Level 2.

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Liabilities

Investment-Type Liabilities Included in Policyholder Account Balances and Other Policyholder Funds

The fair values of supplementary contracts and annuities without life contingencies are estimated to be the present value of payments at a market yield. The fair values of deposits with no stated maturity are estimated to be the amount payable on demand at the measurement date. These liabilities are categorized as Level 3. The Company has not estimated the fair value of the liabilities under contracts that involve significant mortality or morbidity risks, as these liabilities fall within the definition of insurance contracts. Insurance contracts are excluded from financial instruments that require disclosures of fair value.

Guaranteed Minimum Withdrawal Benefits (GMWB) Included in Other Policyholder Funds

The Company offers a GMWB rider that can be added to new or existing variable annuity contracts. The rider provides an enhanced withdrawal benefit that guarantees a stream of income payments to an owner or annuitant, regardless of the contract account value. Fair value for GMWB rider contracts is a Level 3 valuation, as it is based on models which utilize significant unobservable inputs. These models require actuarial and financial market assumptions, which reflect the assumptions market participants would use in pricing the contract, including adjustments for volatility, risk, and issuer non-performance.

Determination of Fair Value

The Company utilizes external third-party pricing services to determine the majority of its fair values on investment securities available for sale. At June 30, 2014 and December 31, 2013, approximately 97% of the carrying value of these investments was from external pricing services, 1% was from brokers, and 2% was derived from internal matrices and calculations. In the event that the primary pricing service does not provide a price, the Company utilizes the price provided by a second pricing service. The Company reviews prices received from service providers for reasonableness and unusual fluctuations but generally accepts the price identified from the primary pricing service. In the event a price is not available from either third-party pricing service, the Company pursues external pricing from brokers. Generally, the Company pursues and utilizes only one broker quote per security. In doing so, the Company solicits only brokers which have previously demonstrated knowledge and experience of the subject security. If a broker price is not available, the Company determines a fair value through various valuation techniques that may include discounted cash flows, spread-based models, or similar techniques, depending upon the specific security to be priced. These techniques are primarily applied to private placement securities. The Company utilizes available market information, wherever possible, to identify inputs into the fair value determination, primarily including prices and spreads on comparable securities.

Each quarter, the Company evaluates the prices received from third-party security pricing services and independent brokers to ensure that the prices represent a reasonable estimate of the fair value within the macro-economic environment, sector factors, and overall pricing trends and expectations. The Company corroborates and validates the primary pricing sources through a variety of procedures that include but are not limited to comparison to additional third-party pricing services or brokers, where possible; a review of third-party pricing service methodologies; back testing; in-depth specific analytics on randomly selected issues; and comparison of prices to actual trades for specific securities where observable data exists. In addition, the Company analyzes the primary third-party pricing service's methodologies and related inputs and also evaluates the various types of securities in its investment portfolio to determine an appropriate fair value hierarchy. Finally, the Company also performs additional evaluations when individual prices fall outside tolerance levels when comparing prices received from third-party pricing services.

Fair value measurements for assets and liabilities where there exists limited or no observable market data are calculated using the Company’s own estimates and are categorized as Level 3. These estimates are based on current interest rates, credit spreads, liquidity premium or discount, the economic and competitive environment, unique characteristics of the asset or liability, and other pertinent factors. Therefore, these estimates cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there may be inherent weaknesses in any valuation technique. Further, changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values.

The Company’s own estimates of fair value of fixed maturity and equity securities may be derived in a number of ways, including but not limited to: 1) pricing provided by brokers, where the price indicates reliability as to value; 2) fair values of comparable securities, incorporating a spread adjustment for maturity differences, collateralization, credit quality, liquidity, and other items, if applicable; 3) discounted cash flow models and margin spreads; 4) bond yield curves; 5) observable market prices and exchange transaction information not provided by external pricing services; and 6) statement values provided to the Company by fund managers.

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Categories Reported at Fair Value
The following tables present categories reported at fair value on a recurring basis.

	June 30, 2014			
	Level 1	Level 2	Level 3	Total
Assets:				
U.S. Treasury securities and obligations of U.S. Government	$12,366	$164,393	$—	$176,759
Federal agencies [1]	—	22,433	—	22,433
Federal agency issued residential mortgage-backed securities [1]	—	54,673	—	54,673
Subtotal	12,366	241,499	—	253,865
Corporate obligations:				
Industrial	—	564,839	—	564,839
Energy	—	244,671	—	244,671
Communications and technology	—	238,663	—	238,663
Financial	—	295,394	—	295,394
Consumer	—	531,228	—	531,228
Public utilities	—	260,161	—	260,161
Subtotal	—	2,134,956	—	2,134,956
Corporate private-labeled residential mortgage-backed securities	—	106,184	—	106,184
Municipal securities	—	154,220	—	154,220
Other	—	94,529	1,277	95,806
Redeemable preferred stocks	—	17,000	—	17,000
Fixed maturity securities	12,366	2,748,388	1,277	2,762,031
Equity securities and other invested assets	5,302	26,157	—	31,459
Total	$17,668	$2,774,545	$1,277	$2,793,490
Percent of total	1 %	99 %	— %	100 %
Liabilities:				