

NATIONAL WESTERN LIFE INSURANCE CO
Form 10-Q
May 10, 2011

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

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2011

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

For the transition period from _____ to _____

Commission File Number: 2-17039

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

COLORADO
(State of Incorporation)

84-0467208
(I.R.S. Employer Identification Number)

850 EAST ANDERSON LANE
AUSTIN, TEXAS 78752-1602
(Address of Principal Executive Offices)

(512) 836-1010
(Telephone Number)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Small reporting company

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

As of May 6, 2011, the number of shares of Registrant's common stock outstanding was: Class A - 3,434,263 and Class B - 200,000.

TABLE OF CONTENTS

	Page
<u>Part I. Financial Information:</u>	3
<u>Item 1. Financial Statements</u>	3
<u>Condensed Consolidated Balance Sheets</u> March 31, 2011 (Unaudited) and December 31, 2010	3
<u>Condensed Consolidated Statements of Earnings</u> For the Three Months Ended March 31, 2011 and 2010 (Unaudited)	5
<u>Condensed Consolidated Statements of Comprehensive Income</u> For the Three Months Ended March 31, 2011 and 2010 (Unaudited)	6
<u>Condensed Consolidated Statements of Stockholders' Equity</u> For the Three Months Ended March 31, 2011 and 2010 (Unaudited)	7
<u>Condensed Consolidated Statements of Cash Flows</u> For the Three Months Ended March 31, 2011 and 2010 (Unaudited)	9
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	11
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	40
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	71
<u>Item 4. Controls and Procedures</u>	71
<u>Part II. Other Information:</u>	71
<u>Item 1. Legal Proceedings</u>	71
<u>Item 1A. Risk Factors</u>	71
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	71
<u>Item 6. Exhibits</u>	72
<u>Signatures</u>	73

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

ASSETS	(Unaudited) March 31, 2011	December 31, 2010
Investments:		
Securities held to maturity, at amortized cost (fair value: \$5,409,535 and \$5,259,332)	\$5,151,130	4,977,516
Securities available for sale, at fair value (amortized cost: \$2,256,986 and \$2,221,579)	2,418,467	2,390,107
Mortgage loans, net of allowance for possible losses (\$4,001 and \$3,962)	142,770	141,247
Policy loans	77,539	78,448
Derivatives, index options	113,992	80,284
Other long-term investments	27,520	29,569
Total Investments	7,931,418	7,697,171
Cash and short-term investments	62,321	80,332
Deferred policy acquisition costs	709,896	691,939
Deferred sales inducements	149,740	143,844
Accrued investment income	87,755	79,720
Federal income tax receivable	-	427
Other assets	88,866	80,515
	\$9,029,996	8,773,948

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

LIABILITIES AND STOCKHOLDERS' EQUITY	(Unaudited) March 31, 2011	December 31, 2010
LIABILITIES:		
Future policy benefits:		
Universal life and annuity contracts	\$7,337,440	7,108,599
Traditional life and annuity contracts	139,058	139,182
Other policyholder liabilities	155,068	151,526
Deferred Federal income tax liability	51,193	57,857
Federal income tax payable	14,734	-
Other liabilities	96,345	97,993
Total liabilities	7,793,838	7,555,157
COMMITMENTS AND CONTINGENCIES (Notes 8)		
STOCKHOLDERS' EQUITY:		
Common stock:		
Class A - \$1 par value; 7,500,000 shares authorized; 3,432,966 and 3,429,241 shares issued and outstanding in 2011 and 2010	3,433	3,429
Class B - \$1 par value; 200,000 shares authorized, issued, and outstanding in 2011 and 2010	200	200
Additional paid-in capital	37,762	37,140
Accumulated other comprehensive income	48,938	50,408
Retained earnings	1,145,825	1,127,614
Total stockholders' equity	1,236,158	1,218,791
	\$9,029,996	8,773,948

Note: The condensed consolidated balance sheet at December 31, 2010, has been derived from the audited consolidated financial statements as of that date.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

For the Three Months Ended March 31, 2011 and 2010

(Unaudited)

(In thousands, except per share amounts)

	2011	2010
Premiums and other revenues:		
Universal life and annuity contract charges	\$29,832	32,094
Traditional life and annuity premiums	4,022	3,617
Net investment income	133,515	102,850
Other revenues	9,906	6,152
Net realized investment gains (losses):		
Total other-than-temporary impairment (“OTTI”) losses	-	(248)
Portion of OTTI losses recognized in other comprehensive income	-	26
Net OTTI losses recognized in earnings	-	(222)
Other net investment gains (losses)	3,092	(207)
Total net realized investment gains (losses)	3,092	(429)
Total revenues	180,367	144,284
Benefits and expenses:		
Life and other policy benefits	12,216	13,287
Amortization of deferred policy acquisition costs	27,489	23,769
Universal life and annuity contract interest	92,149	62,701
Other operating expenses	20,718	17,316
Total benefits and expenses	152,572	117,073
Earnings before Federal income taxes	27,795	27,211
Federal income taxes	9,584	8,803
Net earnings	\$18,211	18,408
Basic Earnings Per Share:		
Class A	\$5.16	5.22
Class B	\$2.58	2.61
Diluted Earnings Per Share:		
Class A	\$5.15	5.20
Class B	\$2.58	2.61

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Three Months Ended March 31, 2011 and 2010
(Unaudited)
(In thousands)

	2011	2010
Net earnings	\$18,211	18,408
Other comprehensive income (loss), net of effects of deferred costs and taxes:		
Unrealized gains on securities:		
Net unrealized holding gains arising during period	6	15,692
Net unrealized liquidity gains (losses)	201	(3,313)
Reclassification adjustment for net amounts included in net earnings	(1,885)	(141)
Amortization of net unrealized losses (gains) related to transferred securities	(7)	7
Net unrealized gains (losses) on securities	(1,685)	12,245
Foreign currency translation adjustments	(75)	(153)
Benefit plans:		
Amortization of net prior service cost and net gain	290	290
Other comprehensive income (loss)	(1,470)	12,382
Comprehensive income	\$16,741	30,790

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Three Months Ended March 31, 2011 and 2010

(Unaudited)

(In thousands)

	2011	2010
Common stock:		
Balance at beginning of period	\$3,629	3,626
Shares exercised under stock option plan	4	-
Balance at end of period	3,633	3,626
Additional paid-in capital:		
Balance at beginning of period	37,140	36,680
Shares exercised under stock option plan	622	-
Balance at end of period	37,762	36,680
Accumulated other comprehensive income:		
Unrealized gains on non-impaired securities:		
Balance at beginning of period	62,499	31,639
Change in unrealized gains during period	(1,886)	11,871
Balance at end of period	60,613	43,510
Unrealized losses on impaired held to maturity securities:		
Balance at beginning of period	(2,713)	(2,751)
Amortization	217	40
Other-than-temporary impairments, non-credit, net of tax	-	(26)
Additional credit loss on previously impaired securities	-	45
Change in shadow deferred policy acquisition costs	(16)	(18)
Balance at end of period	(2,512)	(2,710)
Unrealized losses on impaired available for sale securities:		
Balance at beginning of period	-	(562)
Recoveries	-	332
Balance at end of period	-	(230)
Foreign currency translation adjustments:		
Balance at beginning of period	2,585	2,893
Change in translation adjustments during period	(75)	(153)
Balance at end of period	2,510	2,740

(Continued on Next Page)

7

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY, CONTINUED
For the Three Months Ended March 31, 2011 and 2010
(Unaudited)
(In thousands)

	2011	2010
Benefit plan liability adjustment:		
Balance at beginning of period	(11,963)	(13,459)
Amortization of net prior service cost and net gain	290	290
Balance at end of period	(11,673)	(13,169)
Accumulated other comprehensive income at end of period	48,938	30,141
Retained earnings:		
Balance at beginning of period	1,127,614	1,055,987
Net earnings	18,211	18,408
Balance at end of period	1,145,825	1,074,395
Total stockholders' equity	\$1,236,158	1,144,842

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Three Months Ended March 31, 2011 and 2010

(Unaudited)

(In thousands)

	2011	2010
Cash flows from operating activities:		
Net earnings	\$18,211	18,408
Adjustments to reconcile net earnings to net cash from operating activities:		
Universal life and annuity contract interest	92,149	62,701
Surrender charges and other policy revenues	(6,770)	(9,767)
Realized (gains) losses on investments	(3,092)	429
Accrual and amortization of investment income	(509)	(559)
Depreciation and amortization	195	(2,173)
(Increase) decrease in value of index options	(31,849)	5,788
Increase in deferred policy acquisition and sales inducement costs	(19,730)	(14,218)
Increase in accrued investment income	(8,035)	(4,999)
Increase in other assets	(7,329)	(2,792)
Increase in liabilities for future policy benefits	6,905	2,046
Increase in other policyholder liabilities	3,541	16,407
Increase (decrease) in Federal income tax liability	9,847	(4,657)
(Decrease) increase in other liabilities	(3,532)	9,748
Net cash provided by operating activities	50,002	76,362
Cash flows from investing activities:		
Proceeds from sales of:		
Securities available for sale	10,010	13,899
Other investments	1,940	1,172
Proceeds from maturities and redemptions of:		
Securities held to maturity	150,205	217,556
Securities available for sale	29,127	22,591
Index options	10,180	10,167
Purchases of:		
Securities held to maturity	(321,632)	(393,786)
Securities available for sale	(71,388)	(106,699)
Index options	(12,039)	(9,388)
Other investments	(779)	(524)
Principal payments on mortgage loans	7,904	9,017
Cost of mortgage loans acquired	(9,432)	(19,836)
(Increase) decrease in policy loans	909	(958)
Other, net	(1)	-
Net cash used in investing activities	(204,996)	(256,789)

Table of Contents

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED

For the Three Months Ended March 31, 2011 and 2010

(Unaudited)

(In thousands)

	2011	2010
Cash flows from financing activities:		
Deposits to account balances for universal life and annuity contracts	\$346,146	274,820
Return of account balances on universal life and annuity contracts	(209,714)	(151,416)
Issuance of common stock under stock option plan	626	-
Net cash provided by financing activities	137,058	123,404
Effect of foreign exchange	(75)	(153)
Net decrease in cash and short-term investments	(18,011)	(57,176)
Cash and short-term investments at beginning of period	80,332	108,866
Cash and short-term investments at end of period	\$62,321	51,690

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid during the year for:

Interest	\$10	10
Income taxes	-	13,700
Noncash operating activities:		
Deferral of sales inducements	5,117	3,942

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

(1) CONSOLIDATION AND BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for annual financial statements. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments necessary to present fairly the financial position of National Western Life Insurance Company and its subsidiaries ("Company") as of March 31, 2011, and the results of its operations and its cash flows for the three months ended March 31, 2011 and 2010. The results of operations for the three months ended March 31, 2011 and 2010 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 accessible free of charge through the Company's internet site at www.nationalwesternlife.com or the Securities and Exchange Commission internet site at www.sec.gov. The condensed consolidated balance sheet at December 31, 2010 has been derived from the audited financial statements as of that date.

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

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

The Company is implementing new actuarial reserving systems that enhance its ability to provide better estimates used in establishing future policy liabilities, monitor the deferred acquisition cost asset and the deferred sales asset as well as support other actuarial processes within the Company. The implementation of these new reserving systems for specific blocks of business began in the second quarter of 2009 and is expected to be completed in 2011. As the Company applies these new systems to a line of business, current reserving assumptions are reviewed and updated as appropriate. During the three months ended March 31, 2010 a correction was made to a surrender charge assumption for future years on one deferred annuity product line. This change resulted in an unlocking adjustment that increased Deferred Policy Acquisition Costs ("DPAC") amortization expense in the first quarter of 2010 by \$2.7 million. As the amount of the correction was determined to have occurred over the course of multiple previous reported periods, it was concluded that the amount of the correction was immaterial to the financial results reported in any of these periods.

Certain amounts in the prior year condensed consolidated financial statements have been reclassified to conform to the current year presentation.

(2) NEW ACCOUNTING PRONOUNCEMENTS

During January 2010, the FASB issued new guidance that requires more robust fair value disclosures about the different classes of assets and liabilities measured at fair value. The adoption of this guidance did not have a significant impact on the consolidated financial position or results of operations.

Table of Contents

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

During July 2010 the FASB issued new guidance that requires additional disclosures related to an entity's financing receivables and the nature of its credit risks related to financing receivables. The effective date is for interim and annual periods ending after December 15, 2010. The adoption of this guidance, effective December 31, 2010, did not have a significant impact on the consolidated financial statements.

During October 2010 the FASB issued new guidance effecting insurance companies that incur costs in the acquisition of new and renewal insurance contracts. The guidance address the diversity in practice regarding the interpretation for which costs relating to the acquisition of new or renewal business qualifies for deferral. The new guidance specifies the acquisition costs which are capitalizable and those which must be expensed. The effective date is for interim and annual periods ending after December 15, 2011. The Company is currently evaluating the impact of this guidance on the consolidated financial statements.

During January 2011 the FASB issued new guidance which defers the effective date of disclosures about troubled debt restructurings in Accounting Standards Update No. 2010-20, Receivables (Topic 310). The new anticipated effective date is for interim and annual periods ending after June 15, 2011. The adoption of this guidance will not have a significant impact on the consolidated financial statements.

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

(3) STOCKHOLDERS' EQUITY

The Company is restricted by state insurance laws as to dividend amounts which may be paid to stockholders without prior approval from the Colorado Division of Insurance. The restrictions are based on statutory earnings and surplus levels of the Company. The maximum dividend payment which may be made without prior approval in 2011 is \$87.5 million. The Company did not pay cash dividends on common stock during the three months ended March 31, 2011 and 2010.

Table of Contents

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

(4) EARNINGS PER SHARE

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

	Three Months Ended March 31,			
	2011		2010	
	Class A	Class B	Class A	Class B
	(In thousands, except per share amounts)			
Numerator for Basic and Diluted Earnings Per Share:				
Net income	\$18,211		18,408	
Dividends – Class A shares	-		-	
Dividends – Class B shares	-		-	
Undistributed income	\$18,211		18,408	
Allocation of net income:				
Dividends	\$-	-	-	-
Allocation of undistributed income	17,696	515	17,886	522
Net income	\$17,696	515	17,886	522
Denominator:				
Basic earnings per share - weighted-average shares	3,430	200	3,426	200
Effect of dilutive stock options	9	-	14	-
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,439	200	3,440	200
Basic Earnings Per Share	\$5.16	2.58	5.22	2.61
Diluted Earnings Per Share	\$5.15	2.58	5.20	2.61

Table of Contents

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

(5) PENSION AND OTHER POSTRETIREMENT PLANS

(A) Defined Benefit Pension Plans

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

	Three Months Ended March 31,	
	2011	2010
	(In thousands)	
Service cost	\$-	-
Interest cost	259	259
Expected return on plan assets	(259) (259
Amortization of prior service cost	1	1
Amortization of net loss	124	124
Net periodic benefit cost	\$125	125

The Company expects to contribute \$406,000 to the plan in 2011. During the three months ended March 31, 2011, the Co