

KANSAS CITY LIFE INSURANCE CO  
Form 10-Q  
October 26, 2012  
Table of Contents

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

x **QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended September 30, 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  
(State or other jurisdiction of  
incorporation or organization)

44-0308260  
(I.R.S. Employer  
Identification No.)

3520 Broadway, Kansas City, Missouri  
(Address of principal executive offices)

64111-2565  
(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 ..

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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

No

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

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 Exchange Act).

Yes

No

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  
Class

11,057,052 shares  
Outstanding September 30, 2012

**Table of Contents**

**KANSAS CITY LIFE INSURANCE COMPANY**

**TABLE OF CONTENTS**

<u>Part I. Financial Information</u>	3
<u>Item 1. Financial Statements</u>	3
<u>Consolidated Balance Sheets</u>	3
<u>Consolidated Statements of Comprehensive Income</u>	4
<u>Consolidated Statement of Stockholders' Equity</u>	5
<u>Consolidated Statements of Cash Flows</u>	6
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	37
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	66
<u>Item 4. Controls and Procedures</u>	66
<u>Part II: Other Information</u>	67
<u>Item 1. Legal Proceedings</u>	67
<u>Item 1A. Risk Factors</u>	67
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	68
<u>Item 3. Defaults Upon Senior Securities</u>	68
<u>Item 4. Mine Safety Disclosures</u>	69
<u>Item 5. Other Information</u>	70
<u>Item 6. Exhibits</u>	72
<u>Signatures</u>	73

**Table of Contents****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**

	September 30	December 31
	2012	2011
	(Unaudited)	
<b>ASSETS</b>		
Investments:		
Fixed maturity securities available for sale, at fair value	\$ 2,878,625	\$ 2,682,142
Equity securities available for sale, at fair value	37,453	36,689
Mortgage loans	560,772	601,923
Real estate	120,748	127,962
Policy loans	78,172	80,375
Short-term investments	27,031	49,316
Other investments	2,581	3,364
Total investments	3,705,382	3,581,771
Cash	7,181	10,436
Accrued investment income	39,173	34,705
Deferred acquisition costs	174,755	181,564
Reinsurance receivables	193,384	189,885
Property and equipment	18,408	22,671
Other assets	48,164	60,601
Separate account assets	343,721	316,609
Total assets	\$ 4,530,168	\$ 4,398,242
<b>LIABILITIES</b>		
Future policy benefits	\$ 892,837	\$ 879,015
Policyholder account balances	2,124,501	2,089,452
Policy and contract claims	28,921	36,511
Other policyholder funds	152,033	152,125
Other liabilities	231,733	213,825
Separate account liabilities	343,721	316,609
Total liabilities	3,773,746	3,687,537
<b>STOCKHOLDERS EQUITY</b>		
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	40,960	41,101

Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Retained earnings	803,800	780,918
Accumulated other comprehensive income	61,154	30,086
Treasury stock, at cost (2012 - 7,439,628 shares; 2011 - 7,187,315 shares)	(172,613)	(164,521)
Total stockholders' equity	756,422	710,705
Total liabilities and stockholders' equity	\$ 4,530,168	\$ 4,398,242

*See accompanying Notes to Consolidated Financial Statements (Unaudited).*

**Table of Contents**

**Kansas City Life Insurance Company**  
**Consolidated Statements of Comprehensive Income**

	Quarter Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
	(Unaudited)		(Unaudited)	
<b>REVENUES</b>				
Insurance revenues:				
Premiums, net	\$ 33,049	\$ 32,476	\$ 99,958	\$ 96,902
Contract charges	24,464	25,427	75,187	75,413
<b>Total insurance revenues</b>	<b>57,513</b>	<b>57,903</b>	<b>175,145</b>	<b>172,315</b>
Investment revenues:				
Net investment income	44,645	43,093	132,289	133,377
Net realized investment gains, excluding impairment losses	606	210	17,804	3,115
Net impairment losses recognized in earnings:				
Total other-than-temporary impairment losses	(697)	(167)	(1,153)	(674)
Portion of impairment losses recognized in other comprehensive income	47	17	197	131
<b>Net impairment losses recognized in earnings</b>	<b>(650)</b>	<b>(150)</b>	<b>(956)</b>	<b>(543)</b>
<b>Total investment revenues</b>	<b>44,601</b>	<b>43,153</b>	<b>149,137</b>	<b>135,949</b>
Other revenues	2,146	2,215	6,643	7,289
<b>Total revenues</b>	<b>104,260</b>	<b>103,271</b>	<b>330,925</b>	<b>315,553</b>
<b>BENEFITS AND EXPENSES</b>				
Policyholder benefits	39,500	38,540	119,246	122,679
Interest credited to policyholder account balances	20,436	21,119	61,371	62,366
Amortization of deferred acquisition costs	7,151	11,577	20,173	21,866
Operating expenses	30,943	24,593	81,983	76,956
<b>Total benefits and expenses</b>	<b>98,030</b>	<b>95,829</b>	<b>282,773</b>	<b>283,867</b>
<b>Income before income tax expense</b>	<b>6,230</b>	<b>7,442</b>	<b>48,152</b>	<b>31,686</b>
Income tax expense	2,098	2,976	16,182	11,256
<b>NET INCOME</b>	<b>\$ 4,132</b>	<b>\$ 4,466</b>	<b>\$ 31,970</b>	<b>\$ 20,430</b>
<b>COMPREHENSIVE INCOME, NET OF TAXES</b>				
Change in net unrealized gains on securities available for sale	\$ 22,033	\$ 24,269	\$ 40,050	\$ 43,447
Change in future policy benefits	(3,617)	(3,862)	(8,586)	(6,068)
Change in policyholder account balances	(178)	(95)	(396)	(172)

Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Other comprehensive income	18,238	20,312	31,068	37,207
<b>COMPREHENSIVE INCOME</b>	<b>\$ 22,370</b>	<b>\$ 24,778</b>	<b>\$ 63,038</b>	<b>\$ 57,637</b>
<b>Basic and diluted earnings per share:</b>				
Net income	\$ 0.38	\$ 0.39	\$ 2.88	\$ 1.78

*See accompanying Notes to Consolidated Financial Statements (Unaudited).*

**Table of Contents**

**Kansas City Life Insurance Company**  
**Consolidated Statement of Stockholders Equity**

	Nine Months Ended September 30, 2012 (Unaudited)
<b>COMMON STOCK</b> , beginning and end of period	\$ 23,121
<b>ADDITIONAL PAID IN CAPITAL</b>	
Beginning of period	41,101
Excess of proceeds over cost of treasury stock sold	(141)
End of period	40,960
<b>RETAINED EARNINGS</b>	
Beginning of period	780,918
Net income	31,970
Stockholder dividends of \$0.81 per share	(9,088)
End of period	803,800
<b>ACCUMULATED OTHER COMPREHENSIVE INCOME</b> , net of taxes	
Beginning of period	30,086
Other comprehensive income	31,068
End of period	61,154
<b>TREASURY STOCK</b> , at cost	
Beginning of period	(164,521)
Cost of 82,940 shares acquired	(3,074)
Cost of 19,248 shares sold	1,172
Immaterial correction (See Note 1)	(6,190)
End of period	(172,613)
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>\$ 756,422</b>

*See accompanying Notes to Consolidated Financial Statements (Unaudited).*





**Table of Contents****Kansas City Life Insurance Company****Consolidated Statements of Cash Flows**

	Nine Months Ended September 30	
	2012	2011
	(Unaudited)	
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 31,970	\$ 20,430
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premium and discount	2,971	2,268
Depreciation	6,105	2,345
Acquisition costs capitalized	(27,839)	(26,383)
Amortization of deferred acquisition costs	20,173	21,866
Realized investment gains	(16,848)	(2,572)
Changes in assets and liabilities:		
Reinsurance receivables	(3,499)	(5,007)
Future policy benefits	613	(7,497)
Policyholder account balances	(6,716)	(3,729)
Income taxes payable and deferred	3,264	4,515
Other, net	(8,449)	(5,174)
<b>Net cash provided</b>	<b>1,745</b>	<b>1,062</b>
<b>INVESTING ACTIVITIES</b>		
Purchases:		
Fixed maturity securities	(268,077)	(146,508)
Equity securities	(894)	(191)
Mortgage loans	(38,533)	(122,860)
Real estate	(29,329)	(7,188)
Policy loans	(11,299)	(10,898)
Sales or maturities, calls, and principal paydowns:		
Fixed maturity securities	148,376	225,993
Equity securities	179	1,214
Mortgage loans	79,155	58,655
Real estate	51,864	-
Policy loans	13,502	13,417
Net sales (purchases) of short-term investments	22,285	(24,823)
Net acquisition of property and equipment	(294)	(283)
<b>Net cash used</b>	<b>(33,065)</b>	<b>(13,472)</b>

*See accompanying Notes to Consolidated Financial Statements (Unaudited).*

**Table of Contents**

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

	Nine Months Ended September 30 2012                      2011 (Unaudited)	
<b>FINANCING ACTIVITIES</b>		
Deposits on policyholder account balances	\$ 171,731	\$ 181,502
Withdrawals from policyholder account balances	(129,530)	(149,882)
Net transfers from separate accounts	3,269	3,925
Change in other deposits	(6,274)	(4,795)
Cash dividends to stockholders	(9,088)	(9,287)
Net change in treasury stock	(2,043)	(3,719)
 Net cash provided	 28,065	 17,744
 Increase (decrease) in cash	 (3,255)	 5,334
Cash at beginning of year	10,436	5,445
 Cash at end of period	 \$ 7,181	 \$ 10,779
 Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	\$ 11,000	\$ 8,040
	<i>See accompanying Notes to Consolidated Financial Statements (Unaudited).</i>	

**Table of Contents**

**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 and 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 2011 Form 10-K as filed with the Securities and Exchange Commission. 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 September 30, 2012 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 Errors**

During the second quarter of 2012, the Company identified an error in the presentation of treasury stock held for the benefit of the Company's deferred compensation plans. This treasury stock was previously recorded as a component of other assets but should have been recorded in stockholders' equity as treasury stock. Accordingly, the Company reclassified \$6.2 million (188,621 shares) from other assets to treasury stock. This error had no material impact on net income in the current or prior reporting periods.

During the first quarter of 2012, the Company identified an error related to the amortization period for unrecognized actuarial gains and losses for its pension plan resulting in a reduction to net periodic pension expense of \$2.0 million before applicable income taxes and an after-tax increase of \$1.3 million to net income and stockholders' equity. The excess amortization had been previously recorded during 2011. Please refer to Note 11 - Pensions and Other Postretirement Benefits for additional information.

During 2011, the Company identified errors related to the classification of amounts reported in the Consolidated Statement of Cash Flows. The Company has revised the Consolidated Statement of Cash Flows for the nine months ended September 30, 2011. The changes resulted in an increase of \$4.4 million to cash flows from operating activities and a decrease of the same amount to cash flows from financing activities. This change did not impact net income, the balance sheet, or stockholders' equity for the period.

Management has evaluated these errors both quantitatively and qualitatively, and concluded that these corrections were not material to the consolidated financial statements.

**Significant Accounting Policies**

No significant updates or changes to these policies occurred during the nine months ended September 30, 2012.

For a full discussion of these significant accounting policies, please refer to the Company's 2011 Form 10-K.



---

**Table of Contents**

**Kansas City Life Insurance Company**

**Notes to Consolidated Financial Statements (Unaudited) Continued**

***2. New Accounting Pronouncements***

For a full discussion of new accounting pronouncements and other regulatory activity and their impact on the Company, please refer to the Company's 2011 Form 10-K.

**Accounting Pronouncements Adopted During 2012**

In October 2010, the Financial Accounting Standards Board (FASB) issued guidance that modifies the types of costs incurred by insurance entities that can be capitalized when issuing or renewing insurance contracts. The guidance defines allowable deferred acquisition costs as incremental or directly related to the successful acquisition of new or renewal contracts. In addition, certain costs related directly to acquisition activities performed by the insurer, such as underwriting and policy issuance, are also deferrable. This guidance also defines the considerations for the deferral of direct-response advertising costs. This guidance became effective for interim and annual periods beginning after December 15, 2011, with either prospective or retrospective application permitted. The Company adopted this new guidance prospectively on January 1, 2012. Please refer to Note 3 – Change in Accounting Principle and Change in Accounting Estimate for additional information.

In May 2011, the FASB issued new guidance concerning fair value measurements and disclosure. The new guidance is the result of joint efforts by the FASB and the International Accounting Standards Board (IASB) to develop a single, converged fair value framework on how to measure fair value and the necessary disclosures concerning fair value measurements. The guidance became effective for interim and annual periods beginning after December 15, 2011. The Company adopted this new guidance on January 1, 2012 with no material impact to the consolidated financial statements.

In June 2011, the FASB issued new guidance regarding the manner in which entities present comprehensive income in the financial statements. This guidance removes the previous presentation options and provides that entities must report comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. This guidance also includes the requirement for reclassification adjustments for items that are reclassified from other comprehensive income to net income to be presented on the face of the financial statements. This guidance does not change the items that must be reported in other comprehensive income nor does it require any disclosures in addition to those previously required. In December 2011, the FASB deferred the effective date for amendments to the presentation of reclassification adjustments. The guidance became effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company adopted this new guidance on January 1, 2012 with no 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.

***3. Change in Accounting Principle and Change in Accounting Estimate***

**Change in Accounting Principle**

The Company adopted Accounting Standards Update (ASU) No. 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*, effective January 1, 2012. This guidance modifies the types of costs incurred by insurance entities that can be capitalized when issuing or renewing insurance contracts. The guidance defines allowable deferred acquisition costs as incremental or directly related to the successful acquisition of new or renewal contracts. In addition, certain costs related directly to acquisition activities performed by the insurer, such as underwriting and policy issuance, are also deferrable. This guidance also defines the considerations for the deferral of direct-response advertising costs.

Effective January 1, 2012, the Company prospectively adopted this guidance. Pursuant to this guidance, the Company evaluated the types of acquisition costs it capitalizes. The Company capitalizes agent compensation and benefits and other expenses that are directly related to the successful acquisition of contracts. The Company also capitalizes expenses directly related to activities performed by the Company, such as underwriting, policy issuance, and processing fees incurred in connection with successful contract acquisitions.

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Deferred acquisition costs 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. For interest sensitive and variable insurance products, estimated gross profits are composed of net interest income, net realized investment gains and losses, fees, surrender charges, expenses, and mortality gains and losses. At the issuance of policies,

**Table of Contents**

**Kansas City Life Insurance Company**

**Notes to Consolidated Financial Statements (Unaudited) Continued**

projections of estimated gross profits are made which are then replaced by actual gross profits over the lives of the policies. The Company considers the following assumptions to be of significance when projecting future estimated gross profits: mortality, interest rates and spreads, surrender and withdrawal rates, and expense margins.

The amount of acquisition costs capitalized during the third quarter and nine months ended September 30, 2012 were \$8.8 million and \$27.8 million, respectively. The acquisition costs that would have been capitalized during the third quarter and nine months ended September 30, 2012 if the Company's previous policy had been applied during that period were \$8.2 million and \$25.7 million, respectively. Thus, the adoption of this guidance resulted in increases of \$0.6 million and \$2.1 million in the amount of acquisition costs capitalized during the two respective periods. After consideration of amortization, the net result of the adoption of ASU No. 2010-26 was an increase of \$0.5 million and an increase of \$2.0 million in pretax earnings in the third quarter and nine months ended September 30, 2012, respectively.

**Change in Accounting Estimate**

During the third quarter of 2012, the Company completed a change in accounting estimate related to a long-lived asset. This asset concluded its initial depreciation schedule in the third quarter of 2012. The Company reassessed this asset and its ongoing use of it and determined that it has a useful life greater than estimated at the time of initial implementation. The Company has the ability and the intent to hold and use this asset over the reassessed useful life. The Company also established an updated residual value, consistent with longer use of the asset. The Company recalculated the depreciation that would have been recognized to date using the reevaluated useful life and residual value resulting in additional depreciation of \$3.7 million being recorded as an operating expense in the third quarter of 2012. The Company evaluated the impact of the change in future depreciation and determined that this change in accounting estimate will not materially impact future comparisons.



**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued****4. 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 September 30, 2012.

	Amortized Cost	Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government	\$ 123,536	\$ 15,002	\$ 27	\$ 138,511
Federal agencies <sup>1</sup>	22,068	4,183	1	26,250
Federal agency issued residential mortgage-backed securities <sup>1</sup>	91,963	9,272	-	101,235
Subtotal	237,567	28,457	28	265,996
Corporate obligations:				
Industrial	502,319	53,980	1,749	554,550
Energy	182,835	23,894	17	206,712
Communications and technology	200,756	24,554	-	225,310
Financial	304,512	26,232	1,907	328,837
Consumer	506,386	54,172	14	560,544
Public utilities	255,551	41,256	355	296,452
Subtotal	1,952,359	224,088	4,042	2,172,405
Corporate private-labeled residential mortgage-backed securities	152,355	3,787	1,575	154,567
Municipal securities	146,616	27,755	5	174,366
Other	104,797	6,256	8,973	102,080
Redeemable preferred stocks	9,076	261	126	9,211
Fixed maturity securities	2,602,770	290,604	14,749	2,878,625
Equity securities	35,666	1,893	106	37,453
Total	\$ 2,638,436	\$ 292,497	\$ 14,855	\$ 2,916,078

<sup>1</sup> Federal agency securities are not backed by the full faith and credit of the U.S. Government.

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The following table provides amortized cost and fair value of securities by asset class at December 31, 2011.

	Amortized Cost	Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government	\$ 120,593	\$ 13,856	\$ 12	\$ 134,437
Federal agencies <sup>1</sup>	22,401	3,480	-	25,881
Federal agency issued residential mortgage-backed securities <sup>1</sup>	109,738	9,901	2	119,637
Subtotal	252,732	27,237	14	279,955
Corporate obligations:				
Industrial	444,030	43,710	860	486,880
Energy	152,580	19,131	-	171,711
Communications and technology	184,983	16,566	156	201,393
Financial	308,813	15,155	5,890	318,078
Consumer	452,962	43,788	263	496,487
Public utilities	259,609	38,094	1,366	296,337
Subtotal	1,802,977	176,444	8,535	1,970,886
Corporate private-labeled residential mortgage-backed securities	167,666	1,856	12,620	156,902
Municipal securities	150,267	18,316	61	168,522
Other	100,315	3,576	9,235	94,656
Redeemable preferred stocks	11,735	226	740	11,221
Fixed maturity securities	2,485,692	227,655	31,205	2,682,142
Equity securities	34,951	1,873	135	36,689
Total	\$ 2,520,643	\$ 229,528	\$ 31,340	\$ 2,718,831

<sup>1</sup> 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 September 30, 2012. Expected maturities may differ from these contractual maturities since borrowers may have the right to call or prepay obligations.

	September 30, 2012	
	Amortized Cost	Fair Value
Due in one year or less	\$ 123,131	\$ 125,572

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Due after one year through five years	633,896	693,388
Due after five years through ten years	1,037,386	1,165,940
Due after ten years	477,458	540,120
Securities with variable principal payments	321,823	344,394
Redeemable preferred stocks	9,076	9,211
	\$ 2,602,770	\$ 2,878,625

### Unrealized Losses on Investments

The Company reviews all security investments, with particular attention given to those having unrealized losses. Further, the Company specifically assesses all investments with greater than 10% declines in fair value below amortized cost and, in general, monitors all security investments as to ongoing risk. These risks are fundamentally evaluated through both a qualitative and quantitative analysis of the issuer. The Company also 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.

**Table of Contents**

**Kansas City Life Insurance Company**

**Notes to Consolidated Financial Statements (Unaudited) Continued**

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 Company considers relevant facts and circumstances in evaluating whether the impairment of a security is other-than-temporary. Relevant facts and circumstances considered are described in the Valuation of Investments section of Note 1 – Nature of Operations and Significant Accounting Policies of the Company’s 2011 Form 10-K.

To the extent the Company determines that a fixed maturity security is deemed to be other-than-temporarily impaired, the portion of the impairment that is deemed to be due to credit is charged to the Consolidated Statements of Comprehensive Income and the cost basis of the underlying investment is reduced. The portion of such impairment that is determined to be non-credit-related is deducted from net realized loss in the Consolidated Statements of Comprehensive Income and is reflected in other comprehensive income and accumulated other comprehensive income.

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. These risks and uncertainties are described in the Valuation of Investments section of Note 1 of the Company’s 2011 Form 10-K.

Once a security is determined to have met certain of the criteria for consideration as being other-than-temporarily impaired, further information is gathered and evaluated pertaining to the particular security. If the security is an unsecured obligation, the additional research is a top-down approach with particular emphasis on the likelihood of the issuer to meet the contractual terms of the obligation. If the security is secured by an asset or guaranteed by another party, the value of the underlying secured asset or the financial ability of the third-party guarantor is evaluated as a secondary source of repayment. Such research is based upon a top-down approach, narrowing to the specific estimates of value and cash flow of the underlying secured asset or guarantor. If the security is a collateralized obligation, such as a mortgage-backed or other asset-backed instrument, research is also conducted to obtain and analyze the performance of the collateral relative to expectations at the time of acquisition and with regard to projections for the future. Such analyses are based upon historical results, trends, comparisons to collateral performance of similar securities, and analyses performed by third parties. This information is used to develop projected cash flows that are compared to the amortized cost of the security.

If a determination is made that an unsecured security, secured security, or security with a guaranty of payment by a third-party is other-than-temporarily impaired, an estimate is developed of the portion of such impairment that is due to credit. The estimate of the portion of impairment due to credit is based upon a comparison of ratings and maturity horizon for the security and relative historical default probabilities from one or more nationally recognized rating organizations. When appropriate for any given security, sector or period in the business cycle, the historical default probability is adjusted to reflect periods or situations of distress by adding to the default probability increments of standard deviations from mean historical results. The credit impairment analysis is supplemented by estimates of potential recovery values for the specific security, including the potential impact of the value of any secured assets, in the event of default. This information is used to determine the Company’s best estimate, derived from probability-weighted cash flows.

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 investment is expected to be fully realized. Projections of expected future cash flows are based upon considerations of the performance of the actual underlying assets, including historical delinquencies, defaults, severity of losses incurred, and prepayments, along with the Company’s estimates of future results for these factors. The Company’s estimates of future results are based upon actual historical performance of the underlying assets relative to historical, current and expected general economic conditions, specific conditions related to the underlying assets, industry data, and other factors that are believed to be relevant. If the present value of the projected 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.



**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The discounted future cash flow calculation typically becomes the primary determinant of whether any portion and to what extent an unrealized loss is due to credit on loan-backed and similar asset-backed securities with significant indications of potential other-than-temporary impairment. Such indications typically include below investment grade ratings and significant unrealized losses for an extended period of time, among other factors. The Company identified 17 non-U.S. Agency mortgage-backed securities that had such indications at both September 30, 2012 and December 31, 2011. The discount rate used in calculating the present value of future cash flows was the investment yield at the time of purchase for each security. The initial default rates were assumed to remain constant over a 24-month time frame and grade down thereafter, reflecting the general perspective of a more stabilized residential housing environment in the future.

For loan-backed and similar asset-backed securities, the determination of any amount of impairment that is due to credit is based upon the present value of projected future cash flows being less than the amortized cost of the security. This amount is recognized as a realized loss in the Company's Consolidated Statements of Comprehensive Income and the carrying value of the security is written down by the same amount. The portion of an impairment that is determined not to be due to credit is recorded as a component of accumulated other comprehensive income in the Consolidated Balance Sheets.

As part of the required accounting for unrealized gains and losses, the Company also adjusts the deferred acquisition costs (DAC) and value of business acquired (VOBA) assets to recognize the adjustment to those assets as if the unrealized gains and losses from securities classified as available for sale actually had been realized.

The following table provides information regarding fixed maturity and equity security investments available for sale with unrealized losses by length of time at September 30, 2012.

	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	\$ 1,362	\$ 18	\$ 784	\$ 9	\$ 2,146	\$ 27
Federal agency issued residential mortgage-backed securities <sup>1</sup>	10	-	293	1	303	1
<b>Subtotal</b>	<b>1,372</b>	<b>18</b>	<b>1,077</b>	<b>10</b>	<b>2,449</b>	<b>28</b>
Corporate obligations:						
Industrial	8,462	430	2,825	1,319	11,287	1,749
Energy	1,980	17	-	-	1,980	17
Communications and technology	-	-	-	-	-	-
Financial	1,502	1	15,053	1,906	16,555	1,907
Consumer	7,336	14	-	-	7,336	14
Public utilities	1,995	5	1,240	350	3,235	355
<b>Subtotal</b>	<b>21,275</b>	<b>467</b>	<b>19,118</b>	<b>3,575</b>	<b>40,393</b>	<b>4,042</b>
Corporate private-labeled residential mortgage-backed securities	-	-	52,908	1,575	52,908	1,575
Municipal securities	3,079	5	-	-	3,079	5
Other	-	-	43,087	8,973	43,087	8,973
Redeemable preferred stocks	-	-	2,521	126	2,521	126
<b>Fixed maturity securities</b>	<b>25,726</b>	<b>490</b>	<b>118,711</b>	<b>14,259</b>	<b>144,437</b>	<b>14,749</b>

Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Equity securities	-	-	1,151	106	1,151	106
Total	\$ 25,726	\$ 490	\$ 119,862	\$ 14,365	\$ 145,588	\$ 14,855

<sup>1</sup> Federal agency securities are not backed by the full faith and credit of the U.S. Government.

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

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, 2011.

	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	\$ -	\$ -	\$ 959	\$ 12	\$ 959	\$ 12
Federal agency issued residential mortgage-backed securities <sup>1</sup>	649	-	294	2	943	2
<b>Subtotal</b>	<b>649</b>	<b>-</b>	<b>1,253</b>	<b>14</b>	<b>1,902</b>	<b>14</b>
Corporate obligations:						
Industrial	25,455	860	-	-	25,455	860
Communications and technology	7,239	156	-	-	7,239	156
Financial	51,273	2,107	16,402	3,783	67,675	5,890
Consumer	11,765	119	3,689	144	15,454	263
Public utilities	4,710	344	11,152	1,022	15,862	1,366
<b>Subtotal</b>	<b>100,442</b>	<b>3,586</b>	<b>31,243</b>	<b>4,949</b>	<b>131,685</b>	<b>8,535</b>
Corporate private-labeled residential mortgage-backed securities	41,734	2,668	61,864	9,952	103,598	12,620
Municipal securities	-	-	3,909	61	3,909	61
Other	9,257	921	47,146	8,314	56,403	9,235
Redeemable preferred stocks	2,939	115	3,056	625	5,995	740
<b>Fixed maturity securities</b>	<b>155,021</b>	<b>7,290</b>	<b>148,471</b>	<b>23,915</b>	<b>303,492</b>	<b>31,205</b>
Equity securities	69	104	1,054	31	1,123	135
<b>Total</b>	<b>\$ 155,090</b>	<b>\$ 7,394</b>	<b>\$ 149,525</b>	<b>\$ 23,946</b>	<b>\$ 304,615</b>	<b>\$ 31,340</b>

<sup>1</sup> Federal agency securities are not backed by the full faith and credit of the U.S. Government.

In addition, 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 September 30, 2012, the Company had 41 issues in its investment portfolio of fixed maturity and equity securities with unrealized losses. Included in this total, twelve security issues were below cost for less than one year; five security issues were below cost for one year or more and less than three years; and 24 security issues were below cost for three years or more. At December 31, 2011, the Company had 85 issues in its investment portfolio of fixed maturity and equity securities with unrealized losses. Included in this total, 46 security issues were below cost for less than one year; ten security issues were below cost for one year or more and less than three years; and 29 security issues were below cost for three years or more.



**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The following table provides the distribution of maturities for fixed maturity securities available for sale with unrealized losses at September 30, 2012 and December 31, 2011. Expected maturities may differ from these contractual maturities since borrowers may have the right to call or prepay obligations.

	September 30, 2012		December 31, 2011	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>Fixed maturity security securities available for sale:</b>				
Due in one year or less	\$ -	\$ -	\$ 2,953	\$ 48
Due after one year through five years	3,526	359	42,416	2,120
Due after five years through ten years	32,662	2,040	64,772	2,616
Due after ten years	52,516	10,648	82,816	13,061
<b>Total</b>	<b>88,704</b>	<b>13,047</b>	<b>192,957</b>	<b>17,845</b>
Securities with variable principal payments	53,212	1,576	104,540	12,620
Redeemable preferred stocks	2,521	126	5,995	740
<b>Total</b>	<b>\$ 144,437</b>	<b>\$ 14,749</b>	<b>\$ 303,492</b>	<b>\$ 31,205</b>

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.

	Quarter Ended September 30 2012	Nine Months Ended September 30 2012
Credit losses on securities held at beginning of the period in accumulated other comprehensive income	\$ 13,857	\$ 13,559
Additions for credit losses not previously recognized in other-than-temporary impairment	-	29
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	650	927
Reductions for securities sold during the period (realized)	-	-
Reductions for securities previously recognized in other comprehensive income 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)	(13)
<b>Credit losses on securities held at the end of the period in accumulated other comprehensive income</b>	<b>\$ 14,502</b>	<b>\$ 14,502</b>



**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued****Realized Gains (Losses)**

The following table provides detail concerning realized investment gains and losses for the third quarters and nine months ended September 30, 2012 and 2011.

	Quarter Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Gross gains resulting from:				
Sales of investment securities	\$ 399	\$ 292	\$ 712	\$ 3,944
Investment securities called and other	304	105	1,107	1,355
Sales of real estate	113	-	16,293	-
<b>Total gross gains</b>	<b>816</b>	<b>397</b>	<b>18,112</b>	<b>5,299</b>
Gross losses resulting from:				
Sales of investment securities	(44)	(76)	(76)	(1,666)
Investment securities called and other	(236)	(118)	(440)	(297)
Mortgage loans	-	-	(178)	(3)
<b>Total gross losses</b>	<b>(280)</b>	<b>(194)</b>	<b>(694)</b>	<b>(1,966)</b>
Change in allowance for potential future losses on mortgage loans	75	-	407	-
Amortization of DAC and VOBA	(5)	7	(21)	(218)
<b>Net realized investment gains, excluding impairment losses</b>	<b>606</b>	<b>210</b>	<b>17,804</b>	<b>3,115</b>
Net impairment losses recognized in earnings:				
Total other-than-temporary impairment losses	(697)	(167)	(1,153)	(674)
Portion of loss recognized in other comprehensive income	47	17	197	131
<b>Net impairment losses recognized in earnings</b>	<b>(650)</b>	<b>(150)</b>	<b>(956)</b>	<b>(543)</b>
<b>Net realized investment gains (losses)</b>	<b>\$ (44)</b>	<b>\$ 60</b>	<b>\$ 16,848</b>	<b>\$ 2,572</b>

**Proceeds From Sales of Investment Securities**

The table below provides information regarding sales of fixed maturity and equity securities, excluding maturities and calls, for the third quarters and nine months ended September 30, 2012 and 2011.

	Quarter Ended September 30	Nine Months Ended September 30
--	-------------------------------	-----------------------------------

Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

	2012	2011	2012	2011
Proceeds	\$ 5,378	\$ 9,714	\$ 13,994	\$ 61,255
Gross realized gains	399	292	712	3,944
Gross realized losses	(44)	(76)	(76)	(1,666)

**Mortgage Loans**

The Company invests on an ongoing basis 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 \$2.4 million at September 30, 2012 and \$2.8 million at December 31, 2011. The Company had 15% of its invested assets in commercial mortgage loans at September 30, 2012, compared to 17% at December 31, 2011. 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 44% and 46% at September 30, 2012 and December 31, 2011, respectively, and is based upon the current balance relative to the appraisal of value at the time the loan was originated or acquired.

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The following table identifies the gross mortgage loan principal outstanding and the allowance for potential future losses at September 30, 2012 and December 31, 2011.

	September 30 2012	December 31 2011
Principal outstanding	\$ 563,214	\$ 604,772
Allowance for potential future losses	(2,442)	(2,849)
<b>Carrying value</b>	<b>\$ 560,772</b>	<b>\$ 601,923</b>

The following table summarizes the amount of gross mortgage loans held by the Company at September 30, 2012 and December 31, 2011, 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.

	September 30 2012	% of Total	December 31 2011	% of Total
Prior to 2002	\$ 19,905	4%	\$ 28,437	5%
2003	33,447	6%	42,112	7%
2004	24,587	4%	29,966	5%
2005	50,964	9%	54,802	9%
2006	39,896	7%	42,676	7%
2007	34,066	6%	35,323	6%
2008	36,261	6%	44,285	7%
2009	42,897	8%	50,574	8%
2010	95,687	17%	133,684	22%
2011	133,823	24%	142,913	24%
2012	51,681	9%	-	-
	<b>\$ 563,214</b>	<b>100%</b>	<b>\$ 604,772</b>	<b>100%</b>

The following table identifies gross mortgage loans by geographic region at September 30, 2012 and December 31, 2011.

	September 30 2012	% of Total	December 31 2011	% of Total
Pacific	\$ 127,975	23%	\$ 138,529	23%
West north central	102,206	18%	130,481	22%
West south central	106,981	19%	98,036	16%
Mountain	81,540	14%	82,029	14%
South atlantic	59,017	10%	63,125	10%
Middle atlantic	37,429	7%	42,112	7%
East north central	29,784	5%	30,482	5%
East south central	18,282	4%	19,978	3%

\$	563,214	100%	\$	604,772	100%
----	---------	------	----	---------	------

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The following table identifies the concentration of gross mortgage loans by state greater than 5% of total at September 30, 2012 and December 31, 2011.

	September 30 2012	% of Total	December 31 2011	% of Total
California	\$ 108,622	19%	\$ 117,261	19%
Texas	94,762	17%	84,724	14%
Minnesota	63,671	11%	64,952	11%
Florida	32,889	6%	31,310	5%
All others	263,270	47%	306,525	51%
	\$ 563,214	100%	\$ 604,772	100%

The following table identifies gross mortgage loans by property type at September 30, 2012 and December 31, 2011. The Other category consists of apartments and retail properties.

	September 30 2012	% of Total	December 31 2011	% of Total
Industrial	\$ 240,010	43%	\$ 251,839	42%
Office	217,223	39%	243,885	40%
Medical	41,405	7%	43,089	7%
Other	64,576	11%	65,959	11%
	\$ 563,214	100%	\$ 604,772	100%

The table below identifies the carrying amount of gross mortgage loans by maturity at September 30, 2012 and December 31, 2011.

	September 30 2012	% of Total	December 31 2011	% of Total
Due in one year or less	\$ 335	-	\$ 2,356	-
Due after one year through five years	174,437	31%	153,822	25%
Due after five years through ten years	226,483	40%	255,615	42%
Due after ten years	161,959	29%	192,979	33%
	\$ 563,214	100%	\$ 604,772	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 loans with outstanding balances of \$4.5 million during the third quarter of 2012 and did not refinance any loans during the third quarter of 2011. The Company refinanced loans with outstanding balances of \$13.1 million and \$9.7 million during the first nine months of 2012 and 2011, respectively.

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

In the normal course of business, the Company commits to fund commercial mortgage loans generally 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 16 - Commitments.

At September 30, 2012, the Company had a construction-to-permanent loan commitment in the amount of \$2.8 million, and \$2.5 million had been disbursed on this loan. At completion and fulfillment of occupancy requirements, the construction loan will convert to a long-term, fixed-rate permanent loan.

### *5. Fair Value Measurements*

Under GAAP, fair value represents the price that would be received to sell an asset (exit price) or paid to transfer a liability 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.



**Table of Contents**

**Kansas City Life Insurance Company**

**Notes to Consolidated Financial Statements (Unaudited) Continued**

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 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.

*Short-Term Financial Assets*

Short-term financial assets include cash and other short-term assets. 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.

*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.

*Separate Accounts*

The separate account assets and liabilities, which are equal, are recorded at fair value based upon NAV. They are categorized as Level 2 in the fair value hierarchy, as the Company receives independent prices from external pricing sources to determine the fair value.

*Liabilities*

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

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

Fair values for liabilities under investment-type insurance contracts are based upon account value. The fair values of investment-type insurance contracts included with policyholder account balances for fixed deferred annuities are estimated to be their cash surrender values. The fair values of supplementary contracts without life contingencies are estimated to be the present value of payments using 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.

### *Guaranteed Minimum Withdrawal Benefits (GMWB)*

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.

---

**Table of Contents**

**Kansas City Life Insurance Company**

**Notes to Consolidated Financial Statements (Unaudited) Continued**

*Notes Payable*

Fair values for short-term notes payable approximate their carrying value. The carrying amount is a reasonable estimate of the fair value because of the relatively short time between the origination of the loan and its expected repayment.

**Determination of Fair Value**

The determination of the fair value of the Company's fixed maturity and equity securities is the responsibility of the Company's investment accounting group, which reports to the Principal Accounting Officer. This group manages and creates the policies and processes used to determine the fair value for these assets. This group employs third-party pricing services and obtains selected support from the Company's portfolio managers in order to achieve results for this multi-tiered process. All prices are reviewed by the investment accounting group. The financial reporting group, the Principal Accounting Officer, and the Chief Financial Officer also review the fair value methodologies and the fair values that are obtained each quarter. The results of those reviews are made known to the Company's Disclosure Committee and to the Company's Audit Committee. In addition, any significant policy or process changes made during the quarter are also discussed with the Company's Audit Committee.

The Company utilizes external independent third-party pricing services to determine the majority of its fair values on investment securities available for sale. At September 30, 2012, 96% of the carrying value of these investments was from external pricing services, 1% was from brokers, and 3% was derived from internal matrices and calculations, unchanged from December 31, 2011. 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 that 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. At September 30, 2012, the Company obtained prices for six securities from brokers and internally determined the prices for 18 securities. At December 31, 2011, the Company obtained prices for five securities from brokers and internally determined the prices for 15 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 independent third-party pricing services or brokers, where possible; a review of third-party pricing service methodologies; back testing; 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 for 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 are 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.

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The determination of the value of the Company's liabilities that are reported at fair value in the financial statements is the responsibility of the Company's valuation actuary group, which reports to the Company's Senior Vice President and Actuary. This group manages and creates the policies and processes used to determine the fair value for these liabilities. This methodology uses internal assumptions and directed third-party inputs to derive a value including a risk-neutral option pricing model that incorporates a third-party-developed index that is consistent with the attributes of the product and provides for an approximate match of the volatility measure with the expected life of the underlying contracts. The fair value methodologies and the fair values are reviewed by the Senior Vice President and Actuary, the Principal Accounting Officer, and the Chief Financial Officer. The results of those reviews are made known to the Company's Disclosure Committee and to the Company's Audit Committee. In addition, any significant policy or process changes made during the quarter are also discussed with the Company's Audit Committee.

*Categories Reported at Fair Value*

The following tables present categories reported at fair value on a recurring basis.

	September 30, 2012			
	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
U.S. Treasury securities and obligations of U.S. Government	\$ 12,790	\$ 122,692	\$ 3,029	\$ 138,511
Federal agencies <sup>1</sup>	-	26,250	-	26,250
Federal agency issued residential mortgage-backed securities <sup>1</sup>	-	101,235	-	101,235
<b>Subtotal</b>	<b>12,790</b>	<b>250,177</b>	<b>3,029</b>	<b>265,996</b>
<b>Corporate obligations:</b>				
Industrial	2,900	549,206	2,444	554,550
Energy	2,500	201,853	2,359	206,712
Communications and technology	-	225,310	-	225,310
Financial	2,000	315,303	11,534	328,837
Consumer	4,070	530,605	25,869	560,544
Public utilities	3,000	293,452	-	296,452
<b>Subtotal</b>	<b>14,470</b>	<b>2,115,729</b>	<b>42,206</b>	<b>2,172,405</b>
Corporate private-labeled residential mortgage-backed securities	-	154,567	-	154,567
Municipal securities	-	170,003	4,363	174,366
Other	-	99,886	2,194	102,080
Redeemable preferred stocks	9,211	-	-	9,211
Fixed maturity securities	36,471	2,790,362	51,792	2,878,625
Equity securities	2,172	34,072	1,209	37,453
<b>Total</b>	<b>\$ 38,643</b>	<b>\$ 2,824,434</b>	<b>\$ 53,001</b>	<b>\$ 2,916,078</b>

Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Percent of total	1%	97%	2%	100%
Liabilities:				
Other policyholder funds				
GMWB	\$ -	\$ -	\$ (409)	\$ (409)
Total	\$ -	\$ -	\$ (409)	\$ (409)

<sup>1</sup> Federal agency securities are not backed by the full faith and credit of the U.S. Government.

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

	December 31, 2011			
	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
U.S. Treasury securities and obligations of U.S. Government	\$ 12,876	\$ 118,130	\$ 3,431	\$ 134,437
Federal agencies <sup>1</sup>	-	25,881	-	25,881
Federal agency issued residential mortgage-backed securities <sup>1</sup>	-	119,637	-	119,637
<b>Subtotal</b>	<b>12,876</b>	<b>263,648</b>	<b>3,431</b>	<b>279,955</b>
<b>Corporate obligations:</b>				
Industrial	-	486,380	500	486,880
Energy	-	169,342	2,369	171,711
Communications and technology	-	201,393	-	201,393
Financial	-	307,464	10,614	318,078
Consumer	-	474,553	21,934	496,487
Public utilities	-	296,337	-	296,337
<b>Subtotal</b>	<b>-</b>	<b>1,935,469</b>	<b>35,417</b>	<b>1,970,886</b>
Corporate private-labeled residential mortgage-backed securities	-	156,902	-	156,902
Municipal securities	-	163,611	4,911	168,522
Other	-	94,656	-	94,656
Redeemable preferred stocks	11,221	-	-	11,221
Fixed maturity securities	24,097	2,614,286	43,759	2,682,142
Equity securities	2,216	33,350	1,123	36,689
<b>Total</b>	<b>\$ 26,313</b>	<b>\$ 2,647,636</b>	<b>\$ 44,882</b>	<b>\$ 2,718,831</b>
<b>Percent of total</b>	<b>1%</b>	<b>97%</b>	<b>2%</b>	<b>100%</b>
<b>Liabilities:</b>				
Other policyholder funds				
GMWB	\$ -	\$ -	\$ (187)	\$ (187)
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (187)</b>	<b>\$ (187)</b>

<sup>1</sup> Federal agency securities are not backed by the full faith and credit of the U.S. Government.

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The following tables present the fair value of fixed maturity and equity securities available for sale by pricing source and fair value hierarchy level.

	September 30, 2012			Total
	Level 1	Level 2	Level 3	
<b>Fixed maturity securities available for sale:</b>				
Priced from external pricing services	\$ 36,471	\$ 2,751,815	\$ -	\$ 2,788,286
Priced from independent broker quotations	-	38,547	-	38,547
Priced from internal matrices and calculations	-	-	51,792	51,792
<b>Subtotal</b>	<b>36,471</b>	<b>2,790,362</b>	<b>51,792</b>	<b>2,878,625</b>
<b>Equity securities available for sale:</b>				
Priced from external pricing services	2,172	7,273	-	9,445
Priced from independent broker quotations	-	-	-	-
Priced from internal matrices and calculations	-	26,799	1,209	28,008
<b>Subtotal</b>	<b>2,172</b>	<b>34,072</b>	<b>1,209</b>	<b>37,453</b>
<b>Total</b>	<b>\$ 38,643</b>	<b>\$ 2,824,434</b>	<b>\$ 53,001</b>	<b>\$ 2,916,078</b>
Percent of total	1%	97%	2%	100%
	December 31, 2011			Total
	Level 1	Level 2	Level 3	
<b>Fixed maturity securities available for sale:</b>				
Priced from external pricing services	\$ 24,097	\$ 2,582,617	\$ -	\$ 2,606,714
Priced from independent broker quotations	-	31,669	-	31,669
Priced from internal matrices and calculations	-	-	43,759	43,759
<b>Subtotal</b>	<b>24,097</b>	<b>2,614,286</b>	<b>43,759</b>	<b>2,682,142</b>
<b>Equity securities available for sale:</b>				
Priced from external pricing services	2,216	7,444	-	9,660
Priced from independent broker quotations	-	-	-	-
Priced from internal matrices and calculations	-	25,906	1,123	27,029
<b>Subtotal</b>	<b>2,216</b>	<b>33,350</b>	<b>1,123</b>	<b>36,689</b>
<b>Total</b>	<b>\$ 26,313</b>	<b>\$ 2,647,636</b>	<b>\$ 44,882</b>	<b>\$ 2,718,831</b>
Percent of total	1%	97%	2%	100%





**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the third quarter and nine months ended September 30, 2012 and year ended December 31, 2011 are summarized below:

	Quarter Ended September 30, 2012			Liabilities
	Assets		Total	
	Fixed maturity securities available for sale	Equity securities available for sale		
Beginning balance	\$ 44,999	\$ 1,149	\$ 46,148	\$ 278
Included in earnings	(340)	-	(340)	(978)
Included in other comprehensive income	(107)	60	(47)	-
Purchases, issuances, sales and other dispositions:				
Purchases	-	-	-	-
Issuances	-	-	-	807
Sales	-	-	-	-
Other dispositions	(697)	-	(697)	(516)
Transfers into Level 3	7,990	-	7,990	-
Transfers out of Level 3	(53)	-	(53)	-
Ending balance	\$ 51,792	\$ 1,209	\$ 53,001	\$ (409)
Net unrealized losses	\$ (406)	\$ 30	\$ (376)	

  

	Nine Months Ended September 30, 2012			Liabilities
	Assets		Total	
	Fixed maturity securities available for sale	Equity securities available for sale		
Beginning balance	\$ 43,759	\$ 1,123	\$ 44,882	\$ (187)
Included in earnings	(333)	-	(333)	(295)
Included in other comprehensive income	(146)	86	(60)	-
Purchases, issuances, sales and other dispositions:				
Purchases	-	-	-	-
Issuances	-	-	-	1,003
Sales	-	-	-	-
Other dispositions	(3,239)	-	(3,239)	(930)
Transfers into Level 3	11,804	-	11,804	-
Transfers out of Level 3	(53)	-	(53)	-
Ending balance	\$ 51,792	\$ 1,209	\$ 53,001	\$ (409)

Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Net unrealized losses	\$ (158)	\$ 86	\$ (72)
-----------------------	----------	-------	---------

Table of Contents**Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

	Year Ended December 31, 2011			Liabilities
	Assets		Total	
	Fixed maturity securities available for sale	Equity securities available for sale		
Beginning balance	\$ 55,801	\$ 1,180	\$ 56,981	\$ (2,799)
Included in earnings	11	92	103	2,500
Included in other comprehensive income	1,385	51	1,436	-
Purchases, issuances, sales and other dispositions:				
Purchases	-	-	-	-
Issuances	-	-	-	163
Sales	-	-	-	-
Other dispositions	(2,977)	(200)	(3,177)	(51)
Transfers into Level 3	8,640	-	8,640	-
Transfers out of Level 3	(19,101)	-	(19,101)	-
Ending balance	\$ 43,759	\$ 1,123	\$ 44,882	\$ (187)
Net unrealized gains	\$ 1,401	\$ 105	\$ 1,506	

The Company did not exclude any realized or unrealized gains or losses on items transferred into Level 3 in any of the periods presented. Depending upon the availability of Level 1 or Level 2 pricing, specific securities may transfer into or out of Level 3. The Company transferred five securities from Level 2 to Level 1 during the third quarter ended September 30, 2012. These securities were approaching maturity and the price was known.

The following table presents quantitative information about material Level 3 fair value measurements as of September 30, 2012.

	Fair Value	Valuation Technique	Unobservable Inputs	Range (in basis points)	Weighted Average of Range
Fixed maturity securities	\$ 51,792	Market comparable	Spread adjustment	69 -353	204

The Company's primary category of Level 3 fair values is fixed maturity securities, totaling \$51.8 million as of September 30, 2012. These assets are valued using comparable security valuations through the unobservable input of estimated discount spreads. Specifically, the Company reviews the values and discount spreads on similar securities for which such information is observable in the market. Estimates of increased discount spreads are then determined based upon the characteristics of the securities being evaluated. The Company estimates that an increased spread of 10 basis points on each of the Level 3 securities would reduce the reported fair value by \$0.2 million as of September 30, 2012.

Other assets and liabilities categorized as Level 3 for purposes of fair value determination are not material to the Company's financial statements, and the sensitivities of such valuations to unobservable inputs are also believed to not be material.

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The table below is a summary of fair value estimates at September 30, 2012 and December 31, 2011 for financial instruments. The Company has not included assets and liabilities that are not financial instruments in this disclosure. The total of the fair value calculations presented do not represent, and should not be construed to represent, the underlying value of the Company.

	September 30, 2012		December 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Assets:</b>				
<b>Investments:</b>				
Fixed maturity securities available for sale	\$ 2,878,625	\$ 2,878,625	\$ 2,682,142	\$ 2,682,142
Equity securities available for sale	37,453	37,453	36,689	36,689
Mortgage loans	560,772	602,559	601,923	642,905
Policy loans	78,172	78,172	80,375	80,375
Cash and short-term investments	34,212	34,212	59,752	59,752
Separate account assets	343,721	343,721	316,609	316,609
<b>Liabilities:</b>				
Individual and group annuities	1,125,833	1,105,053	1,082,324	1,062,407
Supplementary contracts without life contingencies	54,694	53,869	56,193	54,824
Separate account liabilities	343,721	343,721	316,609	316,609
Other policyholder funds - GMWB	(409)	(409)	(187)	(187)

**6. Financing Receivables**

The Company has financing receivables that have both a specific maturity date, either on demand or on a fixed or determinable date, and are recognized as an asset in the Consolidated Balance Sheets.

The table below identifies the Company's financing receivables by classification at September 30, 2012 and December 31, 2011.

	September 30 2012	December 31 2011
<b>Receivables:</b>		
Agent receivables, net (allowance \$2,209; \$2,226 - 2011)	\$ 1,540	\$ 1,708
<b>Investment-related financing receivables:</b>		
Mortgage loans, net (allowance \$2,442; \$2,849 - 2011)	560,772	601,923
<b>Total financing receivables</b>	<b>\$ 562,312</b>	<b>\$ 603,631</b>

The following table details the activity of the allowance for uncollectible accounts on agent receivables at September 30, 2012 and December 31, 2011.

September 30 2012	December 31 2011
----------------------	---------------------

Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Beginning of year	\$	2,226	\$	644
Additions		177		1,724
Deductions		(194)		(142)
End of period	\$	2,209	\$	2,226

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The following table details the mortgage loan portfolio as collectively or individually evaluated for impairment at September 30, 2012 and December 31, 2011.

	September 30 2012	December 31 2011
Mortgage loans collectively evaluated for impairment	\$ 563,214	\$ 604,772
Mortgage loans individually evaluated for impairment	-	-
Allowance for potential future losses	(2,442)	(2,849)
Carrying value	\$ 560,772	\$ 601,923

The following table details the activity of the allowance for potential future losses on mortgage loans at September 30, 2012 and December 31, 2011.

	September 30 2012	December 31 2011
Beginning of year	\$ 2,849	\$ 3,410
Additions	-	-
Deductions	(407)	(561)
End of period	\$ 2,442	\$ 2,849

**Agent Receivables**

The Company has agent receivables which are classified as financing receivables and are reduced by an allowance for doubtful accounts. These trade receivables from agents are long-term in nature and are specifically assessed as to the collectability of each receivable. The Company's gross agent receivables totaled \$3.7 million at September 30, 2012, and the Company maintained an allowance for doubtful accounts totaling \$2.2 million. Gross agent receivables totaled \$3.9 million with an allowance for doubtful accounts of \$2.2 million at December 31, 2011. The Company had no material troubled debt that was restructured or modified during any of the periods presented. The Company has two types of agent receivables, including:

Agent specific loans. At September 30, 2012, these loans totaled \$1.0 million with an allowance for doubtful accounts of \$0.2 million. At December 31, 2011, agent specific loans totaled \$0.8 million with an allowance for doubtful accounts of \$0.2 million. Various agent commission advances and other commission receivables. Gross agent receivables in this category totaled \$2.7 million, with an allowance for doubtful accounts of \$2.0 million at September 30, 2012. Gross agent receivables totaled \$3.1 million and the allowance for doubtful accounts was \$2.0 million at December 31, 2011.

**Mortgage Loans**

The Company considers its mortgage loan portfolio to be long-term financing receivables. 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.

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

If a mortgage loan is determined to be on non-accrual status, the Company does not accrue interest income. The loan is independently monitored and evaluated as to potential impairment or foreclosure. If delinquent payments are made and the loan is brought current, then the Company returns the loan to active status and accrues income accordingly.

Generally, the Company considers its mortgage loans to be a portfolio segment. The Company considers its primary class to be property type. The Company primarily uses loan-to-value as its credit risk quality indicator but also monitors additional secondary risk factors, such as geographic distribution both on a regional and specific state basis. The mortgage loan portfolio segment is presented by property type in a table in Note 3 Investments, as are geographic distributions for both regional and significant state concentrations. These measures are also supplemented with various other analytics to provide additional information concerning mortgage loans and management's assessment of financing receivables.



**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The following table presents an aging schedule for delinquent payments for both principal and interest at September 30, 2012 and December 31, 2011, by property type.

	Book Value	Amount of Payments Past Due			Total
		30-59 Days	60-89 Days	> 90 Days	
<b>September 30, 2012</b>					
Industrial	\$ -	\$ -	\$ -	\$ -	\$ -
Medical	2,982	-	-	68	68
Office	12,759	85	44	-	129
Other	-	-	-	-	-
Total	\$ 15,741	\$ 85	\$ 44	\$ 68	\$ 197
<b>December 31, 2011</b>					
Industrial	\$ -	\$ -	\$ -	\$ -	\$ -
Office	816	13	-	-	13
Medical	7,019	75	-	-	75
Other	-	-	-	-	-
Total	\$ 7,835	\$ 88	\$ -	\$ -	\$ 88

At September 30, 2012, there were five mortgage loans 30 or more days past due, including one 60 days past due and one 90 days past due. The loan that is 90 days past due is in the process of foreclosure. Subsequently, payment was received on four of the five delinquent loans and three were brought current in October 2012. Two loans remained 30 or more days delinquent.

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 assesses 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. A loan is considered impaired if it is probable that contractual amounts due will not be collected. The Company's allowance for potential future losses was \$2.4 million at September 30, 2012 and \$2.8 million at December 31, 2011. For information regarding management's periodic evaluation and assessment of mortgage loans and the allowance for potential future losses, please refer to Note 5 Financing Receivables in the Company's 2011 Form 10-K.

The Company has had four mortgage loan defaults in the current and prior year. One loan was foreclosed in the first quarter of 2012 and an impairment of \$0.2 million was recorded. One of two loan defaults in 2011 resulted in an impairment of \$0.4 million, while the second loan default in 2011 did not result in an impairment based upon the fair value of the property being greater than the loan value. The fourth loan default, which occurred in third quarter of 2012, is currently in the foreclosure process. The Company had no troubled loans that were restructured or modified during 2012 or 2011.

**7. Variable Interest Entities**

The Company invests in certain affordable housing and real estate joint ventures which are considered to be variable interest entities (VIEs) and are included in Real Estate in the Consolidated Balance Sheets. The assets held in affordable housing real estate joint venture VIEs are primarily residential real estate properties that are restricted to provide affordable housing under federal or state programs for varying periods of time. The restrictions primarily apply to the rents that may be paid by tenants residing in the properties during the term of an agreement to remain in the

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

affordable housing program. Investments in real estate joint ventures are equity interests in partnerships or limited liability corporations that may or may not participate in profits or residual value. In certain cases, the Company may issue fixed-rate senior mortgage loan investments secured by properties controlled by VIEs. These investments are classified as mortgage loans in the Consolidated Balance Sheets, and the income received from such investments is recorded as investment income in the Consolidated Statements of Comprehensive Income. For additional information, please refer to Note 6 Variable Interest Entities in the Company's 2011 Form 10-K.

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The following table presents the carrying amount and maximum exposure to loss relating to VIEs for which the Company holds a variable interest, but is not the primary beneficiary, and which had not been consolidated at September 30, 2012 and December 31, 2011. The table includes investments in eight real estate joint ventures and 27 affordable housing real estate joint ventures at September 30, 2012 and investments in eleven real estate joint ventures and 28 affordable housing real estate joint ventures at December 31, 2011.

	September 30 2012		December 31 2011	
	Carrying Amount	Maximum Exposure to Loss	Carrying Amount	Maximum Exposure to Loss
Real estate joint ventures	\$ 24,033	\$ 24,033	\$ 35,551	\$ 35,551
Affordable housing real estate joint ventures	23,090	60,419	20,749	61,124
<b>Total</b>	<b>\$ 47,123</b>	<b>\$ 84,452</b>	<b>\$ 56,300</b>	<b>\$ 96,675</b>

The maximum exposure to loss relating to the real estate joint ventures and affordable housing real estate joint ventures, as shown in the table above, is equal to the carrying amounts plus any unfunded equity commitments, exposure to potential recapture of tax credits, guarantees of debt, or other obligations of the VIE with recourse to the Company. Unfunded equity and loan commitments typically require financial or operating performance by other parties and have not yet become due or payable but which may become due in the future.

At September 30, 2012 and December 31, 2011, the Company had \$1.7 million and \$7.0 million, respectively, in fixed-rate senior mortgage loan commitments outstanding to the benefit of entities that are also real estate joint venture VIEs. The loan commitments are included in the discussion of commitments in the Notes to Consolidated Financial Statements for both periods. The Company also has contingent commitments to fund additional equity contributions for operating support to certain real estate joint venture VIEs, which could result in additional exposure to loss. However, the Company is not able to quantify the amount of these contingent commitments.

In addition, the maximum exposure to loss on affordable housing joint ventures at September 30, 2012 and December 31, 2011 includes \$12.8 million and \$13.2 million, respectively, of losses which could be realized if the tax credits received by the VIEs were recaptured. Recapture events would cause the Company to reverse some or all of the benefit previously recognized by the Company or third parties to whom the tax credit interests were transferred. A recapture event can occur at any time during a 15-year required compliance period. The principal causes of recapture include financial default and non-compliance with affordable housing program requirements by the properties controlled by the VIE. The potential exposure due to recapture may be mitigated by guarantees from the managing member or managing partner in the VIE, insurance contracts, or changes in the residual value accruing to the Company's interests in the VIEs.

**8. Separate Accounts**

The Company has a guaranteed minimum withdrawal benefit (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. The value of variable annuity separate accounts with the GMWB rider was \$100.1 million at September 30, 2012 (December 31, 2011-\$86.6 million) and the guarantee liability was (\$0.4) million at September 30, 2012 (December 31, 2011 - (\$0.2) million). The value of the GMWB rider is recorded at fair value. The change in this value is included in policyholder benefits in the Consolidated Statements of Comprehensive Income. The value of variable annuity separate accounts with the GMWB rider is recorded in separate account liabilities, and the value of the rider is included in other policyholder funds in the Consolidated Balance Sheets.

Guarantees are offered under variable universal life and variable annuity contracts: a guaranteed minimum death benefit (GMDB) rider is available on certain variable universal life contracts, and GMDB riders are provided on all variable annuities. The GMDB rider for variable universal life contracts guarantees the death benefit for specified periods of time, regardless of investment performance, provided cumulative

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

premium requirements are met. The GMDB rider for variable annuity contracts guarantees the death benefit for specified periods of time, regardless of investment performance. The total reserve held for the variable annuity GMDB at September 30, 2012 was \$0.1 million (December 31, 2011 - \$0.2 million).

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued****9. Notes Payable**

The Company had no notes payable at September 30, 2012 or December 31, 2011.

As a member of the Federal Home Loan Bank of Des Moines (FHLB) with a capital investment of \$4.7 million, the Company has the ability to borrow on a collateralized basis from the FHLB. The Company received dividends on the capital investment of less than \$0.1 million in both the third quarter and the nine-month period ended September 30, 2012. Dividends received were less than \$0.1 million in the third quarter and \$0.1 million for the nine-month period ended September 30, 2011.

The Company has unsecured revolving lines of credit of \$60.0 million with two major commercial banks with no balances outstanding and which are at variable interest rates based upon short-term indices. These lines of credit will expire in June of 2013. The Company anticipates renewing these lines as they come due.

**10. Income Taxes**

The following table provides a reconciliation of the federal income tax rate to the Company's effective income tax rate for the third quarters and nine months ended September 30, 2012 and 2011.

	Quarter Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Federal income tax rate	35%	35%	35%	35%
Tax credits, net of equity adjustment	1	5	-	1
Permanent differences	(2)	(1)	(1)	(1)
Other	-	1	-	1
<b>Effective income tax rate</b>	<b>34%</b>	<b>40%</b>	<b>34%</b>	<b>36%</b>

The Company did not have any uncertain tax positions at September 30, 2012.

At September 30, 2012, the Company had a \$2.8 million current tax liability and a \$85.6 million deferred tax liability, compared to a \$0.3 million current tax recoverable and a \$68.8 million deferred tax liability at December 31, 2011.

**11. Pensions and Other Postretirement Benefits**

The following table provides the components of net periodic benefit cost for the third quarters and nine months ended September 30, 2012 and 2011:

	Pension Benefits Quarter Ended September 30		Other Benefits Quarter Ended September 30	
	2012	2011	2012	2011
Service cost	\$ -	\$ -	\$ 199	\$ 161
Interest cost	1,475	1,871	452	387

Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Expected return on plan assets	(2,225)	(2,342)	(8)	(9)
Amortization of:				
Unrecognized actuarial loss	575	896	70	4
Unrecognized prior service cost	-	-	(63)	(68)
Net periodic benefit cost (income)	\$ (175)	\$ 425	\$ 650	\$ 475

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

	Pension Benefits Nine Months Ended September 30		Other Benefits Nine Months Ended September 30	
	2012	2011	2012	2011
Service cost	\$ -	\$ -	\$ 598	\$ 482
Interest cost	4,425	5,613	1,354	1,162
Expected return on plan assets	(6,675)	(7,025)	(24)	(28)
Amortization of:				
Unrecognized actuarial (gain) loss	(275)	2,687	211	13
Unrecognized prior service cost	-	-	(189)	(204)
<b>Net periodic benefit cost (income)</b>	<b>\$ (2,525)</b>	<b>\$ 1,275</b>	<b>\$ 1,950</b>	<b>\$ 1,425</b>

During the first quarter of 2012, the Company identified an error related to the amortization period for unrecognized actuarial gains and losses for its pension plan. The Company determined that upon curtailment of the plan on January 1, 2011, the status of the plan participants should have changed from active to inactive. The amortization period was corrected from the average remaining service period of plan participants, approximately ten years, to the average remaining life expectancy of plan participants, approximately 26 years. The Company has recognized a \$2.0 million pre-tax benefit related to the reversal of amortization recorded during 2011.

**12. Share-Based Payment**

The Company has a long-term incentive plan for senior management that provides a cash award to participants for the increase in the share price of the Company's common stock through units (phantom shares) assigned by the Board of Directors. The cash award is calculated over a three-year interval on a calendar year basis. At the conclusion of each three-year interval, participants will receive a cash award based on the increase in the share price during a defined measurement period, multiplied by the number of units. The increase in the share price will be determined based on the change in the share price from the beginning to the end of the three-year interval. Dividends are accrued and paid at the end of each three-year interval to the extent that they exceed negative stock price appreciation. Plan payments are contingent on the continued employment of the participant unless termination is due to a qualifying event such as death, disability, or retirement. The Company does not make payments in shares, warrants, or options.

No payments were made under this plan during the first nine months ended September 30, 2012 and 2011.

At each reporting period, an estimate of the share-based compensation expense is accrued, utilizing the share price at the period end. The cost of share-based compensation accrued as an operating expense in the third quarters of 2012 and 2011 was \$1.3 million and \$0.1 million, respectively, net of tax. The cost of compensation accrued as an operating expense for the nine months ended September 30, 2012 and September 30, 2011 was \$1.8 million and \$0.1 million, respectively, net of tax.

**13. Comprehensive Income**

Comprehensive income is comprised of net income and other comprehensive income. Other comprehensive income includes the unrealized investment gains or losses on securities available for sale (net of adjustments for realized investment gains or losses) net of adjustments to DAC, VOBA, future policy benefits, and policyholder account balances. In addition, other comprehensive income includes the change in the liability for benefit plan obligations. Other comprehensive income reflects these items net of tax.

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The table below provides information about comprehensive income for the third quarters and nine months ended September 30, 2012 and 2011.

	Before-Tax Amount	Quarter Ended September 30, 2012 Tax (Expense) or Benefit	Net-of-Tax Amount
Net unrealized gains (losses) arising during the year:			
Fixed maturity securities	\$ 40,197	\$ 14,068	\$ 26,129
Equity securities	58	21	37
Less reclassification adjustments:			
Net realized investment gains, excluding impairment losses	423	148	275
Other-than-temporary impairment losses recognized in earnings	(697)	(244)	(453)
Other-than-temporary impairment losses recognized in other comprehensive income	47	16	31
Net unrealized gains excluding impairment losses	40,482	14,169	26,313
Effect on DAC and VOBA	(6,585)	(2,305)	(4,280)
Future policy benefits	(5,564)	(1,947)	(3,617)
Policyholder account balances	(274)	(96)	(178)
Other comprehensive income	\$ 28,059	\$ 9,821	\$ 18,238
Net income			4,132
Comprehensive income			\$ 22,370

	Before-Tax Amount	Quarter Ended September 30, 2011 Tax (Expense) or Benefit	Net-of-Tax Amount
Net unrealized gains (losses) arising during the year:			
Fixed maturity securities	\$ 58,107	\$ 20,339	\$ 37,768
Equity securities	(523)	(183)	(340)
Less reclassification adjustments:			
Net realized investment gains, excluding impairment losses	204	71	133
Other-than-temporary impairment losses recognized in earnings	(167)	(59)	(108)
Other-than-temporary impairment losses recognized in other comprehensive income	17	6	11
Net unrealized gains excluding impairment losses	57,530	20,138	37,392
Effect on DAC and VOBA	(20,189)	(7,066)	(13,123)
Future policy benefits	(5,940)	(2,078)	(3,862)
Policyholder account balances	(148)	(53)	(95)



Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Other comprehensive income	\$ 31,253	\$ 10,941	\$ 20,312
Net income			4,466
Comprehensive income			\$ 24,778

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

	Before-Tax Amount	Nine Months Ended September 30, 2012 Tax (Expense) or Benefit	Net-of-Tax Amount
Net unrealized gains (losses) arising during the year:			
Fixed maturity securities	\$ 79,796	\$ 27,928	\$ 51,868
Equity securities	5	2	3
Less reclassification adjustments:			
Net realized investment gains, excluding impairment losses	1,303	456	847
Other-than-temporary impairment losses recognized in earnings	(1,153)	(404)	(749)
Other-than-temporary impairment losses recognized in other comprehensive income	197	69	128
Net unrealized gains excluding impairment losses	79,454	27,809	51,645
Effect on DAC and VOBA	(17,839)	(6,244)	(11,595)
Future policy benefits	(13,209)	(4,623)	(8,586)
Policyholder account balances	(609)	(213)	(396)
Other comprehensive income	\$ 47,797	\$ 16,729	\$ 31,068
Net income			31,970
Comprehensive income			\$ 63,038

	Before-Tax Amount	Nine Months Ended September 30, 2011 Tax (Expense) or Benefit	Net-of-Tax Amount
Net unrealized gains (losses) arising during the year:			
Fixed maturity securities	\$ 97,111	\$ 33,991	\$ 63,120
Equity securities	(454)	(159)	(295)
Less reclassification adjustments:			
Net realized investment gains, excluding impairment losses	3,337	1,168	2,169
Other-than-temporary impairment losses recognized in earnings	(674)	(236)	(438)
Other-than-temporary impairment losses recognized in other comprehensive income	131	46	85
Net unrealized gains excluding impairment losses	93,863	32,854	61,009
Effect on DAC and VOBA	(27,019)	(9,457)	(17,562)
Future policy benefits	(9,335)	(3,267)	(6,068)
Policyholder account balances	(265)	(93)	(172)
Other comprehensive income	\$ 57,244	\$ 20,037	\$ 37,207
Net income			20,430

Comprehensive income

\$ 57,637

**Table of Contents****Kansas City Life Insurance Company****Notes to Consolidated Financial Statements (Unaudited) Continued**

The following table provides accumulated balances related to each component of accumulated other comprehensive income at September 30, 2012.

	Net Unrealized Gain (Loss) on Non-Impaired Securities	Net Unrealized Gain (Loss) on Impaired Securities	Benefit Plan Obligations	DAC/ VOBA Impact	Future Policy Benefits	Policyholder Account Balances	Tax Effect	Total
Beginning of year	\$ 213,800	\$ (15,612)	\$ (78,451)	\$ (56,971)	\$ (15,903)	\$ (578)	\$ (16,199)	\$ 30,086
Other comprehensive income	65,031	14,423	-	(17,839)	(13,209)	(609)	(16,729)	31,068
End of period	\$ 278,831	\$ (1,189)	\$ (78,451)	\$ (74,810)	\$ (29,112)	\$ (1,187)	\$ (32,928)	\$ 61,154

**14. Earnings Per Share**

Due to the Company's capital structure and the absence of other potentially dilutive securities, there is no difference between basic and diluted earnings per common share for any of the periods reported. The average numbers of shares outstanding for the quarters ended September 30, 2012 and 2011 were 11,056,999 and 11,432,209, respectively. The average numbers of shares outstanding for the nine months ended September 30, 2012 and 2011 were 11,111,490 and 11,453,124, respectively. The number of shares outstanding at September 30, 2012 and December 31, 2011 was 11,057,052 and 11,309,365, respectively.

**15. Segment Information**

The following schedule provides the financial performance of each of the three reportable operating segments of the Company.

		Individual Insurance	Group Insurance	Old American	Intercompany Eliminations <sup>1</sup>	Consolidated
<b>Insurance revenues:</b>						
Third quarter:	2012	\$ 27,615	\$ 12,316	\$ 17,680	\$ (98)	\$ 57,513
	2011	28,377	12,613	17,048	(135)	57,903
Nine months:	2012	\$ 86,216	\$ 36,580	\$ 52,644	\$ (295)	\$ 175,145
	2011	84,651	37,413	50,655	(404)	172,315
<b>Net investment income:</b>						
Third quarter:	2012	\$ 41,444	\$ 132	\$ 3,069	\$ -	\$ 44,645
	2011	40,031	133	2,929	-	43,093
Nine months:	2012	\$ 122,899	\$ 392	\$ 8,998	\$ -	\$ 132,289
	2011	123,798	420	9,159	-	133,377
<b>Net income (loss):</b>						
Third quarter:	2012	\$ 2,998	\$ (108)	\$ 1,242	\$ -	\$ 4,132
	2011	3,342	40	1,084	-	4,466
Nine months:	2012	\$ 29,189	\$ (322)	\$ 3,103	\$ -	\$ 31,970
	2011	20,384	(512)	558	-	20,430

<sup>1</sup> Elimination entries to remove intercompany transactions for life and accident and health insurance that the Company purchases for its employees and agents were as follows: insurance revenues from the Group Insurance segment and operating expenses from the Individual Insurance segment to arrive at Consolidated Statements of Comprehensive Income.

**16. Commitments**

In the normal course of business, the Company has open purchase and sale commitments. At September 30, 2012, the Company had purchase commitments to fund mortgage loans and other investments of \$16.4 million. Included in this total, the Company had commitments to originate mortgage loans of \$14.2 million at September 30, 2012 with fixed interest rates ranging from 4.125% to 4.750%. At September 30, 2012, the Company also had a commitment to fund one construction-to-permanent loan of \$0.3 million that is subject to the borrower's performance.

---

**Table of Contents**

**Kansas City Life Insurance Company**

**Notes to Consolidated Financial Statements (Unaudited) Continued**

Subsequent to September 30, 2012, the company entered into commitments to fund additional mortgage loans of \$6.0 million and \$16.5 million for the acquisition and development of real estate investments. In addition, the Company had a commitment to sell its interest in a \$30.0 million joint venture investment, and a gain of approximately \$3.0 million is expected to be realized upon closing of the transaction.

***17. Contingent Liabilities***

The Company is occasionally involved in litigation, both as a defendant and as a plaintiff. The life insurance industry, including the Company and its insurance 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.

The Company and its subsidiaries are also subject to regular reviews and inspections by state and federal regulatory authorities and self-regulatory organizations. In addition, these regulatory bodies also conduct, from time to time, investigations into industry practices and into complaints from customers. A regulatory violation discovered during a review, inspection, or investigation can result in the imposition of sanctions against the Company, its subsidiaries, or its employees.

The Company's retail broker-dealer and investment advisory subsidiary is in a business that involves a substantial risk of liability. The subsidiary has been named as a defendant in several cases in recent periods. Additionally, regulatory proceedings, litigation, and FINRA arbitration actions related to registered representative activity 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 increase over the last few years.

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 regulatory matters, legal actions, and other claims would not have a material effect on the Company's business, results of operations, or financial position.

In accordance with applicable accounting guidelines, the Company has established an accrued liability for litigation and regulatory matters when those matters present loss contingencies that are both probable and estimable. As a litigation or regulatory matter develops, it is evaluated on an ongoing basis, often in conjunction with outside counsel, as to whether the matter presents a loss contingency that meets conditions indicating the need for accrual and/or disclosure. If and when a loss contingency related to litigation or regulatory matters is deemed to be both probable and estimable, the Company establishes an accrued liability. This accrued liability is then monitored for further developments that may affect the amount of the accrued liability.

***18. Guarantees and Indemnifications***

The Company is subject to various indemnification obligations issued in conjunction with certain transactions, primarily assumption reinsurance agreements, stock purchase agreements, mortgage servicing agreements, tax credit assignment agreements, construction and lease guarantees, and borrowing agreements whose terms range in duration and often are not explicitly defined. Generally, a maximum obligation is not explicitly stated. Therefore, the overall maximum amount of the obligation under the indemnifications cannot be reasonably estimated. The Company is unable to estimate with certainty the ultimate legal and financial liability with respect to these indemnifications. The Company believes that the likelihood is remote that material payments would be required under such indemnifications and therefore such indemnifications would not result in a material adverse effect on the financial position or results of operations.

***19. Subsequent Events***

On October 22, 2012, the Board of Directors declared a quarterly dividend of \$0.27 per share that will be paid November 7, 2012 to stockholders of record as of November 1, 2012.



**Table of Contents**

**Item 2. 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 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. The following is a discussion and analysis of the results of operations for the quarters ended September 30, 2012 and 2011 and the financial condition of the Company at September 30, 2012. This discussion should be read in conjunction with the consolidated financial statements and accompanying notes included in this document, as well as the Company's 2011 Form 10-K.

**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. For additional information, please refer to the Overview included in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's 2011 Form 10-K.

**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, phrases, or similar meaning.

Actual results may differ materially from those included in the forward-looking statements as a result of risks and uncertainties. Those risks and uncertainties include, but are not limited to, the risk factors listed in Item 1A. Risk Factors as filed in the Company's 2011 Form 10-K. For additional information, please refer to the Overview included in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's 2011 Form 10-K.



**Table of Contents****Consolidated Results of Operations****Summary of Results**

The Company earned net income of \$4.1 million and \$4.5 million in the third quarters of 2012 and 2011, respectively. Net income per share was \$0.38 in the third quarter of 2012, compared to \$0.39 in the same period in the prior year. Net income for the first nine months of 2012 was \$32.0 million, an increase of \$11.5 million or 56% compared to last year. Net income per share for the nine months was \$2.88, an increase of \$1.10 per share versus the same period one year earlier. The following table presents variances between the results for the third quarters and nine months ended September 30, 2012 and 2011. Additional information on these items is presented below.

	Quarter Ended September 30	Nine Months Ended September 30
	2012 Versus 2011	2012 Versus 2011
Insurance and other revenues	\$ (459)	\$ 2,184
Net investment income	1,552	(1,088)
Net realized investment gains	(104)	14,276
Policyholder benefits and interest credited to policyholder account balances	(277)	4,428
Amortization of deferred acquisition costs	4,426	1,693
Operating expenses	(6,350)	(5,027)
Income tax expense	878	(4,926)
Total variance	\$ (334)	\$ 11,540

**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.

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 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. In addition, the Company places an emphasis on training and direct support to the field force to assist new agents in their start-up phase. Also, 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. On occasion, the Company may also selectively utilize third-party marketing arrangements to enhance its sales objectives. This allows the Company the flexibility to identify niches or pursue unique avenues in the existing market environment and to react quickly to take advantage of opportunities as 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, particularly voluntary-type products.

**Table of Contents**

The following table presents gross premiums by new and renewal business, less reinsurance ceded, as included in insurance revenues for the third quarters and nine months ended September 30, 2012 and 2011. New premiums are also detailed by product.

	Quarter Ended September 30			
	2012	% Change	2011	% Change
<b>New premiums:</b>				
Individual life insurance	\$ 4,284	1	\$ 4,249	1
Immediate annuities	2,187	15	1,903	(72)
Group life insurance	624	21	516	(5)
Group accident and health insurance	2,894	(12)	3,301	13
<b>Total new premiums</b>	<b>9,989</b>	<b>-</b>	<b>9,969</b>	<b>(31)</b>
Renewal premiums	37,453	1	37,079	7
<b>Total premiums</b>	<b>47,442</b>	<b>1</b>	<b>47,048</b>	<b>(4)</b>
Reinsurance ceded	(14,393)	(1)	(14,572)	9
<b>Premiums, net</b>	<b>\$ 33,049</b>	<b>2</b>	<b>\$ 32,476</b>	<b>(9)</b>

	Nine Months Ended September 30			
	2012	% Change	2011	% Change
<b>New premiums:</b>				
Individual life insurance	\$ 13,054	1	\$ 12,973	6
Immediate annuities	7,355	30	5,649	(66)
Group life insurance	1,849	26	1,463	(13)
Group accident and health insurance	8,637	(16)	10,292	9
<b>Total new premiums</b>	<b>30,895</b>	<b>2</b>	<b>30,377</b>	<b>(24)</b>
Renewal premiums	111,736	2	109,034	3
<b>Total premiums</b>	<b>142,631</b>	<b>2</b>	<b>139,411</b>	<b>(4)</b>
Reinsurance ceded	(42,673)	-	(42,509)	5
<b>Premiums, net</b>	<b>\$ 99,958</b>	<b>3</b>	<b>\$ 96,902</b>	<b>(8)</b>

Consolidated total premiums increased \$0.4 million or 1% in the third quarter of 2012 versus the same period in the prior year, as total new premiums were essentially flat and total renewal premiums increased \$0.4 million or 1%. New immediate annuity premiums increased \$0.3 million or 15% and new group life premiums increased \$0.1 million or 21%. These were offset by a \$0.4 million decrease in new group accident and health premiums. Immediate annuity receipts can have sizeable fluctuations, as receipts from policyholders largely result from one-time premiums rather than recurring premiums. The decrease in new accident and health premiums resulted from a decrease in the short-term disability line, which was partially offset by an increase in dental premiums. The increase in consolidated renewal premiums reflected an increase in short-term disability renewal premiums that was partially offset by a decrease in dental renewal premiums.

Consolidated total premiums increased \$3.2 million or 2% in the first nine months of 2012 versus one year earlier, reflecting a \$0.5 million or 2% increase in total new premiums and a \$2.7 million or 2% increase in total renewal premiums. The increase in total new premiums was due to a \$1.7 million or 30% increase in new immediate annuity premiums and a \$0.4 million or 26% increase in new group life premiums. These improvements were partially offset by a \$1.7 million or 16% decrease in new group accident and health premiums, primarily in the short-term disability line. The increase in renewal premiums reflected an increase in group accident and health renewal premiums. This increase was largely from the short-term disability line and a partially offsetting decrease in dental renewal premiums. In addition, individual life insurance premiums

increased \$1.4 million, primarily from the Old American segment.

**Table of Contents**

The following table reconciles deposits with the Consolidated Statements of Cash Flows and provides detail by new and renewal deposits for the third quarters and nine months ended September 30, 2012 and 2011. New deposits are also detailed by product.

	Quarter Ended September 30			
	2012	% Change	2011	% Change
<b>New deposits:</b>				
Universal life insurance	\$ 2,980	25	\$ 2,391	(39)
Variable universal life insurance	144	(21)	183	(43)
Fixed deferred annuities	11,982	(22)	15,368	(42)
Variable annuities	4,863	18	4,119	44
<b>Total new deposits</b>	<b>19,969</b>	<b>(9)</b>	<b>22,061</b>	<b>(34)</b>
<b>Renewal deposits</b>	<b>34,903</b>	<b>(7)</b>	<b>37,459</b>	<b>6</b>
<b>Total deposits</b>	<b>\$ 54,872</b>	<b>(8)</b>	<b>\$ 59,520</b>	<b>(14)</b>

	Nine Months Ended September 30			
	2012	% Change	2011	% Change
<b>New deposits:</b>				
Universal life insurance	\$ 9,140	2	\$ 8,953	(14)
Variable universal life insurance	404	(40)	676	(11)
Fixed deferred annuities	43,601	(10)	48,285	(1)
Variable annuities	13,466	(4)	14,098	(2)
<b>Total new deposits</b>	<b>66,611</b>	<b>(8)</b>	<b>72,012</b>	<b>(3)</b>
<b>Renewal deposits</b>	<b>105,120</b>	<b>(4)</b>	<b>109,490</b>	<b>4</b>
<b>Total deposits</b>	<b>\$ 171,731</b>	<b>(5)</b>	<b>\$ 181,502</b>	<b>1</b>

Total new deposits decreased \$2.1 million or 9% in the third quarter of 2012 compared with the third quarter of 2011. This change was due to a \$3.4 million or 22% decrease in new fixed deferred annuity deposits. Partially offsetting this, new variable annuity deposits increased \$0.7 million or 18% and new universal life deposits increased \$0.6 million or 25%. Total renewal deposits decreased \$2.6 million or 7% in the third quarter of 2012 versus last year, reflecting a \$3.0 million or 25% decrease in fixed deferred annuity renewal deposits. Total new deposits decreased \$5.4 million or 8% in the first nine months of 2012 compared with the prior year. This decrease was largely due to a \$4.7 million or 10% decline in new fixed deferred annuity deposits and a \$0.6 million or 4% decrease in new variable annuity deposits. Total renewal deposits decreased \$4.4 million or 4%, reflecting a \$2.2 million or 7% decrease in fixed deferred annuity renewal deposits and a \$1.0 million or 13% decrease in variable annuity renewal deposits. New sales and renewals for deposit products have been negatively affected for the third quarter and the first nine months of 2012 by continuing low interest rates and the uncertain economic environment.

**Insurance Revenues**

Insurance revenues consist of premiums, net of reinsurance, and contract charges. In the third quarter of 2012, total insurance revenues decreased \$0.4 million or 1%, primarily due to a \$1.0 million or 4% decrease in contract charges compared to the prior year. Partially offsetting the reduction in contract charges was a \$0.6 million or 2% increase in net premiums. The increase in net premiums largely resulted from a \$0.3 million or 15% increase in total immediate annuity premiums.

Insurance revenues increased \$2.8 million or 2% in the first nine months of 2012 compared with the prior year. This increase was due to a \$3.1 million or 3% increase in net premiums, together with an offsetting \$0.2 million decrease in contract charges. The increase in premiums resulted from a \$1.7 million or 2% increase in total individual life insurance premiums, largely from the Old American segment, and a \$1.4 million or

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

24% increase in total immediate annuity premiums.

Contract charges consist of cost of insurance, expense loads, amortization of unearned revenues, and surrender charges on policyholder account balances. Certain contract charges are not recognized in income immediately but are deferred and amortized into income in proportion to the expected future gross profits of the business, in a manner similar to DAC. Profit expectations are based upon assumptions of future interest spreads, mortality margins, expense margins, and policy and premium persistency experience. At least annually, a review is performed of the assumptions related to profit expectations. If it is determined the assumptions should be revised, the impact is recorded as a change in the revenue reported in the current period as an unlocking adjustment.

**Table of Contents**

Contract charges are impacted by the sales of new products and the persistency of both existing and closed blocks of business. The closed blocks of business reflect policies and companies that the Company has purchased. While the Company is not actively pursuing marketing efforts to generate new sales for these closed blocks, it has the intent of servicing this business to achieve long-term profit streams.

Total contract charges on all blocks of business decreased \$1.0 million or 4% in the third quarter of 2012 compared to the same period in 2011. The results for the third quarter of 2012 were largely due to a \$0.5 million decrease in the amortization of deferred revenue and a \$0.3 million decrease in cost of insurance charges. The decrease in cost of insurance charges was largely due to the runoff of closed blocks. Amortization of deferred revenue decreased due to lower actual gross profits on certain lines of business, largely related to increased reinsurance resulting from unlocking that occurred in the second quarter of 2012.

Total contract charges on all blocks of business decreased \$0.2 million in the first nine months of 2012 compared to one year earlier. These results reflected a \$0.7 million decrease in cost of insurance charges and a \$0.5 million decrease in expense loads, partially offset by a \$1.2 million increase in the amortization of deferred revenue. In addition to the results discussed above for the quarter, the amortization of deferred revenue increased during 2012 compared to the prior year due to a system upgrade during 2011 that led to enhanced reinsurance modeling capabilities. The decrease in expense loads is attributed to the increased sale of products with lower expense loads in 2012 than the prior year. The decline in cost of insurance charges was largely due to the runoff of closed blocks.

Total contract charges on closed blocks equaled 35% of total consolidated contract charges for both third quarters and 35% and 36% for the first nine months of 2012 and 2011, respectively. Total contract charges on closed blocks decreased 4% in the third quarter and 3% in the first nine months of 2012 compared to the same periods in the prior year. These declines reflect the results discussed above.

The Company uses reinsurance as a means to mitigate its risks and to reduce the earnings volatility from claims. Reinsurance ceded premiums decreased \$0.2 million or 1% in the third quarter of 2012 and increased \$0.2 million or less than 1% in the first nine months of 2012, as compared to the same periods in 2011. Reinsurance ceded for the Group segment increased \$0.5 million or 17% in the third quarter and \$1.3 million or 16% in the nine months, reflecting increased disability sales that were largely reinsured. Reinsurance ceded for the Old American segment declined \$0.1 million or 16% in the third quarter and \$0.3 million or 15% in the first nine months of 2012, reflecting the continued runoff of a large closed block of reinsured business. Reinsurance ceded for the Individual Insurance segment decreased \$0.6 million or 5% in the third quarter and \$0.9 million or 3% in the first nine months of 2012.

***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 increased \$1.4 million or 3% in the third quarter of 2012 compared with the third quarter of 2011, as both average invested assets and yields earned increased. Gross investment income decreased \$1.0 million or 1% in the first nine months of 2012 compared with the prior year, as an increase in average invested assets was more than offset by lower yields earned.

Fixed maturity securities provided a majority of the Company's investment income during both the quarter and nine months ended September 30, 2012. Income on these investments declined \$0.4 million or 1% in the third quarter and \$3.1 million or 3% in the first nine months of 2012 compared to the prior year, reflecting declines in yields earned.

Investment income from mortgage loans increased \$0.1 million or 1% in the third quarter and \$0.7 million or 3% in the first nine months of 2012 compared to the same periods in 2011. The improvement in the nine months was largely the result of prepayment fees received on loans that were paid off prior to maturity.

Investment income from real estate increased \$0.5 million or 27% in the third quarter and \$1.1 million or 17% in the nine months compared to last year. These improvements reflect higher rental income due to an increase in occupancy rates.

In addition, the fair value improved on an alternative investment fund, which resulted in an increase of investment income of \$1.4 million in the third quarter of 2012 and \$0.8 million in the first nine months, compared to the same periods in 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 third quarters and nine months ended September 30, 2012 and 2011.

	Quarter Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
<b>Gross gains resulting from:</b>				
Sales of investment securities	\$ 399	\$ 292	\$ 712	\$ 3,944
Investment securities called and other	304	105	1,107	1,355
Sales of real estate	113	-	16,293	-
<b>Total gross gains</b>	<b>816</b>	<b>397</b>	<b>18,112</b>	<b>5,299</b>
<b>Gross losses resulting from:</b>				
Sales of investment securities	(44)	(76)	(76)	(1,666)
Investment securities called and other	(236)	(118)	(440)	(297)
Mortgage loans	-	-	(178)	(3)
<b>Total gross losses</b>	<b>(280)</b>	<b>(194)</b>	<b>(694)</b>	<b>(1,966)</b>
Change in allowance for potential future losses on mortgage loans	75	-	407	-
Amortization of DAC and VOBA	(5)	7	(21)	(218)
<b>Net realized investment gains, excluding impairment losses</b>	<b>606</b>	<b>210</b>	<b>17,804</b>	<b>3,115</b>
<b>Net impairment losses recognized in earnings:</b>				
Total other-than-temporary impairment losses	(697)	(167)	(1,153)	(674)
Portion of loss recognized in other comprehensive income	47	17	197	131
<b>Net impairment losses recognized in earnings</b>	<b>(650)</b>	<b>(150)</b>	<b>(956)</b>	<b>(543)</b>
<b>Net realized investment gains (losses)</b>	<b>\$ (44)</b>	<b>\$ 60</b>	<b>\$ 16,848</b>	<b>\$ 2,572</b>

The Company recorded a net realized investment loss of less than \$0.1 million in the third quarter of 2012, compared with a net realized gain of less than \$0.1 million third quarter of 2011. During the third quarter of 2012, investment gains on sales of real estate totaled \$0.1 million. Net realized investment gains for the first nine months totaled \$16.8 million in 2012 compared to \$2.6 million in 2011, largely reflecting gains on sales of real estate of \$16.3 million. In the above table, investment securities called and other includes, but is not limited to, principal payments and sinking funds.

The Company's analysis of securities for the third quarter ended September 30, 2012 resulted in the determination that seven fixed-maturity residential mortgage-backed securities and one corporate security had other-than-temporary credit impairments and were written down by a combined \$0.6 million. These residential mortgage-backed securities had incremental losses, reflecting deterioration in the present value of expected future cash flows. The additional losses from these residential mortgage-backed securities totaled \$0.2 million in the third quarter of 2012, including less than \$0.1 million that was determined to be non-credit and was recognized in other comprehensive income. The total fair value of the affected securities after the write-downs was \$55.5 million.



**Table of Contents**

The following table summarizes securities with other-than-temporary impairments recognized in earnings by business segment during the first, second, and third quarters of 2012 and 2011 by asset class:

	Quarter Ended March 31 2012	Quarter Ended June 30 2012	Quarter Ended September 30 2012	Nine Months Ended September 30 2012
<b>Bonds:</b>				
Corporate obligations:				
Individual Insurance	\$ -	\$ -	\$ 515	\$ 515
Total corporate obligations	\$ -	\$ -	\$ 515	\$ 515
Corporate private-labeled residential mortgage-backed securities:				
Individual Insurance	\$ 143	\$ 134	\$ 129	\$ 406
Old American	17	12	6	35
Total	\$ 160	\$ 146	\$ 650	\$ 956
<b>Segment detail:</b>				
Individual Insurance	\$ 143	\$ 134	\$ 644	\$ 921
Old American	17	12	6	35
Consolidated total	\$ 160	\$ 146	\$ 650	\$ 956

  

	Quarter Ended March 31 2011	Quarter Ended June 30 2011	Quarter Ended September 30 2011	Nine Months Ended September 30 2011
<b>Bonds:</b>				
Corporate private-labeled residential mortgage-backed securities:				
Individual Insurance	\$ 188	\$ 164	\$ 141	\$ 493
Old American	23	18	9	50
Total	\$ 211	\$ 182	\$ 150	\$ 543
<b>Segment detail:</b>				
Individual Insurance	\$ 188	\$ 164	\$ 141	\$ 493
Old American	23	18	9	50
Consolidated total	\$ 211	\$ 182	\$ 150	\$ 543

**Analysis of Investments**

The Company seeks to protect policyholders' benefits and achieve a desired level of organizational profitability by optimizing risk and return on an ongoing basis through managing asset and liability cash flows, monitoring credit risk, avoiding high levels of investments that may be redeemed by the issuer, maintaining sufficiently liquid investments and avoiding undue asset concentrations through diversification, among other things.

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

The primary sources of investment risk to which the Company is exposed include credit risk, interest rate risk, and liquidity risk. The Company's ability to manage these risks is essential to the success of the organization. In particular, the Company devotes considerable resources to both the credit analysis of each new investment and to ongoing credit positions. A default by an issuer usually involves some loss of principal to the investor. Losses can be mitigated by timely sales of affected securities or by active involvement in a restructuring process. However, there can be no assurance that the efforts of an investor will lead to favorable outcomes in a bankruptcy or restructuring. Credit risk is managed primarily through industry, issuer, and structure diversification.

**Table of Contents**

The following table provides information regarding fixed maturity and equity securities by asset class at September 30, 2012.

	Total Fair Value	% of Total	Fair Value of Securities with Gross Unrealized Gains	Gross Unrealized Gains	Fair Value of Securities with Gross Unrealized Losses	Gross Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government	\$ 138,511	5%	\$ 136,365	\$ 15,002	\$ 2,146	\$ 27
Federal agencies <sup>1</sup>	26,250	1%	26,250	4,183		-
Federal agency issued residential mortgage-backed securities <sup>1</sup>	101,235	4%	100,932	9,272	303	1
Subtotal	265,996	10%	263,547	28,457	2,449	28
Corporate obligations:						
Industrial	554,550	19%	543,263	53,980	11,287	1,749
Energy	206,712	7%	204,732	23,894	1,980	17
Communications and technology	225,310	8%	225,310	24,554	-	-
Financial	328,837	11%	312,282	26,232	16,555	1,907
Consumer	560,544	19%	553,208	54,172	7,336	14
Public utilities	296,452	10%	293,217	41,256	3,235	355
Subtotal	2,172,405	74%	2,132,012	224,088	40,393	4,042
Corporate private-labeled residential mortgage-backed securities	154,567	5%	101,659	3,787	52,908	1,575
Municipal securities	174,366	6%	171,287	27,755	3,079	5
Other	102,080	4%	58,993	6,256	43,087	8,973
Redeemable preferred stocks	9,211	-	6,690	261	2,521	126
Fixed maturities	2,878,625	99%	2,734,188	290,604	144,437	14,749
Equity securities	37,453	1%	36,302	1,893	1,151	106
Total	\$ 2,916,078	100%	\$ 2,770,490	\$ 292,497	\$ 145,588	\$ 14,855

<sup>1</sup> Federal agency securities are not backed by the full faith and credit of the U.S. Government.

**Table of Contents**

The following table provides information regarding fixed maturity and equity securities by asset class at December 31, 2011.

	Total Fair Value	% of Total	Fair Value of Securities with Gross Unrealized Gains	Gross Unrealized Gains	Fair Value of Securities with Gross Unrealized Losses	Gross Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government	\$ 134,437	5%	\$ 133,478	\$ 13,856	\$ 959	\$ 12
Federal agencies <sup>1</sup>	25,881	1%	25,881	3,480	-	-
Federal agency issued residential mortgage-backed securities <sup>1</sup>	119,637	4%	118,694	9,901	943	2
Subtotal	279,955	10%	278,053	27,237	1,902	14
Corporate obligations:						
Industrial	486,880	18%	461,425	43,710	25,455	860
Energy	171,711	6%	171,711	19,131	-	-
Communications and technology	201,393	7%	194,154	16,566	7,239	156
Financial	318,078	12%	250,403	15,155	67,675	5,890
Consumer	496,487	18%	481,033	43,788	15,454	263
Public utilities	296,337	11%	280,475	38,094	15,862	1,366
Subtotal	1,970,886	72%	1,839,201	176,444	131,685	8,535
Corporate private-labeled residential mortgage-backed securities	156,902	6%	53,304	1,856	103,598	12,620
Municipal securities	168,522	6%	164,613	18,316	3,909	61
Other	94,656	4%	38,253	3,576	56,403	9,235
Redeemable preferred stocks	11,221	1%	5,226	226	5,995	740
Fixed maturities	2,682,142	99%	2,378,650	227,655	303,492	31,205
Equity securities	36,689	1%	35,566	1,873	1,123	135
Total	\$ 2,718,831	100%	\$ 2,414,216	\$ 229,528	\$ 304,615	\$ 31,340

<sup>1</sup> Federal agency securities are not backed by the full faith and credit of the U.S. Government.

At December 31, 2011, the Company had \$31.3 million in gross unrealized losses on investment securities which were offset by \$229.5 million in gross unrealized gains. At September 30, 2012, the Company's unrealized losses on investment securities had decreased to \$14.9 million and were offset by \$292.5 million in gross unrealized gains, with 27% of the gross unrealized losses in the category of corporate obligations. The financial sector was the single largest contributor to unrealized losses, reflecting the direct and indirect impact of the troubled residential real estate, mortgage, and auction rate securities markets. At September 30, 2012, 95% of the total fair value of the fixed maturities portfolio had unrealized gains, compared to 89% at December 31, 2011.

**Table of Contents**

The Company maintains a high quality securities portfolio. The following table identifies fixed maturity securities available for sale by actual or equivalent Standard & Poor's rating at September 30, 2012 and December 31, 2011.

	September 30, 2012		December 31, 2011	
	Fair Value	% of Total	Fair Value	% of Total
AAA	\$ 132,256	5%	\$ 161,802	6%
AA	612,085	21%	570,157	21%
A	876,911	30%	799,565	30%
BBB	1,046,830	36%	939,373	35%
<b>Total investment grade</b>	<b>2,668,082</b>	<b>92%</b>	<b>2,470,897</b>	<b>92%</b>
BB	70,294	3%	79,760	3%
B and below	140,249	5%	131,485	5%
<b>Total below investment grade</b>	<b>210,543</b>	<b>8%</b>	<b>211,245</b>	<b>8%</b>
	<b>\$ 2,878,625</b>	<b>100%</b>	<b>\$ 2,682,142</b>	<b>100%</b>

The following table provides information regarding fixed maturity and equity security investments available for sale with unrealized losses by length of time, at September 30, 2012.

	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	\$ 1,362	\$ 18	\$ 784	\$ 9	\$ 2,146	\$ 27
Federal agency issued residential mortgage-backed securities <sup>1</sup>	10	-	293	1	303	1
<b>Subtotal</b>	<b>1,372</b>	<b>18</b>	<b>1,077</b>	<b>10</b>	<b>2,449</b>	<b>28</b>
Corporate obligations:						
Industrial	8,462	430	2,825	1,319	11,287	1,749
Energy	1,980	17	-	-	1,980	17
Communications and technology	-	-	-	-	-	-
Financial	1,502	1	15,053	1,906	16,555	1,907
Consumer	7,336	14	-	-	7,336	14
Public utilities	1,995	5	1,240	350	3,235	355
<b>Subtotal</b>	<b>21,275</b>	<b>467</b>	<b>19,118</b>	<b>3,575</b>	<b>40,393</b>	<b>4,042</b>
Corporate private-labeled residential mortgage-backed securities	-	-	52,908	1,575	52,908	1,575
Municipal securities	3,079	5	-	-	3,079	5
Other	-	-	43,087	8,973	43,087	8,973
Redeemable preferred stocks	-	-	2,521	126	2,521	126
<b>Fixed maturity securities</b>	<b>25,726</b>	<b>490</b>	<b>118,711</b>	<b>14,259</b>	<b>144,437</b>	<b>14,749</b>
<b>Equity securities</b>	<b>-</b>	<b>-</b>	<b>1,151</b>	<b>106</b>	<b>1,151</b>	<b>106</b>
<b>Total</b>	<b>\$ 25,726</b>	<b>\$ 490</b>	<b>\$ 119,862</b>	<b>\$ 14,365</b>	<b>\$ 145,588</b>	<b>\$ 14,855</b>

<sup>1</sup> Federal agency securities are not backed by the full faith and credit of the U.S. Government.

**Table of Contents**

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, 2011.

	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	\$ -	\$ -	\$ 959	\$ 12	\$ 959	\$ 12
Federal agency issued residential mortgage-backed securities <sup>1</sup>	649	-	294	2	943	2
Subtotal	649	-	1,253	14	1,902	14
Corporate obligations:						
Industrial	25,455	860	-	-	25,455	860
Communications and technology	7,239	156	-	-	7,239	156
Financial	51,273	2,107	16,402	3,783	67,675	5,890
Consumer	11,765	119	3,689	144	15,454	263
Public utilities	4,710	344	11,152	1,022	15,862	1,366
Subtotal	100,442	3,586	31,243	4,949	131,685	8,535
Corporate private-labeled residential mortgage-backed securities	41,734	2,668	61,864	9,952	103,598	12,620
Municipal securities	-	-	3,909	61	3,909	61
Other	9,257	921	47,146	8,314	56,403	9,235
Redeemable preferred stocks	2,939	115	3,056	625	5,995	740
Fixed maturity securities	155,021	7,290	148,471	23,915	303,492	31,205
Equity securities	69	104	1,054	31	1,123	135
Total	\$ 155,090	\$ 7,394	\$ 149,525	\$ 23,946	\$ 304,615	\$ 31,340

<sup>1</sup> Federal agency securities are not backed by the full faith and credit of the U.S. Government.

Gross unrealized losses on fixed maturity and equity security investments attributable to securities having gross unrealized losses of 12 months or longer were \$14.4 million at September 30, 2012, a decrease of 40% from \$23.9 million at December 31, 2011. The largest component of this decrease was from the corporate private-labeled residential mortgage-backed securities category, which decreased \$8.4 million or 84% during the first nine months of 2012. Certain securities continue to be challenged by the economy and recovering markets, and the Company continues to monitor the cash flows on each of these investments.

**Table of Contents**

The following table summarizes the Company's investments in securities available for sale with unrealized losses at September 30, 2012.

	Amortized Cost	Fair Value	Gross Unrealized Losses
<b>Securities owned without realized impairment:</b>			
Unrealized losses of 10% or less	\$ 44,169	\$ 43,156	\$ 1,013
Unrealized losses of 20% or less and greater than 10%	32,500	27,594	4,906
<b>Subtotal</b>	<b>76,669</b>	<b>70,750</b>	<b>5,919</b>
<b>Unrealized losses greater than 20%:</b>			
<b>Investment grade</b>			
Less than twelve months	-	-	-
Twelve months or greater	5,854	4,335	1,519
<b>Total investment grade</b>	<b>5,854</b>	<b>4,335</b>	<b>1,519</b>
<b>Below investment grade</b>			
Less than twelve months	4,145	2,825	1,320
Twelve months or greater	3,010	2,308	702
<b>Total below investment grade</b>	<b>7,155</b>	<b>5,133</b>	<b>2,022</b>
<b>Unrealized losses greater than 20%</b>	<b>13,009</b>	<b>9,468</b>	<b>3,541</b>
<b>Subtotal</b>	<b>89,678</b>	<b>80,218</b>	<b>9,460</b>
<b>Securities owned with realized impairment:</b>			
Unrealized losses of 10% or less	48,841	47,939	902
Unrealized losses of 20% or less and greater than 10%	9,367	8,174	1,193
<b>Subtotal</b>	<b>58,208</b>	<b>56,113</b>	<b>2,095</b>
<b>Unrealized losses greater than 20%:</b>			
<b>Investment grade</b>			
Less than twelve months	-	-	-
Twelve months or greater	-	-	-
<b>Total investment grade</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Below investment grade</b>			
Less than twelve months	1,590	1,240	350
Twelve months or greater	10,967	8,017	2,950
<b>Total below investment grade</b>	<b>12,557</b>	<b>9,257</b>	<b>3,300</b>
<b>Unrealized losses greater than 20%</b>	<b>12,557</b>	<b>9,257</b>	<b>3,300</b>
<b>Subtotal</b>	<b>70,765</b>	<b>65,370</b>	<b>5,395</b>



Total	\$ 160,443	\$ 145,588	\$ 14,855
-------	------------	------------	-----------

**Table of Contents**

The following table summarizes the Company's investments in securities available for sale with unrealized losses at December 31, 2011.

	Amortized Cost	Fair Value	Gross Unrealized Losses
<b>Securities owned without realized impairment:</b>			
Unrealized losses of 10% or less	\$ 154,445	\$ 151,008	\$ 3,437
Unrealized losses of 20% or less and greater than 10%	53,042	45,689	7,353
<b>Subtotal</b>	<b>207,487</b>	<b>196,697</b>	<b>10,790</b>
<b>Unrealized losses greater than 20%:</b>			
<b>Investment grade:</b>			
Less than twelve months	4,946	3,752	1,194
Twelve months or greater	908	450	458
<b>Total investment grade</b>	<b>5,854</b>	<b>4,202</b>	<b>1,652</b>
<b>Below investment grade:</b>			
Less than twelve months	8,210	5,977	2,233
Twelve months or greater	-	-	-
<b>Total below investment grade</b>	<b>8,210</b>	<b>5,977</b>	<b>2,233</b>
<b>Unrealized losses greater than 20%</b>	<b>14,064</b>	<b>10,179</b>	<b>3,885</b>
<b>Subtotal</b>	<b>221,551</b>	<b>206,876</b>	<b>14,675</b>
<b>Securities owned with realized impairment:</b>			
Unrealized losses of 10% or less	37,639	36,420	1,219
Unrealized losses of 20% or less and greater than 10%	24,789	20,843	3,946
<b>Subtotal</b>	<b>62,428</b>	<b>57,263</b>	<b>5,165</b>
<b>Unrealized losses greater than 20%:</b>			
<b>Investment grade:</b>			
Less than twelve months	-	-	-
Twelve months or greater	-	-	-
<b>Total investment grade</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Below investment grade:</b>			
Less than twelve months	29,391	23,178	6,213
Twelve months or greater	22,585	17,298	5,287
<b>Total below investment grade</b>	<b>51,976</b>	<b>40,476</b>	<b>11,500</b>
<b>Unrealized losses greater than 20%</b>	<b>51,976</b>	<b>40,476</b>	<b>11,500</b>
<b>Subtotal</b>	<b>114,404</b>	<b>97,739</b>	<b>16,665</b>

Total	\$ 335,955	\$ 304,615	\$ 31,340
-------	------------	------------	-----------

**Table of Contents**

The following table provides information on fixed maturity securities with gross unrealized losses by actual or equivalent Standard & Poor's rating at September 30, 2012.

	Fair Value	% of Total	Gross Unrealized Losses	% of Total
AAA	\$ 3,056	2%	\$ 65	1%
AA	30,043	21%	4,935	33%
A	8,404	6%	472	3%
BBB	20,425	14%	1,313	9%
<b>Total investment grade</b>	<b>61,928</b>	<b>43%</b>	<b>6,785</b>	<b>46%</b>
BB	9,545	7%	351	2%
B and below	72,964	50%	7,613	52%
<b>Total below investment grade</b>	<b>82,509</b>	<b>57%</b>	<b>7,964</b>	<b>54%</b>
	<b>\$ 144,437</b>	<b>100%</b>	<b>\$ 14,749</b>	<b>100%</b>

The following table provides information on fixed maturity securities with gross unrealized losses by actual or equivalent Standard & Poor's rating at December 31, 2011.

	Fair Value	% of Total	Gross Unrealized Losses	% of Total
AAA	\$ 32,245	11%	\$ 4,475	14%
AA	8,986	3%	125	1%
A	32,550	11%	1,207	4%
BBB	65,557	21%	2,925	9%
<b>Total investment grade</b>	<b>139,338</b>	<b>46%</b>	<b>8,732</b>	<b>28%</b>
BB	45,845	15%	4,063	13%
B and below	118,309	39%	18,410	59%
<b>Total below investment grade</b>	<b>164,154</b>	<b>54%</b>	<b>22,473</b>	<b>72%</b>
	<b>\$ 303,492</b>	<b>100%</b>	<b>\$ 31,205</b>	<b>100%</b>

The following is a discussion of all non-asset backed securities whose fair value had been less than 80% of amortized cost for at least six consecutive months at September 30, 2012. The Company has considered a wide variety of factors to determine that these positions were not other-than-temporarily impaired.

Security	Description
Financial institutions	Institutions impacted by housing and mortgage crisis. These securities continue to perform within contractual obligations.

The discounted future cash flow calculation typically becomes the primary determinant of whether any portion and to what extent an unrealized loss is due to credit on loan-backed and similar asset-backed securities with significant indications of potential other-than-temporary impairment. Such indications typically include below investment grade ratings and significant unrealized losses for an extended period of time, among other factors. The Company identified 17 non-U.S. Agency mortgage-backed securities that were determined to have such indications at

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

September 30, 2012 and December 31, 2011. Discounted future cash flow analysis was performed for each of these securities to determine if any portion of the impairment was due to credit and deemed to be other-than-temporary. The discount rate used in calculating the present value of future cash flows was the investment yield at the time of purchase for each security. The initial default rates were assumed to remain constant over a 24-month time frame and grade down thereafter, reflecting the general perspective of a more stabilized residential housing environment in the future.

**Table of Contents**

The following tables present the range of significant assumptions used in projecting the future cash flows at September 30, 2012 and December 31, 2011. The Company believes that the assumptions below are reasonable because they are based upon the actual results of the underlying security collateral.

Vintage	September 30, 2012					
	Initial Default Rate		Initial Severity Rate		Prepayment Speed	
	Low	High	Low	High	Low	High
2003	4.7%	4.7%	40%	40%	18.0%	18.0%
2004	5.7%	7.4%	35%	57%	8.0%	13.0%
2005	3.0%	15.2%	40%	73%	6.0%	15.0%
2006	5.1%	6.3%	46%	85%	8.0%	16.0%
2007	10.2%	10.2%	60%	60%	8.0%	8.0%

Vintage	December 31, 2011					
	Initial Default Rate		Initial Severity Rate		Prepayment Speed	
	Low	High	Low	High	Low	High
2003	3.9%	3.9%	40%	40%	18.0%	18.0%
2004	4.9%	7.7%	40%	56%	8.0%	13.0%
2005	3.5%	13.7%	40%	68%	6.0%	15.0%
2006	4.9%	10.0%	52%	90%	8.0%	18.0%
2007	8.8%	8.8%	66%	66%	8.0%	8.0%

For loan-backed and similar asset-backed securities, the determination of any amount of impairment that is due to credit is based upon the present value of projected future cash flows being less than the amortized cost of the security. This amount is recognized as a realized loss in the Company's Consolidated Statements of Comprehensive Income and the carrying value of the security is written down by the same amount. The portion of an impairment that is determined not to be due to credit is recorded as a component of accumulated other comprehensive income in the Consolidated Balance Sheets.

Significant unrealized losses on securities can continue for extended periods of time, particularly for certain individual securities. While this can be an indication of potential credit impairments, it can also be an indication of illiquidity in a particular sector or security. In addition, the fair value of an individual security can be heavily influenced by the complexities of varying market sentiment or uncertainty regarding the prospects for an individual security. This has been the situation in the non-U.S. Agency mortgage-backed securities market in recent periods. Based upon the process described above, the Company is best able to determine if and to what extent credit impairment may exist in these securities by performing present value calculations of projected future cash flows at the conclusion of each reporting period. By reviewing the most recent data available regarding the security and other relevant industry and market factors, the Company can modify assumptions used in the cash flow projections and determine the best estimate of the portion of any impairment that is due to credit at the conclusion of each period.

The Company closely monitors its investments in securities classified as subprime. Subprime securities include all bonds or portions of bonds where the underlying collateral is made up of home equity loans or first mortgage loans to borrowers whose credit scores at the time of origination were lower than the level recognized in the market as prime. The Company's classification of subprime does not include Alt-A or jumbo loans, unless the collateral otherwise meets the preceding definition. At September 30, 2012, the fair value of investments with subprime residential mortgage exposure was \$15.4 million with a related \$2.7 million unrealized loss. At December 31, 2011, the Company had investments with subprime residential mortgage exposure of \$17.4 million and a related \$3.5 million unrealized loss. This exposure amounted to less than 1% of the Company's invested assets at both September 30, 2012 and December 31, 2011. These investments are included in the Company's process for evaluation of other-than-temporarily impaired securities.

The Company has a significant level of non-U.S. Agency structured securities. Structured securities include asset-backed, residential mortgage-backed securities, along with collateralized debt obligations, collateralized mortgage obligations and other collateralized obligations. The Company monitors these securities through a combination of an analysis of vintage, credit ratings and other factors.

**Table of Contents**

The following tables divide these investment types among vintage and credit ratings at September 30, 2012.

	Fair Value	Amortized Cost	Unrealized Gains (Losses)
<b>Residential &amp; Non-agency MBS <sup>1</sup></b>			
Investment Grade:			
Vintage 2003 and earlier	\$ 21,505	\$ 20,703	\$ 802
2004	28,657	27,543	1,114
2005	-	-	-
2006	-	-	-
2007	-	-	-
<b>Total investment grade</b>	<b>50,162</b>	<b>48,246</b>	<b>1,916</b>
<b>Below Investment Grade:</b>			
Vintage 2003 and earlier	-	-	-
2004	32,306	31,601	705
2005	77,344	81,364	(4,020)
2006	7,411	6,763	648
2007	4,111	4,308	(197)
<b>Total below investment grade</b>	<b>121,172</b>	<b>124,036</b>	<b>(2,864)</b>
<b>Other Structured Securities:</b>			
Investment grade	80,974	80,609	365
Below investment grade	2,760	2,722	38
<b>Total other</b>	<b>83,734</b>	<b>83,331</b>	<b>403</b>
<b>Total structured securities</b>	<b>\$ 255,068</b>	<b>\$ 255,613</b>	<b>\$ (545)</b>

<sup>1</sup> This chart accounts for all vintages owned by the Company.

**Table of Contents**

The following tables divide these investment types among vintage and credit ratings at December 31, 2011.

	Fair Value	Amortized Cost	Unrealized Gains (Losses)
<b>Residential &amp; Non-agency MBS: <sup>1</sup></b>			
Investment Grade:			
Vintage 2003 and earlier	\$ 27,700	\$ 26,974	\$ 726
2004	29,682	28,693	989
2005	-	-	-
2006	-	-	-
2007	-	-	-
Total investment grade	57,382	55,667	1,715
Below Investment Grade:			
Vintage 2003 and earlier	-	-	-
2004	34,497	34,821	(324)
2005	72,619	87,447	(14,828)
2006	6,960	7,309	(349)
2007	3,868	4,864	(996)
Total below investment grade	117,944	134,441	(16,497)
Other Structured Securities:			
Investment grade	71,793	72,998	(1,205)
Below investment grade	3,179	3,444	(265)
Total other	74,972	76,442	(1,470)
Total structured securities	\$ 250,298	\$ 266,550	\$ (16,252)

<sup>1</sup> This chart accounts for all vintages owned by the Company.

Total unrealized losses on non-U.S. Agency structured securities totaled \$0.5 million at September 30, 2012, compared to \$16.3 million at December 31, 2011. Total unrealized losses on these securities as a percent of total amortized cost totaled less than 1% at September 30, 2012, an improvement from 6% at year-end 2011.

The Company has written down certain investments in previous periods. Securities written down and continuing to be owned at September 30, 2012 had a fair value of \$136.1 million with a net unrealized loss of \$1.2 million.

The Company evaluated the current status of all investments previously written-down to assess the ongoing expectations of amounts to be collected. The Company's evaluation process is similar to its impairment evaluation process. If evidence exists that the Company believes that it will receive all or a materially greater portion of its contractual maturities from securities previously written down, the accretion of income is adjusted. The Company did not change its evaluation of any investments under this process during the first six months of 2012 or 2011.



---

**Table of Contents**

The Company maintains a diversified investment portfolio, including 5% of its investment portfolio in municipal bond securities and 6% in bond securities from foreign issuers. Approximately 74% of the Company's foreign securities were from issuers in Canada, Australia, and Great Britain at September 30, 2012. The Company has no holdings in European sovereign debt and all investments are denominated in U.S. dollars. The fair value of the Company's securities from foreign issuers at September 30, 2012 was \$239.4 million with a net unrealized gain of \$17.9 million. This compares to a fair value of \$199.5 million with a net unrealized gain of \$8.7 million at December 31, 2011.

The Company does not have a material amount of direct or indirect guarantees for the securities in its investment portfolio. The Company did not have any direct exposure to financial guarantors at September 30, 2012. The Company's indirect exposure to financial guarantors totaled \$34.8 million, which was approximately 1% of the Company's investments at September 30, 2012. The unrealized gain on these investments totaled \$3.1 million at September 30, 2012. The Company's indirect exposure to financial guarantors at December 31, 2011 totaled \$36.8 million, which was approximately 1% of the Company's investments. Total unrealized gains on these investments totaled \$1.7 million at December 31, 2011.

***Other Revenues***

Other revenues consist primarily of supplementary contract considerations; policyholder dividends left with the Company to accumulate; income received on the sale of low income housing tax credit (LIHTC) investments by a subsidiary of the Company; and fees charged on products and sales from the Company's broker-dealer subsidiary. Other revenues decreased 3% in the third quarter and 9% in the first nine months of 2012 compared to the same periods one year earlier. The decreases in both periods reflected lower income from the sale of LIHTC investments. In addition, the decrease in the nine months also reflected lower supplementary contract considerations.

***Policyholder Benefits***

Policyholder benefits consist of death benefits, immediate annuity benefits, accident and health benefits, surrenders, other benefits, and the associated increase or decrease in reserves for future policy benefits. The largest component of policyholder benefits was death benefits for the periods presented. Death benefits reflect mortality results, after consideration of the impact of reinsurance. Mortality will fluctuate from period to period. However, mortality experience has generally remained within pricing expectations for the periods presented. Following is a discussion of significant fluctuations in policyholder benefits during the periods presented.

Policyholder benefits increased \$1.0 million or 2% in the third quarter of 2012 compared to the same period one year earlier. The largest factors were increased death benefits, net of reinsurance, and increased benefit and contract reserves. The increase in reserves was largely due to favorable changes in immediate annuity premiums and benefits and a decrease that occurred during 2011 in benefit and contract reserves that resulted from system changes and refinements. Partially offsetting these was the change in the value of the GMWB rider liability, as discussed below.

Policyholder benefits decreased \$3.4 million or 3% in the first nine months compared to the same period one year ago. The largest single factor in the decrease in policyholder benefits resulted from a decline in death benefits, net of reinsurance. Other contributing factors were reductions in group accident and health benefits, supplementary contract payments, and policy dividends and coupons. Partially offsetting these was an increase in benefit and contract reserves. This increase was the result of several factors, including favorable changes in immediate annuity premiums and benefits and prior year system changes and refinements. Also, the Company recaptured a block of previously reinsured policies in the second quarter of 2012 which also contributed to the increase in reserves. Partially offsetting these items was the change in the value of the GMWB rider liability, as discussed below.

The Company has a GMWB rider for variable annuity contracts that is considered to be a financial derivative and, as such, is accounted for at fair value. The Company determines the fair value of the GMWB rider using a risk-neutral valuation method. The value of the riders will fluctuate depending on market conditions. At September 30, 2012, the fair value of the liability decreased \$0.2 million compared to the fair value at December 31, 2011. The change in this liability resulted in a decrease in reserves of \$0.2 million in the first nine months of 2012 compared to an increase in reserves of \$3.5 million in the first nine months of 2011. These changes resulted in a decrease of \$3.7 million in the year-over-year comparison. This fluctuation can be attributed to favorable capital market returns and a decline in market volatility, partially offset by declines in interest rates and issuer discount spreads.

***Interest Credited to Policyholder Account Balances***

Interest is credited to policyholder account balances according to terms of the policies or contracts for universal life, fixed deferred annuities, and other investment-type products. There are minimum levels of interest crediting assumed in certain policies or contracts, as well as allowances for adjustments to be made to reflect current market conditions in certain policies



**Table of Contents**

or contracts. Accordingly, the Company reviews and adjusts crediting rates as necessary and appropriate. Amounts credited are a function of account balances and current period crediting rates. As account balances fluctuate, so will the amount of interest credited to policyholder account balances. Interest credited to policyholder account balances decreased \$0.7 million or 3% in the third quarter and \$1.0 million or 2% in the first nine months of 2012 compared with the same periods one year earlier. While total policyholder account balances have increased during 2012, average crediting rates have declined slightly.

***Amortization of Deferred Acquisition Costs***

The amortization of deferred acquisition costs decreased \$4.4 million or 38% in the third quarter and \$1.7 million or 8% in the first nine months of 2012 compared with the prior year. Contributing to the decrease in both periods were refinements in estimates made during the third quarter of 2011 that increased the amortization of DAC by \$2.4 million in the third quarter of 2011. In addition, increases in account values decreased the amortization of DAC for certain products. Partially offsetting these was the impact of unlocking during the second quarter of 2012. Unlocking in 2012 resulted in an increase to the DAC asset of \$1.3 million and was primarily attributable to refinements in mortality, interest, and persistency assumptions.

***Operating Expenses***

Operating expenses consist of incurred commission expense from the sale of insurance products, net of the deferral of certain commissions and certain expenses directly associated with the acquisition of new business; expenses from the Company's operations; the amortization of VOBA; and other expenses. Operating expenses increased \$6.4 million or 26% in the third quarter of 2012 and \$5.0 million or 7% in the first nine months compared to last year. The increase in the third quarter was largely due to increased salaries and employee benefit costs, increased legal fees, and an increase in depreciation on a long-lived asset. The increased depreciation expense of \$3.7 million resulted from a change in accounting estimate for a long-lived asset, as described in Note 3. The increase in the nine months reflected increases in salaries and employee benefit costs, legal fees, and the depreciation on a long-lived asset. These were partially offset by a decline in the amount charged to allowance for doubtful accounts for agent receivables.

The amortization of VOBA decreased \$0.3 million or 19% in the third quarter of 2012 and \$0.1 million or 2% in the first nine months of 2012 compared to the same periods one year earlier. The decrease in the third quarter of 2012 reflected \$0.5 million in less amortization as the traditional life insurance block from the Old American segment became fully amortized at December 31, 2011. The increase in VOBA in the first nine months of 2012 reflected a \$1.4 million decrease resulting from the fully amortized traditional life insurance block from in the Old American segment. Offsetting this, VOBA amortization increased during the nine months due to unlocking that occurred during the second quarter of 2012.

***Income Taxes***

The third quarter income tax expense was \$2.1 million or 34% of income before tax for 2012, versus \$3.0 million or 40% of income before tax for the prior year period. The income tax expense for the nine months ended September 30, 2012 was \$16.2 million or 34% of income before tax, versus \$11.3 million or 36% of income before tax for the prior year period.

The effective income tax rate was less than the prevailing corporate federal income tax rate of 35% in the third quarter of 2012. Permanent differences, including the dividends-received deduction, resulted in a benefit of approximately 2% of income before tax. Partially offsetting the benefit from permanent differences was tax expense of approximately 1% of income before tax related to investments in affordable housing.

The effective income tax rate was less than the prevailing corporate federal income tax rate of 35% in the nine months ended September 30, 2012, primarily due to permanent differences that resulted in a benefit of approximately 1% of income before tax.

The effective income tax rate in the third quarter of 2011 and for the nine months ended September 30, 2011 was greater than the prevailing corporate federal income tax rate of 35%, primarily due to adjustments related to the Company's investments in affordable housing. The affordable housing adjustments resulted in a tax expense of approximately 5% and 1% of income before tax in the third quarter and nine months ended September 30, 2011, respectively.

**Operating Results by Segment**

The Company has three reportable business segments, which are 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 is marketed through a nationwide sales force of independent general agents and

Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

third-party marketing arrangements. The Group Insurance segment consists of sales of group life, group disability, dental, and vision products. This segment is marketed through a nationwide

**Table of Contents**

sales force of independent general agents, group brokers, and third-party marketing arrangements. Old American consists of individual insurance products designed largely as final expense products. These products are marketed through a nationwide general agency sales force with exclusive territories, using direct response marketing to supply agents with leads. For more information, refer to Note 15 - Segment Information in the Notes to Consolidated Financial Statements (Unaudited).

**Table of Contents****Individual Insurance**

The following table presents financial data of the Individual Insurance business segment for the third quarters and nine months ended September 30, 2012 and 2011:

	Quarter Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
<b>Insurance revenues:</b>				
Premiums, net	\$ 3,151	\$ 2,950	\$ 11,029	\$ 9,238
Contract charges	24,464	25,427	75,187	75,413
Total insurance revenues	27,615	28,377	86,216	84,651
<b>Investment revenues:</b>				
Net investment income	41,444	40,031	122,899	123,798
Net realized investment gains, excluding impairment losses	665	209	17,890	3,149
<b>Net impairment losses recognized in earnings:</b>				
Total other-than-temporary impairment losses	(691)	(157)	(1,118)	(607)
Portion of impairment losses recognized in other comprehensive income	47	16	197	114
Net impairment losses recognized in earnings	(644)	(141)	(921)	(493)
Total investment revenues	41,465	40,099	139,868	126,454
Other revenues	2,110	2,176	6,523	7,162
Total revenues	71,190	70,652	232,607	218,267
<b>Policyholder benefits</b>				
Interest credited to policyholder account balances	21,730	21,775	64,096	66,799
Amortization of deferred acquisition costs	20,436	21,119	61,371	62,366
Operating expenses	3,701	8,267	10,438	11,750
Operating expenses	20,960	13,869	53,094	45,797
Total benefits and expenses	66,827	65,030	188,999	186,712
Income before income tax expense	4,363	5,622	43,608	31,555
Income tax expense	1,365	2,280	14,419	11,171
Net income	\$ 2,998	\$ 3,342	\$ 29,189	\$ 20,384

**Table of Contents**

The net income for this segment in the third quarter of 2012 was \$3.0 million, compared to \$3.3 million in the third quarter of 2011. This change was primarily the result of lower insurance revenues and higher operating expenses. Partially offsetting these, net investment income increased, along with lower amortization of deferred acquisition costs and interest credited to policyholder account balances.

Net income for this segment was \$29.2 million for the first nine months of 2012, an increase of \$8.8 million from the first nine months of 2011. Contributing to this improvement were increases in net realized investment gains and insurance revenues, along with lower policyholder benefits, amortization of deferred acquisition costs, and interest credited to policyholder account balances. Partially offsetting these changes was a decrease in net investment income and increased operating expenses.

Total insurance revenues for this segment decreased \$0.8 million or 3% in the third quarter of 2012 compared with the same period in the prior year. Total premiums decreased \$0.4 million or 3%, reflecting a \$0.6 million decrease in individual life premiums that was partially offset by a \$0.3 million increase in immediate annuity premiums. Contract charges decreased \$1.0 million or 4%, and reinsurance ceded premiums decreased \$0.6 million or 5%.

Total insurance revenues for this segment increased \$1.6 million or 2% for the first nine months of 2012 compared to one year earlier. Total premiums increased \$0.9 million or 2%, reflecting a \$1.4 million or 24% increase in immediate annuity premiums that was partially offset by a \$0.5 million or 1% decrease in individual life premiums. Contract charges decreased \$0.2 million and reinsurance ceded premiums decreased \$0.9 million or 3%.

The following table presents gross premiums by new and renewal business, less reinsurance ceded, as included in insurance revenues for the third quarters and nine months ended September 30, 2012 and 2011. New premiums are also detailed by product.

	Quarter Ended September 30			
	2012	% Change	2011	% Change
<b>New premiums:</b>				
Individual life insurance	\$ 1,119	(6)	\$ 1,194	(7)
Immediate annuities	2,187	15	1,903	(72)
Total new premiums	3,306	7	3,097	(61)
Renewal premiums	10,393	(5)	10,970	4
Total premiums	13,699	(3)	14,067	(24)
Reinsurance ceded	(10,548)	(5)	(11,117)	6
Premiums, net	\$ 3,151	7	\$ 2,950	(63)

	Nine Months Ended September 30			
	2012	% Change	2011	% Change
<b>New premiums:</b>				
Individual life insurance	\$ 3,445	(9)	\$ 3,783	(2)
Immediate annuities	7,355	30	5,649	(66)
Total new premiums	10,800	15	9,432	(54)
Renewal premiums	31,527	(1)	31,998	2
Total premiums	42,327	2	41,430	(20)
Reinsurance ceded	(31,298)	(3)	(32,192)	1

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Premiums, net	\$ 11,029	19	\$ 9,238	(54)
---------------	-----------	----	----------	------

Total new premiums for this segment increased \$0.2 million or 7% in the third quarter of 2012. This improvement resulted from increased sales of immediate annuities. Immediate annuity receipts can have sizeable fluctuations, as receipts from policyholders largely result from one-time premiums rather than recurring premiums. Total renewal premiums decreased \$0.6 million or 5% compared to last year, due to a decline in individual life renewal premiums.

Total new premiums for this segment increased \$1.4 million or 15% in the first nine months of 2012 versus the prior year. This improvement also resulted from increased immediate annuities. Total renewal premiums decreased 1%, reflecting lower individual life and annuity renewal premiums.



**Table of Contents**

The following table provides detail by new and renewal deposits for the third quarters and nine months ended September 30, 2012 and 2011. New deposits are also detailed by product.

	Quarter Ended September 30			
	2012	% Change	2011	% Change
<b>New deposits:</b>				
Universal life insurance	\$ 2,980	25	\$ 2,391	(39)
Variable universal life insurance	144	(21)	183	(43)
Fixed deferred annuities	11,982	(22)	15,368	(42)
Variable annuities	4,863	18	4,119	44
<b>Total new deposits</b>	<b>19,969</b>	<b>(9)</b>	<b>22,061</b>	<b>(34)</b>
<b>Renewal deposits</b>	<b>34,903</b>	<b>(7)</b>	<b>37,459</b>	<b>6</b>
<b>Total deposits</b>	<b>\$ 54,872</b>	<b>(8)</b>	<b>\$ 59,520</b>	<b>(14)</b>

	Nine Months Ended September 30			
	2012	% Change	2011	% Change
<b>New deposits:</b>				
Universal life insurance	\$ 9,140	2	\$ 8,953	(14)
Variable universal life insurance	404	(40)	676	(11)
Fixed deferred annuities	43,601	(10)	48,285	(1)
Variable annuities	13,466	(4)	14,098	(2)
<b>Total new deposits</b>	<b>66,611</b>	<b>(8)</b>	<b>72,012</b>	<b>(3)</b>
<b>Renewal deposits</b>	<b>105,120</b>	<b>(4)</b>	<b>109,490</b>	<b>4</b>
<b>Total deposits</b>	<b>\$ 171,731</b>	<b>(5)</b>	<b>\$ 181,502</b>	<b>1</b>

Total new deposits decreased \$2.1 million or 9% in the third quarter of 2012 compared to last year, reflecting a \$3.4 million or 22% decrease in new fixed deferred annuity deposits. Partially offsetting this, new variable annuity deposits increased \$0.7 million or 18% and new universal life deposits increased \$0.6 million or 25%. Total renewal deposits decreased \$2.6 million or 7% in the third quarter of 2012. This decrease was due to a \$3.0 million or 25% decline in fixed deferred annuity renewal deposits. Total new deposits decreased \$5.4 million or 8% in the first nine months of 2012 compared with the prior year. This decrease reflected a \$4.7 million or 10% decline in new fixed deferred annuity deposits and a \$0.6 million or 4% decline in new variable annuity deposits. Total renewal deposits decreased \$4.4 million or 4% in the first nine months of 2012. This decline resulted from a \$2.2 million or 7% decrease in fixed deferred annuity renewal deposits and a \$1.0 million or 13% decrease in variable annuity renewal deposits. New sales and renewals for deposit products have been negatively affected for the third quarter and the first nine months of 2012 by continuing low interest rates and the uncertain economic environment.

Total contract charges decreased \$1.0 million or 4% in the third quarter of 2012 compared to the third quarter of 2011. This largely resulted from decreases in cost of insurance charges and the amortization of deferred revenue. The decrease in cost of insurance charges was largely due to the runoff of closed blocks. Amortization of deferred revenue decreased due to lower actual gross profits on certain lines of business, largely related to increased reinsurance resulting from unlocking that occurred in the second quarter of 2012. Total contract charges on the closed blocks equaled 35% of total consolidated contract charges in both the third quarters of 2012 and 2011. Total contract charges on closed blocks declined 4% in the third quarter of 2012 compared to the same period in 2011. Total contract charges on open blocks of business, where there is ongoing marketing for new sales, decreased 4% in the third quarter of 2012.

Total contract charges decreased \$0.2 million in the first nine months of 2012 compared to one year earlier, reflecting decreases in cost of insurance charges and expense loads. These were partially offset by an increase in the amortization of deferred revenue. In addition to the results

## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

discussed above for the quarter, the amortization of deferred revenue increased during 2012 due to a system upgrade that occurred during 2011 and led to enhanced reinsurance modeling capabilities. The decrease in expense loads is attributed to the increased sale of products with lower expense loads in 2012 than the prior year. The decline in cost of insurance charges was largely due to the runoff of closed blocks.

Total contract charges on the closed blocks equaled 35% of total consolidated contract charges in the first nine months of 2012 compared to 36% in the first nine months of 2011. Total contract charges on closed blocks declined 3% in the first nine months of 2012, while total contract charges on open blocks of business increased 1%.

## **Table of Contents**

Net investment income increased \$1.4 million or 4% in the third quarter of 2012 compared to the third quarter of 2011, as both average invested assets and yields earned increased. Net investment income decreased \$0.9 million in the first nine months of 2012 compared to one year earlier, as an increase in average invested assets was offset by a decline in yields earned. Also, this segment had a net realized gain of \$17.0 million in the first nine months of 2012 compared to a net gain of \$2.7 million in the first nine months of 2011.

Please see Consolidated Results of Operations in Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for a table that provides securities that were written down through earnings by business segment for the first three quarters of 2012 and 2011.

Other revenues decreased 3% in the third quarter and 9% in the first nine months of 2012 compared to the same periods one year earlier. The decreases in both periods reflected lower income from the sale of LIHTC investments. In addition, the decrease in the nine months also reflected lower supplementary contract considerations.

Policyholder benefits were flat for the third quarter of 2012 compared to the prior year. However, a decrease in supplementary contract payments was partially offset by an increase in benefit and contract reserves. Several factors contributed to the increase in benefit and contract reserves, including favorable changes in immediate annuity premiums and benefits and prior year system changes and refinements. Partially offsetting these items was the change in the value of the GMWB rider liability.

Policyholder benefits decreased \$2.7 million or 4% in the first nine months of 2012 compared to the prior year. The largest factor in this decrease was death benefits, net of reinsurance. Other factors contributing to the decrease in policyholder benefits were reduced supplementary contract payments, dividends, and coupons. Partially offsetting this was an increase in benefit and contract reserves. This increase was the result of several factors, including favorable changes in immediate annuity premiums and benefits and prior year system changes and refinements. Also, the Company recaptured a block of previously reinsured policies in the second quarter of 2012 which also contributed to the increase in reserves. Partially offsetting these items was the change in the value of the GMWB rider liability.

Interest credited to policyholder account balances decreased 3% in the third quarter and 2% in the first nine months of 2012 compared to the same periods one year earlier. While total policyholder account balances increased in 2012, average crediting rates declined slightly.

The amortization of deferred acquisition costs decreased \$4.6 million in the third quarter and \$1.3 million in the first nine months of 2012 compared with the prior year. Contributing to the decrease in both periods were the aforementioned refinements in estimates made during the third quarter of 2011 that increased the amortization of DAC by \$2.4 million in the third quarter of 2011. In addition, increases in account values decreased the amortization of DAC for certain products. Partially offsetting these was the impact of unlocking during the second quarter of 2012. Unlocking in 2012 resulted in an increase to the DAC asset of \$1.3 million and was primarily attributable to refinements in mortality, interest, and persistency assumptions.

Operating expenses consist of incurred commissions, net of the capitalization of commissions, expenses from the Company's operations, the amortization of VOBA, and other expenses. Operating expenses increased \$7.1 million or 51% in the third quarter and \$7.3 million or 16% in the first nine months of 2012 compared with the same periods one year earlier. The increases for both periods were largely attributable to higher salaries and employee benefit costs, legal fees, and depreciation on a long-lived asset.

The amortization of VOBA increased \$0.2 million or 18% in the third quarter and \$1.3 million or 32% in the first nine months of 2012 compared to one year earlier. The increase in the third quarter reflected higher amortization of VOBA on certain policies due to improved mortality. The increase in the nine months was largely due to unlocking that occurred during the second quarter of 2012.

**Table of Contents****Group Insurance**

The following table presents financial data of the Group Insurance business segment for the third quarters and nine months ended September 30, 2012 and 2011:

	Quarter Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
<b>Insurance revenues:</b>				
Premiums, net	\$ 12,316	\$ 12,613	\$ 36,580	\$ 37,413
<b>Total insurance revenues</b>	<b>12,316</b>	<b>12,613</b>	<b>36,580</b>	<b>37,413</b>
<b>Investment revenues:</b>				
Net investment income	132	133	392	420
Other revenues	35	38	108	113
<b>Total revenues</b>	<b>12,483</b>	<b>12,784</b>	<b>37,080</b>	<b>37,946</b>
Policyholder benefits	6,590	6,289	20,203	21,373
Operating expenses	6,058	6,433	17,372	17,360
<b>Total benefits and expenses</b>	<b>12,648</b>	<b>12,722</b>	<b>37,575</b>	<b>38,733</b>
<b>Income (loss) before income tax expense (benefit)</b>	<b>(165)</b>	<b>62</b>	<b>(495)</b>	<b>(787)</b>
Income tax expense (benefit)	(57)	22	(173)	(275)
<b>Net income (loss)</b>	<b>\$ (108)</b>	<b>\$ 40</b>	<b>\$ (322)</b>	<b>\$ (512)</b>

The following table presents gross premiums by new and renewal business, less reinsurance ceded, as included in insurance revenues for the third quarters and nine months ended September 30, 2012 and 2011. New premiums are also detailed by product.

	Quarter Ended September 30			
	2012	% Change	2011	% Change
<b>New premiums:</b>				
Group life insurance	\$ 624	21	\$ 516	(5)
Group dental insurance	1,261	51	834	(54)
Group disability insurance	1,605	(34)	2,425	118
Other group insurance	28	(33)	42	500
<b>Total new premiums</b>	<b>3,518</b>	<b>(8)</b>	<b>3,817</b>	<b>10</b>
<b>Renewal premiums</b>	<b>12,156</b>	<b>4</b>	<b>11,672</b>	<b>14</b>
<b>Total premiums</b>	<b>15,674</b>	<b>1</b>	<b>15,489</b>	<b>13</b>
<b>Reinsurance ceded</b>	<b>(3,358)</b>	<b>17</b>	<b>(2,876)</b>	<b>30</b>
Premiums, net	\$ 12,316	(2)	\$ 12,613	9



**Table of Contents**

	Nine Months Ended September 30			
	2012	% Change	2011	% Change
<b>New premiums:</b>				
Group life insurance	\$ 1,849	26	\$ 1,463	(13)
Group dental insurance	3,226	-	3,213	(47)
Group disability insurance	5,293	(24)	6,967	110
Other group insurance	118	5	112	11
<b>Total new premiums</b>	<b>10,486</b>	<b>(11)</b>	<b>11,755</b>	<b>6</b>
Renewal premiums	35,939	5	34,166	6
<b>Total premiums</b>	<b>46,425</b>	<b>1</b>	<b>45,921</b>	<b>6</b>
Reinsurance ceded	(9,845)	16	(8,508)	30
<b>Premiums, net</b>	<b>\$ 36,580</b>	<b>(2)</b>	<b>\$ 37,413</b>	<b>2</b>

Total new premiums decreased \$0.3 million or 8% in the third quarter of 2012 compared with the prior year. This decrease was driven by a decline in new group disability premiums of \$0.8 million or 34%. Partially offsetting this was a \$0.4 million or 51% increase in new dental premiums and a \$0.1 million or 21% increase in new group life premiums. Renewal premiums increased \$0.5 million or 4% in the third quarter, reflecting an increase in short-term disability renewal premiums that was partially offset by a decline in dental renewal premiums.

Total new premiums decreased \$1.3 million or 11% in the first nine months of 2012, compared to one year earlier. This decrease was largely due to a \$2.0 million or 33% decline in new short-term disability premiums. Partially offsetting this change, new group life premiums increased \$0.4 million or 26%. Renewal premiums increased \$1.8 million or 5% in the nine months, as an increase in disability renewal premiums was partially offset by a decrease in dental renewal premiums.

The Company uses reinsurance in several of its group product lines to help mitigate risk. Reinsurance premiums increased \$0.5 million or 17% in the third quarter and \$1.3 million or 16% in the first nine months of 2012 compared to the prior year. The increase in both periods was largely due to an increase in short-term disability renewal premiums that are highly reinsured.

Policyholder benefits consist of death benefits, accident and health benefits, and the associated increase or decrease in reserves for future policy benefits. Policyholder benefits increased \$0.3 million or 5% in the third quarter and decreased \$1.2 million or 5% in the nine months compared to the prior year. The increase during the third quarter was largely due to higher benefits paid for the dental product line. The decrease in the nine months was largely due to a reduction in the benefits paid for the group life and dental product lines.

The policyholder benefit ratio is derived by dividing policyholder benefits, net of reinsurance, by total net premiums. The ratio for the Group Insurance segment was 54% in the third quarter and 55% for the first nine months of 2012, compared to 50% in the third quarter and 57% first nine months of 2011. The policyholder benefit ratios for the dental product line were approximately 68% in the third quarter and 70% first nine months of 2012, compared to approximately 62% in the third quarter and 72% first nine months of 2011.

Operating expenses consist of commissions, fees to third-party marketing and administrative organizations, and expenses from the Company's operations. Operating expenses decreased \$0.4 million or 6% in the third quarter and were essentially flat in the nine months. The decrease in the third quarter was largely due to lower commission expenses associated with the disability and dental products.

**Table of Contents****Old American**

The following table presents financial data for the Old American business segment for the third quarters and nine months ended September 30, 2012 and 2011:

	Quarter Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
<b>Insurance revenues:</b>				
Premiums, net	\$ 17,680	\$ 17,048	\$ 52,644	\$ 50,655
<b>Total insurance revenues</b>	<b>17,680</b>	<b>17,048</b>	<b>52,644</b>	<b>50,655</b>
<b>Investment revenues:</b>				
Net investment income	3,069	2,929	8,998	9,159
Net realized investment gains, excluding impairment losses	(59)	1	(86)	(34)
<b>Net impairment losses recognized in earnings:</b>				
Total other-than-temporary impairment losses	(6)	(10)	(35)	(67)
Portion of impairment losses recognized in other comprehensive income	-	1	-	17
<b>Net impairment losses recognized in earnings</b>	<b>(6)</b>	<b>(9)</b>	<b>(35)</b>	<b>(50)</b>
<b>Total investment revenues</b>	<b>3,004</b>	<b>2,921</b>	<b>8,877</b>	<b>9,075</b>
Other revenues	1	1	12	14
<b>Total revenues</b>	<b>20,685</b>	<b>19,970</b>	<b>61,533</b>	<b>59,744</b>
Policyholder benefits	11,180	10,476	34,947	34,507
Amortization of deferred acquisition costs	3,450	3,310	9,735	10,116
Operating expenses	4,023	4,426	11,812	14,203
<b>Total benefits and expenses</b>	<b>18,653</b>	<b>18,212</b>	<b>56,494</b>	<b>58,826</b>
Income before income tax expense	2,032	1,758	5,039	918
<b>Income tax expense</b>	<b>790</b>	<b>674</b>	<b>1,936</b>	<b>360</b>
Net income	\$ 1,242	\$ 1,084	\$ 3,103	\$ 558

Net income for this segment totaled \$1.2 million in the third quarter of 2012 compared to \$1.1 million in the prior year. The increase in net income for the third quarter reflected a \$0.6 million increase in insurance revenues, a \$0.1 million increase in net investment income, and a \$0.4 million decrease in operating expenses. These were partially offset by a \$0.7 million increase in policyholder benefits. Net income for the first nine months of 2012 was \$3.1 million compared to \$0.6 million for the same period in 2011. The increase in net income in the first nine months of 2012 reflected a \$2.0 million increase in insurance revenues, a \$0.4 million decrease in the amortization of DAC, and a \$2.4 million decrease in operating expenses. These were partially offset by a \$0.2 million decrease in net investment income and a \$0.4 million increase in policyholder benefits.

**Table of Contents**

The following table presents gross premiums by new and renewal business, less reinsurance ceded, as included in insurance revenues for the third quarters and nine months ended September 30, 2012 and 2011.

	Quarter Ended September 30			
	2012	% Change	2011	% Change
New individual life premiums	\$ 3,165	4	\$ 3,055	5
Renewal premiums	15,002	3	14,572	3
<b>Total premiums</b>	<b>18,167</b>	<b>3</b>	<b>17,627</b>	<b>3</b>
Reinsurance ceded	(487)	(16)	(579)	(12)
<b>Premiums, net</b>	<b>\$ 17,680</b>	<b>4</b>	<b>\$ 17,048</b>	<b>4</b>

	Nine Months Ended September 30			
	2012	% Change	2011	% Change
New individual life premiums	\$ 9,609	5	\$ 9,190	10
Renewal premiums	44,565	3	43,274	2
<b>Total premiums</b>	<b>54,174</b>	<b>3</b>	<b>52,464</b>	<b>3</b>
Reinsurance ceded	(1,530)	(15)	(1,809)	(12)
<b>Premiums, net</b>	<b>\$ 52,644</b>	<b>4</b>	<b>\$ 50,655</b>	<b>4</b>

Total new premiums increased \$0.1 million or 4% in the third quarter and \$0.4 million or 5% in the nine months, while total renewal premiums increased \$0.4 million or 3% in the third quarter and \$1.3 million or 3% in the nine months. The increases in premiums reflect a combination of expanded distribution efforts and improved agency productivity. Old American continues to focus on the recruitment and development of new agencies and agents, along with improved production from existing agencies and agents. In addition, proactive territorial management by agencies and the home office have contributed to the increased sales.

Net investment income increased \$0.1 million or 5% in the third quarter as both average invested assets and yields earned increased. Net investment income decreased \$0.2 million or 2% in the first nine months as an increase in average invested assets was more than offset by lower yields earned.

Please see Consolidated Results of Operations in Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for a table that provides securities that were written down through earnings by business segment for the first three quarters of 2012 and 2011.

Policyholder benefits increased \$0.7 million or 7% in the third quarter versus last year. The increase was largely due to a \$0.6 million increase in death benefits, net of reinsurance, and a \$0.3 million increase in benefit and contract reserves. Policyholder benefits increased \$0.4 million or 1% in the first nine months of 2012 compared with the prior year. This increase was due to a \$1.0 million increase in benefit and contract reserves. Partially offsetting this change was a \$0.4 million decrease in death benefits and a \$0.2 million decrease in life surrenders. The increase in reserves occurred in both the third quarter and nine months of 2012, can largely be attributed to the increase in both sales and retention of business. Mortality fluctuations occur each period, and the Company monitors these fluctuations in relation to its pricing expectations. While death benefits decreased during the first nine months of 2012, the results remained within pricing expectations.

Amortization of DAC increased \$0.1 million or 4% in the third quarter but decreased \$0.4 million or 4% in the nine months compared to one year earlier. The decline in the nine months was primarily due to the implementation of ASU No. 2010-26, as described in Note 7 Change in Accounting Principle and Change in Accounting Estimate.



## Edgar Filing: KANSAS CITY LIFE INSURANCE CO - Form 10-Q

Operating expenses decreased \$0.4 million or 9% in the third quarter and \$2.4 million or 17% in the nine months compared to one year earlier. The decreases in both periods were largely due to reduced agent meeting costs. In addition, salaries and benefits decreased in the nine months. Also contributing to the decreases for both periods was lower amortization of VOBA, due to the traditional life insurance block being fully amortized at December 31, 2011. This resulted in less VOBA amortization of \$0.5 million and \$1.4 million in the third quarter and first nine months of 2012, respectively, compared to the same periods in the prior year. Capitalized commissions increased in the nine months, primarily related to the implementation of ASU No. 2010-26, as described in Note 3.

**Table of Contents****Liquidity and Capital Resources***Liquidity*

Statements made in the Company's 2011 Form 10-K remain pertinent, as the Company's liquidity position is materially unchanged from year-end 2011.

Net cash provided by operating activities was \$1.7 million in the nine months ended September 30, 2012. The primary sources of cash from operating activities in the first nine months of 2012 were premium receipts and net investment income. The primary uses of cash from operating activities in the first nine months of 2012 were for the payment of policyholder benefits and operating expenses. Net cash used for investing activities was \$33.1 million. The primary sources of cash were sales, maturities, calls, and principal paydowns of investments totaling \$293.1 million. Offsetting these, the Company's new investments totaled \$348.1 million. Net cash provided by financing activities was \$28.1 million, primarily including \$42.2 million of deposits net of withdrawals from policyholder account balances, and reflecting the payment of stockholder dividends.

*Debt and Short-Term Borrowing*

The Company and certain subsidiaries have access to borrowing capacity through their membership affiliation with the Federal Home Loan Bank of Des Moines (FHLB). At September 30, 2012, there were no outstanding balances with the FHLB, and there were no outstanding balances at year-end 2011. The Company has access to unsecured revolving lines of credit of \$60.0 million with two major commercial banks with no balances outstanding. These lines of credit will expire in June of 2013. The Company anticipates renewing these lines of credit as they come due.

*Capital Resources*

The Company considers existing capital resources to be adequate to support the current level of business activities. In addition, the Company's statutory equity exceeds the minimum capital deemed necessary to support its insurance business, as determined by the risk-based capital calculations and guidelines established by the National Association of Insurance Commissioners. The Company believes these statutory limitations impose no practical restrictions on its dividend payment plans.

The following table shows the capital adequacy for the Company.

	September 30 2012	December 31 2011
Total assets, excluding separate accounts	\$ 4,186,447	\$ 4,081,633
Total stockholders' equity	756,422	710,705
Ratio of stockholders' equity to assets, excluding separate accounts	18%	17%

The ratio of equity to assets less separate accounts increased from 17% at December 31, 2011 to 18% at September 30, 2012. Unrealized investment gains on available for sale securities, which are included as a part of stockholders' equity (net of securities losses, related taxes, policyholder account balances, future policy benefits, and DAC), totaled \$112.1 million at September 30, 2012. This represents an increase of \$31.0 million in net unrealized gains from the \$81.1 million in net unrealized investment gains at December 31, 2011. Stockholders' equity increased \$45.7 million from year-end 2011, largely due to growth in retained earnings from increased net income experienced in the first nine months of 2012. In addition, the Company experienced growth in accumulated other comprehensive income, reflecting the increase in net unrealized gains.

The stock repurchase program was extended by the Board of Directors through January 27, 2013 to permit the purchase of up to one million of the Company's shares on the open market. During the first nine months of 2012, the Company purchased 72,126 shares under the stock repurchase program for \$2.3 million. Through the nine months ended September 30, 2011, the Company purchased 121,241 shares of stock under the stock repurchase program for \$3.7 million.

During the nine months ended September 30, 2012, the Company purchased 2,669 shares and sold 660 shares of treasury stock from the Company's employee stock ownership plan for a net increase in treasury stock of \$0.1 million. During the six months ended June 30, 2012, the Company purchased 8,098 shares and sold 18,588 shares of treasury stock from the Company's deferred compensation plans for a net decrease in

treasury stock of \$0.5 million.

## **Table of Contents**

During the second quarter of 2012, the Company reclassified 188,621 shares from other assets to treasury stock. Please see the discussion of the immaterial correction in Note 1 Nature of Operations and Significant Accounting Policies for additional information.

On October 22, 2012, the Board of Directors declared a quarterly dividend of \$0.27 per share, unchanged from the prior year, which will be paid November 7, 2012 to stockholders of record as of November 1, 2012. Total stockholder dividends paid were \$9.1 million and \$9.3 million in the first nine months ended September 30, 2012 and 2011, respectively.

## **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

In the most recent reporting periods, financial market volatility and liquidity have shown continued improvement. While the improvement has been fairly broad-based, normal market conditions have not yet returned in all sectors or markets. Periods of volatility and market uncertainty represent a heightened risk for all financial institutions. Such events could negatively affect the Company and policyholder activity, such as a reduction in sales, increased policy surrenders, increased policy loans and reduced earnings. The Company has factored these risks into its risk management processes and its disclosures of financial condition.

Please refer to the Company's 2011 Form 10-K for a more complete discussion of quantitative and qualitative disclosures about market risk.

## **Item 4. Controls and Procedures**

As required by Exchange Act Rule 13a-15(b), Kansas City Life Insurance Company management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation as of the end of the period covered by this report, of the effectiveness of the Company's disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. As required by Exchange Act Rule 13a-15(d), Kansas City Life Insurance Company management, including the Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of the Company's internal control over financial reporting to determine whether any changes occurred during the period covered by this report materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting. Based on that evaluation, there has been no such change during the period covered by this report.

**Table of Contents**

**Part II: Other Information**

**Item 1. 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 increase. Given the significant decline in the major market indices beginning in 2008, and the generally poor performance of investments that have historically been considered safe and conservative, 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 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 that are discussed more fully in the Company's Risk Factors included in Part I, Item 1A of the Company's 2011 Form 10-K.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****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	- <sup>1</sup>	\$ -	-	1,000,000
	2,464 <sup>2</sup>	33.53		
2/1/12 - 2/29/12	- <sup>1</sup>	-	-	1,000,000
	1,675 <sup>2</sup>	34.33		
3/1/12 - 3/31/12	- <sup>1</sup>	-	-	1,000,000
	407 <sup>2</sup>	32.37		
4/1/12 - 4/30/12	13,047 <sup>1</sup>	31.76	13,047	986,953
	2,870 <sup>2</sup>	32.13		
5/1/12 - 5/31/12	42,382 <sup>1</sup>	32.21	42,382	944,571
	3,060 <sup>2</sup>	32.24		
6/1/12 - 6/30/12	16,697 <sup>1</sup>	32.19	16,697	927,874
	223 <sup>2</sup>	33.39		
7/1/12 - 7/31/12	- <sup>1</sup>	-	-	927,874
	21 <sup>2</sup>	35.19		
8/1/12 - 8/31/12	- <sup>1</sup>	-	-	927,874
	- <sup>2</sup>	-		
9/1/12 - 9/30/12	- <sup>1</sup>	-	-	927,874
	94 <sup>2</sup>	35.40		
<b>Total</b>	<b>82,940</b>		<b>72,126</b>	

<sup>1</sup> On January 23, 2012, the Company's Board of Directors authorized the repurchase of up to 1,000,000 shares of its common stock through January 27, 2013.

<sup>2</sup> 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 September 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.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Table of Contents**

**Item 4. Mine Safety Disclosures**

Not applicable.

---

**Table of Contents**

**Item 5. Other Information**

**3520 Broadway, Kansas City, MO 64111**

**Contact:** Tracy W. Knapp, Chief Financial Officer,

(816) 753-7299, Ext. 8216

**For Immediate Release:** October 26, 2012, press release reporting financial results for the third quarter of 2012.

**Kansas City Life Announces Third Quarter 2012 Results**

Kansas City Life Insurance Company recorded net income of \$4.1 million or \$0.38 per share in the third quarter of 2012, down slightly from prior year third quarter earnings of \$4.5 million or \$0.39 per share. The third quarter 2012 results were favorably impacted by improved net investment income of \$1.6 million but offset by increased benefits and expenses of \$2.2 million.

Net income through the first nine months of 2012 was \$32.0 million or \$2.88 per share, an increase of \$11.5 million or \$1.10 per share over the prior year. The increase was largely the result of net realized investment gains of \$16.8 million in 2012, primarily from the sale of real estate during the first quarter. Also contributing to the favorable results year to date were higher insurance revenues of \$2.8 million and lower benefits and expenses of \$1.1 million.

Insurance revenues declined \$0.4 million or 1% in the third quarter of 2012, largely due to a \$1.0 million decrease in contract charges. The change in contract charges was primarily the result of lower universal life balances. Partially offsetting this change was a \$0.3 million increase in immediate annuity premiums. Insurance revenues increased \$2.8 million or 2% in the nine months of 2012, reflecting increases in immediate annuity and individual life premiums.

Total deposits on the Company's interest sensitive products decreased \$4.7 million or 8% for the third quarter, as increased variable annuity deposits were offset by lower fixed deferred annuity deposits. Total deposits decreased \$9.8 million or 5% in the nine months, largely due to declines in fixed deferred annuity and variable life and annuity deposits.

Total investment revenues, which includes net investment income and net realized investment gains and losses, increased \$1.4 million or 3% in the third quarter. The improved investment revenues were the result of both increased invested assets and higher yields earned. Total investment revenues in the nine months increased \$13.2 million over the prior year, largely from gains on real estate sales. Net investment income decreased \$1.1 million or 1% for the nine months, primarily due to a decline in yields.

Policyholder benefits increased \$1.0 million or 2% for the third quarter of 2012, primarily due to increased policy reserves and net death benefits. However, policyholder benefits declined by \$3.4 million or 3% for the nine month period. The reduction year to date reflected reduced net death benefits, partially offset by an increase in benefit and contract reserves.

The amortization of deferred acquisition costs (DAC) decreased \$4.4 million in the third quarter of 2012 and \$1.7 million for the nine months. The decrease for the comparative third quarters was due to unlocking and system refinements that increased DAC amortization in 2011, while the reduction in DAC amortization year to date was primarily due to unlocking that occurred during the second quarter of 2012.

Operating expenses increased \$6.4 million in the third quarter and \$5.0 million for the nine months. The increase in the third quarter was due to increased depreciation, salaries and employee benefit costs, and legal fees. The increase in the nine months was reflective of the same items, but these were partially offset by a decline in pension expense and a reduction in allowances for doubtful accounts earlier in the year.

On October 22, 2012, the Kansas City Life Board of Directors declared a quarterly dividend of \$0.27 per share that will be paid on November 7, 2012 to stockholders of record on November 1, 2012.

Kansas City Life Insurance Company (NASDAQ: KCLI) was established in 1895 and is based in Kansas City, Missouri. The Company's primary business is providing financial protection through the sale of life insurance and annuities. The Company's revenues were \$419.0 million in 2011, and assets and life insurance in force were \$4.4 billion and \$29.2 billion, respectively, as of December 31, 2011. The Company operates in 49 states and the District of Columbia. For more information, please visit [www.kclife.com](http://www.kclife.com).





**Table of Contents****Kansas City Life Insurance Company****Condensed Consolidated Income Statement (Unaudited)**

(amounts in thousands, except share data)

	Quarter Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Revenues	\$ 104,260	\$ 103,271	\$ 330,925	\$ 315,553
Net income	\$ 4,132	\$ 4,466	\$ 31,970	\$ 20,430
Net income per share, basic and diluted	\$ 0.38	\$ 0.39	\$ 2.88	\$ 1.78
Dividends paid	\$ 0.27	\$ 0.27	\$ 0.81	\$ 0.81
Average number of shares outstanding	11,056,999	11,432,209	11,111,490	11,453,124

**Table of Contents**

**Item 6. Exhibits**

(a) Exhibits

Exhibit

Number:

10(a)	Kansas City Life Deferred Compensation Plan, as amended and restated effective July 2, 2012.
10(b)	Kansas City Life Insurance Company Savings and Profit Sharing Plan, Thirty-Sixth Amendment.
31(a)	Section 302 Certification.
31(b)	Section 302 Certification.
32	Section 1350 Certification.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

**Table of Contents**

**Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**KANSAS CITY LIFE INSURANCE COMPANY**  
(Registrant)

/s/ R. Philip Bixby

R. Philip Bixby  
President, Chief Executive Officer

and Chairman of the Board

/s/ Tracy W. Knapp

Tracy W. Knapp  
Senior Vice President, Finance  
Date: October 26, 2012