

National Western Life Group, Inc.  
Form 10-Q  
May 10, 2018

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

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2018  
 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: 000-55522

NATIONAL WESTERN LIFE GROUP, INC.  
(Exact name of Registrant as specified in its charter)

DELAWARE  
(State of Incorporation)

47-3339380  
(I.R.S. Employer Identification Number)

10801 N. MOPAC EXPY BLDG 3  
AUSTIN, TEXAS 78759-5415

(Address of Principal Executive Offices) (Zip Code) (512) 836-1010  
(Telephone Number, including area code)

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

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). :

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer (Do not check if a smaller reporting company)   
Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of May 8, 2018, the number of shares of Registrant's common stock outstanding was: Class A – 3,436,166 and Class B - 200,000.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

NATIONAL WESTERN LIFE GROUP, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (In thousands)

| ASSETS  | (Unaudited)       |                      |
|---|-------------------|----------------------|
|   | March 31,<br>2018 | December 31,<br>2017 |
| Investments:  |                   |                      |
| Debt securities held to maturity, at amortized cost (fair value: \$7,302,034 and \$7,434,104) | \$7,280,200       | 7,247,024            |
| Debt securities available for sale, at fair value (cost: \$3,087,827 and \$2,964,510)         | 3,084,789         | 3,041,131            |
| Mortgage loans, net of allowance for possible losses (\$650 and \$650)                        | 204,948           | 208,249              |
| Policy loans  | 55,515            | 56,405               |
| Derivatives, index options  | 116,356           | 194,731              |
| Equity securities   | 18,173            | 18,478               |
| Other long-term investments   | 51,733            | 51,828               |
| Total investments   | 10,811,714        | 10,817,846           |
| Cash and cash equivalents   | 82,924            | 217,624              |
| Deferred policy acquisition costs   | 840,039           | 819,511              |
| Deferred sales inducements  | 138,993           | 135,570              |
| Accrued investment income   | 99,784            | 96,818               |
| Federal income tax receivable   | 10,750            | —                    |
| Other assets  | 142,114           | 137,725              |
| Total assets  | \$12,126,318      | 12,225,094           |

See accompanying notes to Condensed Consolidated Financial Statements (unaudited).

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NATIONAL WESTERN LIFE GROUP, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (In thousands, except share amounts)

|   | (Unaudited)       |                      |
|---|-------------------|----------------------|
|   | March 31,<br>2018 | December 31,<br>2017 |
| LIABILITIES AND STOCKHOLDERS' EQUITY  |                   |                      |
| LIABILITIES:  |                   |                      |
| Future policy benefits:   |                   |                      |
| Universal life and annuity contracts  | \$9,855,395       | 9,962,589            |
| Traditional life reserves   | 136,804           | 135,895              |
| Other policyholder liabilities  | 137,109           | 128,009              |
| Deferred Federal income tax liability   | 29,082            | 25,408               |
| Federal income tax payable  | —                 | 2,701                |
| Other liabilities   | 139,697           | 138,318              |
| Total liabilities   | 10,298,087        | 10,392,920           |
| COMMITMENTS AND CONTINGENCIES (Note 8)  |                   |                      |
| STOCKHOLDERS' EQUITY:   |                   |                      |
| Common stock:   |                   |                      |
| Class A - \$.01 par value; 7,500,000 shares authorized; 3,436,166 issued and outstanding in 2018 and 2017 | 34                | 34                   |
| Class B - \$.01 par value; 200,000 shares authorized, issued, and outstanding in 2018 and 2017            | 2                 | 2                    |
| Additional paid-in capital  | 41,716            | 41,716               |
| Accumulated other comprehensive income  | (20,951           | ) 14,281             |
| Retained earnings   | 1,807,430         | 1,776,141            |
| Total stockholders' equity  | 1,828,231         | 1,832,174            |
| Total liabilities and stockholders' equity  | \$12,126,318      | 12,225,094           |

Note: The Condensed Consolidated Balance Sheet at December 31, 2017 has been derived from the audited Consolidated Financial Statements as of that date.

See accompanying notes to Condensed Consolidated Financial Statements (unaudited).

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CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

For the Three Months Ended March 31, 2018 and 2017

(Unaudited)

(In thousands, except per share amounts)

|   | 2018     | 2017      |
|---|----------|-----------|
| Premiums and other revenues:  |          |           |
| Universal life and annuity contract charges                             | \$38,520 | 41,364    |
| Traditional life premiums   | 4,145    | 4,221     |
| Net investment income   | 60,745   | 171,742   |
| Other revenues  | 4,997    | 4,505     |
| Net realized investment gains (losses):                                 |          |           |
| Total other-than-temporary impairment (“OTTI”) gains (losses)           | 3        | 20        |
| Portion of OTTI (gains) losses recognized in other comprehensive income | (3       | ) (20     |
| Net OTTI losses recognized in earnings                                  | —        | —         |
| Other net investment gains (losses)                                     | 611      | 2,585     |
| Total net realized investment gains (losses)                            | 611      | 2,585     |
| Total revenues  | 109,018  | 224,417   |
| Benefits and expenses:  |          |           |
| Life and other policy benefits  | 21,401   | 19,757    |
| Amortization of deferred policy acquisition costs                       | 32,229   | 34,212    |
| Universal life and annuity contract interest                            | (1,818   | ) 109,893 |
| Other operating expenses  | 23,633   | 25,092    |
| Total benefits and expenses   | 75,445   | 188,954   |
| Earnings before Federal income taxes                                    | 33,573   | 35,463    |
| Federal income taxes  | 6,698    | 11,925    |
| Net earnings  | \$26,875 | 23,538    |
| Basic earnings per share:   |          |           |
| Class A   | \$7.60   | \$ 6.66   |
| Class B   | \$3.80   | \$ 3.33   |
| Diluted earnings per share:   |          |           |
| Class A   | \$7.60   | \$ 6.65   |
| Class B   | \$3.80   | \$ 3.33   |

See accompanying notes to Condensed Consolidated Financial Statements (unaudited).



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## NATIONAL WESTERN LIFE GROUP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

For the Three Months Ended March 31, 2018 and 2017

(Unaudited)

(In thousands)

|  | 2018       | 2017   |
|--|------------|--------|
| Net earnings   | \$26,875   | 23,538 |
| Other comprehensive income (loss), net of effects of deferred costs and taxes: |            |        |
| Unrealized gains (losses) on securities:                                       |            |        |
| Net unrealized holding gains (losses) arising during period                    | (34,754 )  | 5,479  |
| Net unrealized liquidity gains (losses)  | —          | 43     |
| Reclassification adjustment for net amounts included in net earnings           | (33 )      | (690 ) |
| Net unrealized gains (losses) on securities                                    | (34,787 )  | 4,832  |
| Foreign currency translation adjustments                                       | 1,168      | (85 )  |
| Benefit plans:   |            |        |
| Amortization of net prior service cost and net gain (loss)                     | 2,801      | (887 ) |
| Other comprehensive income (loss)  | (30,818 )  | 3,860  |
| Comprehensive income (loss)  | \$(3,943 ) | 27,398 |

See accompanying notes to Condensed Consolidated Financial Statements (unaudited).



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NATIONAL WESTERN LIFE GROUP, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS'  
 EQUITY

For the Three Months Ended March 31, 2018 and 2017

(Unaudited)

(In thousands)

|  | 2018     | 2017   |
|--|----------|--------|
| Common stock:  |          |        |
| Balance at beginning of period   | \$ 36    | 36     |
| Shares exercised under stock option plan                                     | —        | —      |
| Balance at end of period   | 36       | 36     |
| Additional paid-in capital:  |          |        |
| Balance at beginning of period   | 41,716   | 41,716 |
| Shares exercised under stock option plan                                     | —        | —      |
| Balance at end of period   | 41,716   | 41,716 |
| Accumulated other comprehensive income:                                      |          |        |
| Unrealized gains on non-impaired securities:                                 |          |        |
| Balance at beginning of period   | 33,664   | 22,813 |
| Change in unrealized gains (losses) during period, net of tax                | (34,787) | 4,789  |
| Cumulative effect of change in accounting principle, net of tax (See Note 2) | (4,414)  | —      |
| Balance at end of period   | (5,537)  | 27,602 |
| Unrealized losses on impaired held to maturity securities:                   |          |        |
| Balance at beginning of period   | (10 )    | Ø203   |
| Amortization   | 2        | 85     |
| Other-than-temporary impairments, non-credit, net of tax                     | —        | —      |
| Additional credit loss on previously impaired securities                     | —        | —      |
| Change in shadow deferred policy acquisition costs                           | (2 )     | Ø42    |
| Balance at end of period   | (10 )    | Ø160   |
| Unrealized losses on impaired available for sale securities:                 |          |        |
| Balance at beginning of period   | (1 )     | Ø1     |
| Other-than-temporary impairments, non-credit, net of tax                     | —        | —      |
| Change in shadow deferred policy acquisition costs                           | —        | —      |
| Recoveries, net of tax   | —        | —      |
| Balance at end of period   | (1 )     | Ø1     |

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NATIONAL WESTERN LIFE GROUP, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES  
 IN STOCKHOLDERS' EQUITY (continued)  
 For the Three Months Ended March 31, 2018 and 2017  
 (Unaudited)  
 (In thousands)

|  | 2018         | 2017         |
|--|--------------|--------------|
| Foreign currency translation adjustments:                                    |              |              |
| Balance at beginning of period   | 3,223        | 2,661        |
| Change in translation adjustments during period                              | 1,168        | (85 )        |
| Balance at end of period   | 4,391        | 2,576        |
| Benefit plan liability adjustment:   |              |              |
| Balance at beginning of period   | (22,595 )    | (14,718 )    |
| Amortization of net prior service cost and net loss, net of tax              | 2,801        | (887 )       |
| Balance at end of period   | (19,794 )    | (15,605 )    |
| Accumulated other comprehensive income at end of period                      | (20,951 )    | 14,412       |
| Retained earnings:   |              |              |
| Balance at beginning of period   | 1,776,141    | 1,669,524    |
| Cumulative effect of change in accounting principle, net of tax (See Note 2) | 4,414        | —            |
| Net earnings   | 26,875       | 23,538       |
| Stockholder dividends  | —            | —            |
| Balance at end of period   | 1,807,430    | 1,693,062    |
| Total stockholders' equity   | \$ 1,828,231 | \$ 1,749,226 |

See accompanying notes to Condensed Consolidated Financial Statements (unaudited).

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NATIONAL WESTERN LIFE GROUP, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 For the Three Months Ended March 31, 2018 and 2017  
 (Unaudited)  
 (In thousands)

|   | 2018      | 2017    |
|---|-----------|---------|
| Cash flows from operating activities:   |           |         |
| Net earnings  | \$26,875  | 23,538  |
| Adjustments to reconcile net earnings to net cash from operating activities:  |           |         |
| Universal life and annuity contract interest                                  | (1,818 )  | 109,893 |
| Surrender charges and other policy revenues                                   | (8,988 )  | 12,268  |
| Realized (gains) losses on investments  | (611 )    | 2,585   |
| Accretion/amortization of discounts and premiums, investments                 | 123       | 116     |
| Depreciation and amortization   | 3,021     | 2,474   |
| (Increase) decrease in value of equity securities                             | 541       | —       |
| (Increase) decrease in value of derivatives                                   | 44,394    | 61,206  |
| (Increase) decrease in deferred policy acquisition and sales inducement costs | 11,673    | 11,003  |
| (Increase) decrease in accrued investment income                              | (2,966 )  | 2,737   |
| (Increase) decrease in other assets   | (7,635 )  | 2,390   |
| Increase (decrease) in liabilities for future policy benefits                 | 2,594     | 4,171   |
| Increase (decrease) in other policyholder liabilities                         | 9,101     | 9,284   |
| Increase (decrease) in Federal income taxes liability                         | (13,451 ) | 17,504  |
| Increase (decrease) in deferred Federal income tax                            | 11,864    | 11,019  |
| Increase (decrease) in other liabilities                                      | (1,844 )  | 6,654   |
| Net cash provided by operating activities                                     | 72,873    | 92,432  |
| Cash flows from investing activities:   |           |         |
| Proceeds from sales of:   |           |         |
| Securities held to maturity   | —         | —       |
| Securities available for sale   | —         | 22,184  |
| Other investments   | —         | —       |
| Proceeds from maturities and redemptions of:                                  |           |         |
| Securities held to maturity   | 113,157   | 120,507 |
| Securities available for sale   | 7,156     | 70,603  |
| Equity securities   | 140       | —       |
| Derivatives, index options  | 59,321    | 48,856  |
| Property and equipment  | 9         | 10      |
| Purchases of:   |           |         |
| Securities held to maturity   | (142,867) | 217,275 |
| Securities available for sale   | (126,544) | 44,817  |
| Equity securities   | (376 )    | —       |
| Derivatives, index options  | (22,556 ) | 17,649  |
| Other investments   | (96 )     | —       |
| Property and equipment  | (2,553 )  | 44      |

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NATIONAL WESTERN LIFE GROUP, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)  
 For the Three Months Ended March 31, 2018 and 2017  
 (Unaudited)  
 (In thousands)

|   | 2018      | 2017      |
|---|-----------|-----------|
| Principal payments on mortgage loans                                  | 3,365     | 18,999    |
| Cost of mortgage loans acquired                                       | (24 )     | (8,323 )  |
| Decrease (increase) in policy loans                                   | 890       | 930       |
| Net cash provided by/(used in) investing activities                   | (110,978) | (6,019 )  |
| Cash flows from financing activities:                                 |           |           |
| Deposits to account balances for universal life and annuity contracts | 154,914   | 181,856   |
| Return of account balances on universal life and annuity contracts    | (252,988) | (231,899) |
| Net cash provided by (used in) financing activities                   | (98,074 ) | (50,043 ) |
| Effect of foreign exchange  | 1,479     | (131 )    |
| Net increase (decrease) in cash and cash equivalents                  | (134,700) | 36,239    |
| Cash and cash equivalents at beginning of period                      | 217,624   | 51,247    |
| Cash and cash equivalents at end of period                            | \$82,924  | \$87,486  |

## SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

|   |            |          |
|---|------------|----------|
| Cash paid (received) during the period for: |            |          |
| Interest                                    | \$10       | 10       |
| Income taxes                                | \$8,283    | 5,440    |
| Noncash operating activities:               |            |          |
| Deferral of sales inducements               | \$(3,007 ) | (1,515 ) |

See accompanying notes to Condensed Consolidated Financial Statements (unaudited).

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NATIONAL WESTERN LIFE GROUP, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (UNAUDITED)

(1) CONSOLIDATION AND BASIS OF PRESENTATION

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for annual financial statements. In the opinion of management, the accompanying Condensed Consolidated Financial Statements contain all adjustments necessary to present fairly the financial position of National Western Life Group, Inc. ("NWLGI") and its wholly owned subsidiaries ("Company") as of March 31, 2018, and the results of its operations and its cash flows for the three months ended March 31, 2018 and March 31, 2017. Such adjustments are of a normal recurring nature. The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results to be expected for the full year. It is recommended that these Condensed Consolidated Financial Statements be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 which is accessible free of charge through the Company's internet site at [www.nwlg.com](http://www.nwlg.com) or the Securities and Exchange Commission internet site at [www.sec.gov](http://www.sec.gov). The Condensed Consolidated Balance Sheet at December 31, 2017 has been derived from the audited consolidated financial statements as of that date.

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of NWLGI and its wholly owned subsidiaries: National Western Life Insurance Company ("NWLIC" or "National Western"), Regent Care San Marcos Holdings, LLC, NWL Investments, Inc., and NWL Services, Inc. National Western's wholly owned subsidiaries include The Westcap Corporation, NWL Financial, Inc., NWLSM, Inc., and Braker P III, LLC. Where comments or disclosures are made specifically in reference to the insurance operations of National Western, the "company" is used in order to distinguish such comments from the consolidated entity. All significant intercorporate transactions and accounts have been eliminated in consolidation.

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

The table below shows the unrealized gains and losses on available-for-sale securities that were reclassified out of accumulated other comprehensive income for the three months ended March 31, 2018 and March 31, 2017.

| Affected Line Item in the Statements of Earnings | Amount<br>Reclassified<br>From<br>Accumulated<br>Other<br>Comprehensive<br>Income |
|--|---|
|--|---|

Three Months  
Ended March  
31,  
2018 2017  
(In thousands)

|  |       |       |
|--|-------|-------|
| Other net investment gains (losses)    | \$ 40 | 1,061 |
| Net OTTI losses recognized in earnings | —     | —     |
| Earnings before Federal income taxes   | 40    | 1,061 |
| Federal income taxes                   | 7     | 371   |
| Net earnings                           | \$ 33 | 690   |



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NATIONAL WESTERN LIFE GROUP, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

(2) NEW ACCOUNTING PRONOUNCEMENTS

Recent accounting pronouncements not yet adopted

In June 2016, the FASB released Accounting Standards Update ("ASU") 2016-13, Financial Instruments-Credit Losses, which revises the credit loss recognition criteria for certain financial assets measured at amortized cost. The new guidance replaces the existing incurred loss recognition model with an expected loss recognition model. The objective of the expected credit loss model is for the reporting entity to recognize its estimate of expected credit losses for affected financial assets in a valuation allowance deducted from the amortized cost basis of the related financial assets that results in presenting the net carrying value of the financial assets at the amount expected to be collected. The guidance is effective for interim and annual periods beginning after December 15, 2019, and for most affected instruments must be adopted using a modified retrospective approach, with a cumulative effect adjustment recorded to beginning retained income. Adoption of the guidance is not expected to have a material effect on the Company's results of operations or financial position.

In March 2017, the FASB issued ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs: Premium Amortization on Purchased Callable Debt Securities, which amends the amortization period for certain purchased callable debt securities held at a premium. The amortization period for premiums is being shortened to the earliest call date. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. Adoption of the guidance is not expected to have a material effect on the Company's results of operations or financial position.

In July 2017, the FASB released ASU 2017-11, Earnings Per Share; Distinguishing Liabilities from Equity; and, Derivatives and Hedging. This update includes: (I) Accounting for Certain Financial Instruments with Down Round Features, and (II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interest with a Scope Exception. Part I of this update changes the classification analysis of certain equity-linked financial instruments with down round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. Part II of this update recharacterizes the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Codification, to a scope exception. Those amendments do not have an accounting effect. The Company does not expect a material effect on the results of operations or financial position with the adoption of this ASU.

Recent accounting pronouncements adopted

In January 2018, the Company adopted ASU 2017-07 Compensation-Retirement Benefits (Topic 615): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The new guidance requires that an employer that offers to its employees defined benefit pension or other postretirement benefit plans report the service cost component in the same line item or items as other compensation costs. The other components of net periodic benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item is not used, the line item used in the income statement to present the other components of net periodic benefit cost must be disclosed. In addition, the guidance allows only the service cost component to be eligible for capitalization when applicable. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.



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NATIONAL WESTERN LIFE GROUP, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

In February 2018, the FASB released ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The update addresses certain stranded income tax effects in accumulated other comprehensive income caused by the Tax Cuts and Job Act ("Tax Act") which was passed in December 2017. Under the new FASB rules, financial statement preparers are provided the option to reclassify stranded tax effects within accumulated other comprehensive income in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Act is recorded. Companies must apply the new guidance for fiscal years, including interim periods within such years, starting after December 15, 2018, with early adoption permitted. The amendments are to be applied in either the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the federal corporate income tax rate from the Tax Act is recognized. The Company's accounting policy for the release of stranded tax effects in AOCI is on an aggregate portfolio basis. The Company elected to adopt the requirements of this update in its Consolidated Financial Statements for the year ended December 31, 2017 and has reported the resultant reclassification amount, \$2.5 million, as a charge to Retained Earnings in the accompanying Consolidated Statements of Changes in Stockholders' Equity.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). The guidance requires companies to recognize revenue that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. As an insurance enterprise, the primary sources of revenue are excluded from this guidance, including insurance premiums, contract charges, and investment revenues. We have certain types of non-insurance and non-investment revenue from contracts with customers that fall under this guidance. These revenues are recognized when obligations under the terms of the contract are satisfied. The amount of revenue recognized reflects the consideration we expect to be entitled to in exchange for those services. For these revenues, the performance obligation is fulfilled as services are rendered. Revenues from contracts with customers identified under Topic 606 are not material, approximately 2% of total revenues for the year ended December 31, 2017. The guidance was effective for reporting periods beginning after December 15, 2017. The adoption of this ASU did not have a material effect on the results of operations or financial position of the Company.

In January 2016, the FASB released ASU 2016-01, Recognition and Measurement of Financial Assets and Liabilities. The main provisions of the update eliminate the available for sale classification of accounting for equity securities and to adjust the fair value disclosures for financial instruments carried at amortized costs such that the disclosed fair values represent an exit price as opposed to an entry price. The provisions of this update require that equity securities be carried at fair market value on the balance sheet and any periodic changes in value be recorded as adjustments directly to the income statement. The provisions of this update became effective for the Company beginning January 1, 2018. The prospective adoption of this update resulted in the reclassification of \$4.4 million pertaining to unrealized gains, net of tax, out of Accumulated Other Comprehensive Income into Retained Earnings as a cumulative effect of a change in accounting principle, as shown in the Condensed Consolidated Statements of Changes in Stockholders' Equity. Equity securities, previously included in Securities Available for Sale are now reported as a separate line item on the Consolidated Balance Sheet. The change in fair value of equity securities, previously reported in Other Comprehensive income, is now included in Net investment income in the Condensed Consolidated Statements of Earnings. As the Company's equity securities holdings are not significant, the adoption of the requirements of this update did not have a material impact on the Company's financial position, results of operations or cash flows.

In May 2017, the FASB released ASU 2017-09, Compensation - Stock Compensation. The update provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Accounting Standards Codification ("ASC") Topic 718. An entity shall account for the

effects of a modification described in ASC paragraphs 718-20-35-3 through 35-9, unless all the following are met: (1) The fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; (2) The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (3) The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The provisions of this update became effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. The adoption of this ASU did not have a material effect on the results of operations or financial position of the Company.

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

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(3) STOCKHOLDERS' EQUITY

NWLIC is restricted by state insurance laws as to dividend amounts which may be paid to stockholders without prior approval from the Colorado Division of Insurance. The restrictions are based on the lesser of statutory earnings from operations, excluding capital gains, from the prior calendar year or 10% of statutory surplus of the company as of the previous calendar year-end. The maximum dividend payment which may be made without prior approval in 2018 is \$127.3 million. As the sole owner of NWLIC, all dividends declared by National Western are payable entirely to NWLGI and are eliminated in consolidation.

In the first quarter of 2018, National Western declared and paid a \$3.0 million dividend to NWLGI. No dividends were declared or paid by National Western in the quarter ended March 31, 2017.

NWLGI did not declare or pay cash dividends on its common shares during the three months ended March 31, 2018 and 2017.

(4) EARNINGS PER SHARE

Basic earnings per share of common stock are computed by dividing net income available to each class of common stockholders on an as if distributed basis by the weighted-average number of common shares outstanding for the period. Diluted earnings per share, by definition, reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock, that then shared in the distributed earnings of each class of common stock. U.S. GAAP requires a two-class presentation for the Company's two classes of common stock. However, settlement of stock option exercises in cash or by issuance of shares is at the discretion of the Company's option holders and such exercises have been predominantly in cash. Consequently, the Company's stock options outstanding are not considered potentially dilutive under accounting guidance.

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Net income for the periods shown below is allocated between Class A shares and Class B shares based upon (1) the proportionate number of shares issued and outstanding as of the end of the period, and (2) the per share dividend rights of the two classes under the Company's Restated Certificate of Incorporation (the Class B dividend per share is equal to one-half the Class A dividend per share).

|   | Three Months Ended March 31,            |         |         |         |
|---|---|---------|---------|---------|
|   | 2018                                    | 2017    |         |         |
|   | Class A                                 | Class B | Class A | Class B |
|   | (In thousands except per share amounts) |         |         |         |
| Numerator for Basic and Diluted Earnings Per Share:                                   |   |         |         |         |
| Net income  | \$26,875                                |         | 23,538  |         |
| Dividends - Class A shares  | —                                       |         | —       |         |
| Dividends - Class B shares  | —                                       |         | —       |         |
| Undistributed income  | \$26,875                                |         | 23,538  |         |
| Allocation of net income:   |   |         |         |         |
| Dividends   | \$—                                     | —       | —       | —       |
| Allocation of undistributed income  | 26,115                                  | 760     | 22,872  | 666     |
| Net income  | \$26,115                                | 760     | 22,872  | 666     |
| Denominator:  |   |         |         |         |
| Basic earnings per share - weighted-average shares                                    | 3,436                                   | 200     | 3,436   | 200     |
| Effect of dilutive stock options  | —                                       | —       | 4       | —       |
| Diluted earnings per share - adjusted weighted-average shares for assumed conversions | 3,436                                   | 200     | 3,440   | 200     |
| Basic Earnings Per Share  | \$7.60                                  | 3.80    | 6.66    | 3.33    |
| Diluted Earnings Per Share  | \$7.60                                  | 3.80    | 6.65    | 3.33    |

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## (5) PENSION AND OTHER POSTRETIREMENT PLANS

## (A) Defined Benefit Pension Plans

National Western sponsors a qualified defined benefit pension plan covering employees enrolled prior to 2008. The plan provides benefits based on the participants' years of service and compensation. The company makes annual contributions to the plan that comply with the minimum funding provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). On October 19, 2007, National Western's Board of Directors approved an amendment to freeze the pension plan as of December 31, 2007. The freeze ceased future benefit accruals to all participants and closed the plan to any new participants. In addition, all participants became immediately 100% vested in their accrued benefits as of that date. As participants are no longer earning a credit for service, future qualified defined benefit plan expense is projected to be minimal. Fair values of plan assets and liabilities are measured as of the prior December 31 for each year. The following table summarizes the components of net periodic benefit cost.

|                                    | Three<br>Months<br>Ended<br>March 31,<br>2018 2017<br>(In<br>thousands) |       |
|------------------------------------|---|-------|
| Service cost                       | \$28  | 27    |
| Interest cost                      | 225   | 239   |
| Expected return on plan assets     | (325)   | (307) |
| Amortization of prior service cost | —   | —     |
| Amortization of net loss           | 131   | 159   |
| Net periodic benefit cost          | \$59  | 118   |

The service cost shown above for each period represents plan expenses expected to be paid out of plan assets. Under the clarified rules of the Pension Protection Act, plan expenses paid from plan assets are to be included in the plan's service cost component.

The company's minimum required contribution for the 2018 plan year is \$0.1 million. There was no remaining contribution payable for the 2017 plan year as of March 31, 2018. As of March 31, 2018, the company had no contributions to the plan for the 2018 plan year.

National Western also sponsors three non-qualified defined benefit pension plans. The first plan covers certain senior officers and provides benefits based on the participants' years of service and compensation. The primary pension obligations and administrative responsibilities of the plan are maintained by a pension administration firm, which is a subsidiary of American National Insurance Company ("ANICO"), a related party. ANICO has guaranteed the payment of pension obligations under the plan. However, the company has a contingent liability with respect to the plan should these entities be unable to meet their obligations under the existing agreements. Also, the company has a contingent liability with respect to the plan in the event that a plan participant continues employment with National Western

beyond age seventy, the aggregate average annual participant salary increases exceed 10% per year, or any additional employees become eligible to participate in the plan. If any of these conditions are met, the company would be responsible for any additional pension obligations resulting from these items. Amendments were made to the plan to allow an additional employee to participate and to change the benefit formula for the then Chairman of the company. As previously mentioned, these additional obligations are a liability to the company. Effective December 31, 2004, this plan was frozen with respect to the continued accrual of benefits of the then Chairman and the then President of the company in order to comply with law changes under the American Jobs Creation Act of 2004 ("Act").



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

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

The following table summarizes the components of net periodic benefit costs for the nonqualified defined benefit plans.

|                                    | Three<br>Months<br>Ended<br>March 31,<br>2018 2017<br>(In<br>thousands) |       |
|------------------------------------|---|-------|
| Service cost                       | \$90  | 204   |
| Interest cost                      | 213   | 347   |
| Amortization of prior service cost | 15  | 15    |
| Amortization of net loss           | 176   | 818   |
| Net periodic benefit cost          | \$494   | 1,384 |

The company expects to contribute \$2.0 million to these plans in 2018. As of March 31, 2018, the company has contributed \$0.4 million to the plans.

(B) Postretirement Employment Plans Other Than Pension

National Western sponsors two healthcare plans that were amended in 2004 to provide postretirement benefits to certain fully-vested individuals. The plan is unfunded. The following table summarizes the components of net periodic benefit costs.

|  | Three<br>Months<br>Ended<br>March 31,<br>2018 2017<br>(In<br>thousands) |  |
|--|---|--|
|--|---|--|

|                                    |        |    |
|------------------------------------|--------|----|
| Interest cost                      | \$ 40  | 30 |
| Amortization of prior service cost | 26     | 26 |
| Amortization of net loss           | 37     | —  |
| Net periodic benefit cost          | \$ 103 | 56 |

The company expects to contribute minimal amounts to the plan in 2018.

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## (6) SEGMENT AND OTHER OPERATING INFORMATION

The Company defines its reportable operating segments as domestic life insurance, international life insurance, and annuities. These segments are organized based on product types and geographic marketing areas. A summary of segment information as of March 31, 2018 and December 31, 2017 for the Condensed Consolidated Balance Sheet items and for the three months ended March 31, 2018 and March 31, 2017 for the Condensed Consolidated Statement of Earnings is provided below.

## Condensed Consolidated Balance Sheet Items:

|   | March 31, 2018                |                                    |           |               |            |
|---|-------------------------------|------------------------------------|-----------|---------------|------------|
|   | Domestic<br>Life<br>Insurance | International<br>Life<br>Insurance | Annuities | All<br>Others | Totals     |
|   | (In<br>thousands)             |                                    |           |               |            |
| Deferred policy acquisition costs and sales inducements | \$ 106,029                    | 251,225                            | 621,778   | —             | 979,032    |
| Total segment assets                                    | 1,125,889                     | 1,231,846                          | 9,155,547 | 395,648       | 11,908,930 |
| Future policy benefits                                  | 964,219                       | 906,855                            | 8,121,125 | —             | 9,992,199  |
| Other policyholder liabilities                          | 14,909                        | 18,380                             | 103,820   | —             | 137,109    |
|   | December 31, 2017             |                                    |           |               |            |
|   | Domestic<br>Life<br>Insurance | International<br>Life<br>Insurance | Annuities | All<br>Others | Totals     |
|   | (In<br>thousands)             |                                    |           |               |            |
| Deferred policy acquisition costs and sales inducements | \$ 101,253                    | 250,128                            | 603,700   | —             | 955,081    |
| Total segment assets                                    | 1,106,410                     | 1,236,733                          | 9,269,956 | 398,597       | 12,011,696 |
| Future policy benefits                                  | 950,884                       | 915,384                            | 8,232,216 | —             | 10,098,484 |
| Other policyholder liabilities                          | 13,643                        | 11,318                             | 103,048   | —             | 128,009    |

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## Condensed Consolidated Statement of Earnings:

|   | Three Months Ended March 31, 2018 |                                    |               |               | Totals         |
|---|-----------------------------------|------------------------------------|---------------|---------------|----------------|
|   | Domestic<br>Life<br>Insurance     | International<br>Life<br>Insurance | Annuities     | All<br>Others |                |
|   | (In<br>thousands)                 |                                    |               |               |                |
| Premiums and contract revenues                    | \$9,601                           | 27,917                             | 5,147         | —             | 42,665         |
| Net investment income                             | 663                               | 1,971                              | 53,543        | 4,568         | 60,745         |
| Other revenues                                    | —                                 | 30                                 | 19            | 4,948         | 4,997          |
| <b>Total revenues</b>                             | <b>10,264</b>                     | <b>29,918</b>                      | <b>58,709</b> | <b>9,516</b>  | <b>108,407</b> |
| Life and other policy benefits                    | 4,809                             | 5,728                              | 10,864        | —             | 21,401         |
| Amortization of deferred policy acquisition costs | 2,675                             | 7,380                              | 22,174        | —             | 32,229         |
| Universal life and annuity contract interest      | (2,861 )                          | (1,150 )                           | 2,193         | —             | (1,818 )       |
| Other operating expenses                          | 5,147                             | 5,381                              | 7,935         | 5,170         | 23,633         |
| Federal income taxes (benefit)                    | 98                                | 2,507                              | 3,098         | 867           | 6,570          |
| <b>Total expenses</b>                             | <b>9,868</b>                      | <b>19,846</b>                      | <b>46,264</b> | <b>6,037</b>  | <b>82,015</b>  |
| <b>Segment earnings (loss)</b>                    | <b>\$396</b>                      | <b>10,072</b>                      | <b>12,445</b> | <b>3,479</b>  | <b>26,392</b>  |

|  | Three Months Ended March 31, 2017 |                                    |                |               | Totals         |
|--|-----------------------------------|------------------------------------|----------------|---------------|----------------|
|  | Domestic<br>Life<br>Insurance     | International<br>Life<br>Insurance | Annuities      | All<br>Others |                |
|  | (In<br>thousands)                 |                                    |                |               |                |
| Premiums and contract revenues               | \$8,849                           | 31,500                             | 5,236          | —             | 45,585         |
| Net investment income                        | 19,590                            | 18,619                             | 126,434        | 7,099         | 171,742        |
| Other revenues                               | 13                                | 26                                 | 26             | 4,440         | 4,505          |
| <b>Total revenues</b>                        | <b>28,452</b>                     | <b>50,145</b>                      | <b>131,696</b> | <b>11,539</b> | <b>221,832</b> |
| Life and other policy benefits               | 4,919                             | 6,285                              | 8,553          | —             | 19,757         |
| Amortization of deferred acquisition costs   | 2,789                             | 7,406                              | 24,017         | —             | 34,212         |
| Universal life and annuity contract interest | 16,247                            | 16,382                             | 77,264         | —             | 109,893        |
| Other operating expenses                     | 4,732                             | 5,978                              | 10,060         | 4,322         | 25,092         |
| Federal income taxes (benefit)               | (79 )                             | 4,724                              | 3,956          | 2,419         | 11,020         |

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|                         |          |        |         |       |         |
|-------------------------|----------|--------|---------|-------|---------|
| Total expenses          | 28,608   | 40,775 | 123,850 | 6,741 | 199,974 |
| Segment earnings (loss) | \$(156 ) | 9,370  | 7,846   | 4,798 | 21,858  |

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Reconciliations of segment information to the Company's Condensed Consolidated Financial Statements are provided below.

|  | Three Months<br>Ended March 31,<br>2018 2017<br>(In thousands) |         |
|--|--|---------|
| Premiums and Other Revenues:                             |  |         |
| Premiums and contract revenues                           | \$42,665   | 45,585  |
| Net investment income                                    | 60,745   | 171,742 |
| Other revenues   | 4,997  | 4,505   |
| Realized gains (losses) on investments                   | 611  | 2,585   |
| Total condensed consolidated premiums and other revenues | \$109,018  | 224,417 |

|   | Three Months<br>Ended March<br>31,<br>2018 2017<br>(In thousands) |        |
|---|---|--------|
| Federal Income Taxes:                             |   |        |
| Total segment Federal income taxes                | \$6,570   | 11,020 |
| Taxes on realized gains (losses) on investments   | 128   | 905    |
| Total condensed consolidated Federal income taxes | \$6,698   | 11,925 |

|  | Three Months<br>Ended March<br>31,<br>2018 2017<br>(In thousands) |        |
|--|---|--------|
| Net Earnings:  |   |        |
| Total segment earnings                               | \$26,392  | 21,858 |
| Realized gains (losses) on investments, net of taxes | 483   | 1,680  |
| Total condensed consolidated net earnings            | \$26,875  | 23,538 |

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|                                     | March 31,<br>2018<br>(In thousands) | December<br>31,<br>2017 |
|-------------------------------------|-------------------------------------|-------------------------|
| Assets:                             |                                     |                         |
| Total segment assets                | \$ 11,908,930                       | 12,011,696              |
| Other unallocated assets            | 217,388                             | 213,398                 |
| Total condensed consolidated assets | \$ 12,126,318                       | 12,225,094              |

**(7) SHARE-BASED PAYMENTS**

The Company had a stock and incentive plan ("1995 Plan") which provided for the grant of any or all of the following types of awards to eligible employees: (1) stock options, including incentive stock options and nonqualified stock options; (2) stock appreciation rights ("SARs"), in tandem with stock options or freestanding; (3) restricted stock or restricted stock units; and, (4) performance awards. The 1995 Plan began on April 21, 1995, and was amended on June 25, 2004 to extend the termination date to April 20, 2010. The number of shares of Class A, \$1.00 par value, common stock which were allowed to be issued under the 1995 Plan, or as to which SARs or other awards were allowed to be granted, could not exceed 300,000. Effective June 20, 2008, the Company's shareholders approved a 2008 Incentive Plan ("2008 Plan"). The 2008 Plan is substantially similar to the 1995 Plan and authorized an additional number of Class A common stock shares eligible for issue not to exceed 300,000. These plans were assumed by NWLGI from National Western pursuant to the terms of the holding company reorganization in 2015. On June 15, 2016, stockholders of NWLGI approved the Incentive Plan, which is a stock and incentive plan essentially similar to the 2008 Plan. The Incentive Plan includes additional provisions, most notably regarding the definition of performance objectives which could be used in the issuance of the fourth type of award noted above (performance awards).

All of the employees of the Company and its subsidiaries are eligible to participate in the current Incentive Plan. In addition, directors of the Company are eligible to receive the same types of awards as employees except that they are not eligible to receive incentive stock options. Company directors, including members of the Compensation and Stock Option Committee, are eligible for nondiscretionary stock options. All current stock options outstanding were granted under the 1995 Plan and 2008 Plan. Employee stock options and SARs granted vest 20% annually following three years of service following the grant date. Directors' stock options and SARs grants vest 20% annually following one year of service from the date of grant.

Effective during March 2006, the Company adopted and implemented a limited stock buy-back program with respect to the 1995 Plan which provides stock option holders the additional alternative of selling shares acquired through the exercise of options directly back to the Company. Option holders may elect to sell such acquired shares back to the Company at any time within ninety (90) days after the exercise of options at the prevailing market price as of the date of notice of election. The buy-back program did not alter the terms and conditions of the 1995 Plan; however, the program necessitated a change in accounting from the equity classification to the liability classification. In August 2008, the Company implemented another limited stock buy-back program, substantially similar to the 2006 program, for shares issued under the 2008 Plan. These plans were assumed as well by NWLGI from National Western pursuant

to the terms of the holding company reorganization.

The Incentive Plan allows for certain other share or unit awards which are solely paid out in cash based on the value of the Company's shares, or changes therein, as well as the financial performance of the Company under pre-determined target performance metrics. Certain awards, such as restricted stock units ("RSUs") provide solely for cash settlement based upon the market price of the Company's Class A common shares, often referred to as "phantom stock-based awards". Unlike share-settled awards, which have a fixed grant-date fair value, the fair value of unsettled or unvested liability awards is remeasured at the end of each reporting period based on the change in fair value of a share. The liability and corresponding expense are adjusted accordingly until the award is settled. For employees, the vesting period for RSUs is 100% at the end of three years from the grant date. The RSUs are payable in cash at the vesting date equal to the closing price of the Company's Class A common shares at that time.



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Other awards may involve performance share units ("PSUs") which are units granted at a specified dollar amount per unit, typically linked to the Company's Class A common share price, that are subsequently multiplied by an attained performance factor to derive the number of PSUs to be paid as cash compensation at the vesting date. PSUs also vest three years from the date of grant. For PSUs, the performance period begins the first day of the calendar year in which the PSUs are granted and runs three calendar years. At that time, the three-year performance outcome will be measured against the pre-defined target amounts to determine the number of PSUs earned as compensation.

Directors of the Company are eligible to receive RSUs under the Incentive Plan. Unlike RSUs granted to officers, the RSUs granted to directors vest one year from the date of grant. They are payable in cash at the vesting date equal to the closing price of the Company's Class A common shares at that time.

The following table shows all grants issued to officers and directors for the three months ended March 31, 2018 and 2017. These grants were made based upon closing market price per Class A common share at the time of the grant.

|        | Three Months Ended |                  |
|--------|--------------------|------------------|
|        | March 31,<br>2018  | March 31, 2017   |
|        | Director           | Officer Director |
| SARs — | 11,512 —           |                  |
| RSUs — | 2,674              | 1,660            |
| PSUs — | 4,425              | —                |

The Company uses the current fair value method to measure compensation cost for awards granted under the share-based plans. As of March 31, 2018 and 2017, the liability balance was \$13.2 million and \$12.7 million, respectively. A summary of awards by type and related activity is detailed below.

|                            | Shares Available For Grant | Options Outstanding Shares | Weighted-Average Exercise Price |
|----------------------------|----------------------------|----------------------------|---------------------------------|
| Stock Options:             |                            |                            |                                 |
| Balance at January 1, 2018 | 291,000                    | 18,018                     | \$ 242.07                       |
| Exercised                  | —                          | (15,018)                   | \$ 248.86                       |
| Forfeited                  | —                          | —                          | \$ —                            |
| Expired                    | —                          | —                          | \$ —                            |
| Stock options granted      | —                          | —                          | \$ —                            |
| Balance at March 31, 2018  | 291,000                    | 3,000                      | \$ 208.05                       |



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|                            | Liability Awards |          |        |
|----------------------------|------------------|----------|--------|
|                            | SAR              | RSU      | PSU    |
| Other Share/Unit Awards:   |                  |          |        |
| Balance at January 1, 2018 | 92,667           | 11,721   | 14,052 |
| Exercised                  | (975 )           | (1,494 ) | —      |
| Forfeited                  | (907 )           | (325 )   | —      |
| Granted                    | —                | —        | —      |
| Balance at March 31, 2018  | 90,785           | 9,902    | 14,052 |

Stock options, SARs, and RSUs shown as forfeited in the above tables represent vested and unvested awards not exercised by plan participants prior to their termination from the Company. Forfeited stock options, if any, are not shown as being added back to the "Shares Available For Grant" balance as they were awarded under the 1995 Plan which was terminated during calendar year 2010.

The total intrinsic value of shared-based compensation exercised was \$1.5 million and \$0.1 million for the three months ended March 31, 2018 and 2017, respectively. The total share-based compensation paid during the period was \$1.5 million and \$0.1 million for the three months ended March 31, 2018 and 2017, respectively. The total fair value of stock options and SARs vested during the three months ended March 31, 2018 and 2017 was \$0.8 million and \$0.5 million, respectively. For the three months ended March 31, 2018 and 2017, no cash was received from the exercise of stock options under the Plans.

The following table summarizes information about stock options and SARs outstanding at March 31, 2018.

|                               | Options/SARs Outstanding |                                   |             |
|-------------------------------|--------------------------|-----------------------------------|-------------|
|                               | Number                   | Weighted-Average Contractual Life | Number      |
|                               | Outstanding              | Remaining                         | Exercisable |
| Exercise prices:              |                          |                                   |             |
| 208.05 (options)              | 3,000                    | 0.2 years                         | 3,000       |
| 114.64 (SARs)                 | 10,900                   | 0.9 years                         | 10,900      |
| 132.56 (SARs)                 | 20,018                   | 3.7 years                         | 16,115      |
| 210.22 (SARs)                 | 26,550                   | 5.7 years                         | 11,750      |
| 216.48 (SARs)                 | 12,036                   | 7.9 years                         | 7,847       |
| 311.16 (SARs)                 | 10,814                   | 8.8 years                         | 3,645       |
| 310.55 (SARs)                 | 203                      | 9.1 years                         | —           |
| 334.34 (SARs)                 | 10,264                   | 9.7 years                         | —           |
| Totals                        | 93,785                   |                                   | 53,257      |
| Aggregate intrinsic value (in | \$9,391                  |                                   | \$ 6,947    |

thousands)

The aggregate intrinsic value in the table above is based on the closing Class A stock price of \$304.88 per share on March 31, 2018.

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The stock options shown above with exercise price of \$208.05 have a remaining contractual life of less than one year. The option holders for this grant have until the end of the contractual life of June 20, 2018 to exercise these holdings or otherwise forfeit the option grants held.

In estimating the fair value of the share-based awards outstanding at March 31, 2018 and December 31, 2017, the Company employed the Black-Scholes option pricing model with assumptions detailed below.

|                                      | March 31,<br>2018 | December 31,<br>2017 |   |  |
|--------------------------------------|-------------------|----------------------|---|--|
| Expected term of options             | 0.2 to 9.7 years  | 0.3 to 10.0 years    |   |  |
| Expected volatility weighted-average | 21.69             | % 21.55              | % |  |
| Expected dividend yield              | 0.12              | % 0.11               | % |  |
| Risk-free rate weighted-average      | 2.19              | % 1.82               | % |  |

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

The pre-tax compensation cost/(benefit) recognized in the financial statements related to these plans was \$(0.5) million and \$0.8 million for the three months ended March 31, 2018 and 2017, respectively. The related tax expense/(benefit) recognized was \$0.1 million and \$(0.3) million for the three months ended March 31, 2018 and 2017, respectively.

As of March 31, 2018, the total compensation cost related to non-vested share based awards not yet recognized was \$5.8 million. This amount is expected to be recognized over a weighted-average period of 1.3 years. The Company recognizes compensation cost over the graded vesting periods.

## (8) COMMITMENTS AND CONTINGENCIES

### (A) Legal Proceedings

In the normal course of business, the Company is involved or may become involved in various legal actions in which claims for alleged economic and punitive damages have been or may be asserted, some for substantial amounts. In recent years, carriers offering life insurance and annuity products have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices, and similar claims. Given the uncertainty involved in these types of actions, the ability to make a reliable evaluation of the likelihood of an unfavorable outcome or an estimate of the amount of or range of potential loss is endemic to the particular circumstances and evolving developments of each individual matter on its own merits.

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National Western was the named defendant in the case of Damaris Maldonado Vinas, et al. vs. National Western Life Insurance, in which the plaintiffs, after National Western had paid the death benefits to the beneficiary (Francisco Iglesias-Alvarez) upon the annuitant's (Carlos Iglesias-Alvarez) death, sought to annul two annuity policies issued by National Western at the behest of Carlos Iglesias-Alvarez and which named Francisco Iglesias-Alvarez as their beneficiary. On March 31, 2016, the United States District Court for the District of Puerto Rico (the "Court") issued its Opinion and Order on the pending Motions for Summary Judgment submitted by the parties, and therein denied National Western's motion and granted plaintiffs' motion voiding the two annuities and requesting a refund of the premiums paid (\$2.9 million). National Western vigorously defended the case and believes that the Court's Opinion and Order is contrary to applicable law. As such, National Western filed a Motion for Reconsideration of Opinion and Order and Corresponding Judgment with the Court on April 27, 2016, which the Court denied on May 5, 2016. National Western filed a Notice of Appeal on June 10, 2016, filed its Appeal Brief on September 12, 2016, and oral arguments with the U.S. Court of Appeals for the First Circuit were held on March 9, 2017. On June 29, 2017, the Court of Appeals vacated the district court's judgment and remanded to the district court to determine whether it is nevertheless equitable for the case to proceed without Francisco Iglesias-Alvarez. Plaintiffs filed a Motion in Support of Determination in Equity and Good Conscience That Action Should Proceed Among Existing Parties Under Fed.R.Civ.P. 19(B) on September 14, 2017, and National Western filed its Opposition to Plaintiff's Motion on October 27, 2017. On April 2, 2018 the Court asked the parties for additional briefing regarding the Court's jurisdiction over Francisco Iglesias-Alvarez, which the parties filed on April 30, 2018.

On September 28, 2017, a purported shareholder derivative lawsuit was filed in the 122nd District Court of Galveston County, State of Texas entitled Robert L. Moody, Jr. derivatively on behalf of National Western Life Insurance Company and National Western Life Group, Inc. v. Ross Rankin Moody, et al., naming certain current and former directors and current officers as defendants. The complaint challenges the directors' oversight of insurance sales to non-U.S. residents and alleges that the defendants breached their fiduciary duties in the conduct of their duties as board members by failing to act (i) on an informed basis and (ii) in good faith or with the honest belief that their actions were in the best interests of the Company. The complaint seeks an undetermined amount of damages, attorneys' fees and costs, and equitable relief, including the removal of the Company's Chairman and Chief Executive Officer and other board members and/or officers of the Company. The Company believes that the claims in the complaint are baseless and without merit, will vigorously defend this lawsuit, and will seek reimbursement of all legal costs and expenses from plaintiff. The Company believes, based on information currently available, that the final outcome of this lawsuit will not have a material adverse effect on the Company's business, results of operations, or consolidated financial position. The companies and directors filed their respective Pleas to the Jurisdiction ("Pleas") contesting the plaintiff's standing to even pursue this action, along with their Answers, on October 27, 2017. On December 14, 2017, plaintiff filed a Response to the Pleas and on December 21, 2017, the Court heard oral argument on the Pleas. Plaintiff then filed a First Amended Petition on January 11, 2018. The companies and directors filed a Supplement to the Pleas on January 30, 2018, to which plaintiff responded on February 1, 2018, and the companies and directors replied on February 9, 2018. On May 3, 2018, the Court issued a memorandum to all attorneys of record stating that the Court will grant the defendants' Pleas and asking the attorney for defendants to prepare and submit proposed orders/judgments granting the requested relief for consideration by the Court. The defendants filed such proposed order granting the Pleas on May 7, 2018.

Although there can be no assurances, at the present time, the Company does not anticipate that the ultimate liability arising from such other potential, pending, or threatened legal actions will have a material adverse effect on the financial condition or operating results of the Company.

Separately, Brazilian authorities commenced an investigation into possible violations of Brazilian criminal law in connection with the issuance of National Western insurance policies to Brazilian residents, and in assistance of such

investigation a Commissioner appointed by the U.S. District Court for the Western District of Texas issued a subpoena in March of 2015 upon the company to provide information relating to such possible violations. No conclusion can be drawn at this time as to its outcome or how such outcome may impact the Company's business, results of operations or financial condition. National Western has been cooperating with the relevant governmental authorities in regard to this matter.

(B) Financial Instruments

In order to meet the financing needs of its customers in the normal course of business, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments are commitments to extend credit which involve elements of credit and interest rate risk in excess of the amounts recognized in the Condensed Consolidated Balance Sheets.

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The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amounts, assuming that the amounts are fully advanced and that collateral or other security is of no value. Commitments to extend credit are legally binding agreements to lend to a customer that generally have fixed expiration dates or other termination clauses and may require payment of a fee. Commitments do not necessarily represent future liquidity requirements, as some could expire without being drawn upon. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Company controls the credit risk of these transactions through credit approvals, limits, and monitoring procedures.

The Company had \$16.2 million commitments to fund new loans and \$1.2 million in commitments to extend credit relating to existing loans at March 31, 2018. The Company evaluates each customer's creditworthiness on a case-by-case basis.

## (9) INVESTMENTS

## (A) Investment Gains and Losses

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

|   | Three<br>Months<br>Ended<br>March 31,<br>2018 2017<br>(In<br>thousands) |       |
|---|---|-------|
| Available for sale debt securities:       |   |       |
| Realized gains on disposal                | \$40  | 973   |
| Realized losses on disposal               | —   | —     |
| Held to maturity debt securities:         |   |       |
| Realized gains on disposal                | 571   | 1,557 |
| Realized losses on disposal               | —   | (34 ) |
| Equity securities realized gains (losses) | —   | 89    |
| Totals                                    | \$611   | 2,585 |

Disposals in the held to maturity category during the periods shown primarily represent calls initiated by the credit issuer of the debt security. It is the Company's policy to initiate disposals of debt securities in the held to maturity category only in instances in which the credit status of the issuer comes into question and the realization of all or a significant portion of the investment principal of the holding is deemed to be in jeopardy.





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The Company uses the specific identification method in computing realized gains and losses. For the three months ended March 31, 2018 and 2017 the percentage of gains on bonds due to the call of securities was 99.0% and 63.0%, respectively. This includes calls out of the Company's available for sale portfolio of debt securities.

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

|   | Three<br>Months<br>Ended<br>March 31,<br>2018 2017<br>(In<br>thousands) |       |
|---|---|-------|
| Total other-than-temporary impairment gains (losses) on debt securities | \$ 3  | 20    |
| Portion of loss (gain) recognized in comprehensive income               | (3 )  | (20 ) |
| Net impairment losses on debt securities recognized in earnings         | —   | —     |
| Equity securities impairments   | —   | —     |
| Totals  | \$ —  | —     |

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

|   | Three<br>Months<br>Ended<br>March<br>31,<br>2018<br>(In thousands) |        | Year<br>Ended<br>December<br>31,<br>2017 |
|---|--|--------|--|
| Beginning balance, cumulative credit losses related to other-than-temporary impairments   | \$627  | 1,440  |  |
| Reductions for securities sold during current period                                      | —  | (813 ) |  |
| Additions for credit losses not previously recognized in other-than-temporary impairments | —  | —      |  |
| Ending balance, cumulative credit losses related to other-than-temporary impairments      | \$627  | 627    |  |

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## (B) Debt Securities

The table below presents amortized costs and fair values of debt securities held to maturity at March 31, 2018.

|                                   | Debt Securities Held to Maturity |            |            |           |
|-----------------------------------|----------------------------------|------------|------------|-----------|
|                                   | Amortized                        | Gross      | Gross      | Fair      |
|                                   | Cost                             | Unrealized | Unrealized | Value     |
|                                   |                                  | Gains      | Losses     |           |
|                                   | (In thousands)                   |            |            |           |
| Debt securities:                  |                                  |            |            |           |
| U.S. Treasury                     | \$1,338                          | 150        | —          | 1,488     |
| States and political subdivisions | 462,708                          | 14,097     | (1,580)    | 475,225   |
| Public utilities                  | 1,038,226                        | 14,664     | (8,408)    | 1,044,482 |
| Corporate                         | 4,521,036                        | 52,589     | (49,835)   | 4,523,790 |
| Residential mortgage-backed       | 1,251,971                        | 15,936     | (15,895)   | 1,252,012 |
| Home equity                       | 3,994                            | 56         | (8)        | 4,042     |
| Manufactured housing              | 927                              | 68         | —          | 995       |
| Totals                            | \$7,280,200                      | 97,560     | (75,726)   | 7,302,034 |

The table below presents amortized costs and fair values of debt securities available for sale at March 31, 2018. As indicated in Note (2) New Accounting Pronouncements, effective January 1, 2018, equity securities are no longer included in the Securities Available for Sale category.

|                                   | Debt Securities Available for Sale |            |            |           |
|-----------------------------------|------------------------------------|------------|------------|-----------|
|                                   | Amortized                          | Gross      | Gross      | Fair      |
|                                   | Cost                               | Unrealized | Unrealized | Value     |
|                                   |                                    | Gains      | Losses     |           |
|                                   | (In thousands)                     |            |            |           |
| Debt securities:                  |                                    |            |            |           |
| States and political subdivisions | \$574                              | —          | (25)       | 549       |
| Foreign governments               | 9,967                              | 88         | —          | 10,055    |
| Public utilities                  | 83,461                             | 2,342      | (128)      | 85,675    |
| Corporate                         | 2,967,125                          | 36,520     | (43,336)   | 2,960,309 |
| Residential mortgage-backed       | 19,248                             | 1,191      | (36)       | 20,403    |
| Home equity                       | 7,452                              | 346        | —          | 7,798     |
| Totals                            | \$3,087,827                        | 40,487     | (43,525)   | 3,084,789 |

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The table below presents amortized costs and fair values of securities held to maturity at December 31, 2017.

|                                   | Securities Held to Maturity |                              |                               |               |
|-----------------------------------|-----------------------------|------------------------------|-------------------------------|---------------|
|                                   | Amortized<br>Cost           | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|                                   | (In thousands)              |                              |                               |               |
| Debt securities:                  |                             |                              |                               |               |
| U.S. Treasury                     | \$1,337                     | 177                          | —                             | 1,514         |
| States and political subdivisions | 467,437                     | 21,907                       | (100)                         | 489,244       |
| Public utilities                  | 1,062,545                   | 30,527                       | (894)                         | 1,092,178     |
| Corporate                         | 4,430,099                   | 121,978                      | (7,876)                       | 4,544,201     |
| Residential mortgage-backed       | 1,280,307                   | 27,445                       | (6,216)                       | 1,301,536     |
| Home equity                       | 4,262                       | 57                           | (4)                           | 4,315         |
| Manufactured housing              | 1,037                       | 79                           | —                             | 1,116         |
| Totals                            | \$7,247,024                 | 202,170                      | (15,090)                      | 7,434,104     |

The table below presents amortized costs and fair values of securities available for sale at December 31, 2017.

|                                   | Securities Available for Sale |                              |                               |               |
|-----------------------------------|-------------------------------|------------------------------|-------------------------------|---------------|
|                                   | Amortized<br>Cost             | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|                                   | (In thousands)                |                              |                               |               |
| Debt securities:                  |                               |                              |                               |               |
| States and political subdivisions | \$575                         | —                            | (29)                          | 546           |
| Foreign governments               | 9,964                         | 326                          | —                             | 10,290        |
| Public utilities                  | 83,466                        | 3,640                        | —                             | 87,106        |
| Corporate                         | 2,842,381                     | 81,737                       | (10,744)                      | 2,913,374     |
| Residential mortgage-backed       | 20,246                        | 1,376                        | (52)                          | 21,570        |
| Home equity                       | 7,878                         | 367                          | —                             | 8,245         |
| Manufactured housing              | —                             | —                            | —                             | —             |
|                                   | 2,964,510                     | 87,446                       | (10,825)                      | 3,041,131     |
| Equity securities                 | 12,890                        | 5,708                        | (120)                         | 18,478        |
| Totals                            | \$2,977,400                   | 93,154                       | (10,945)                      | 3,059,609     |

The Company does not consider securities to be other-than-temporarily impaired when the market decline is attributable to factors such as market volatility, liquidity, spread widening and credit quality where it is anticipated that a recovery of all amounts due under the contractual terms of the security will occur and the Company has the intent and ability to hold until recovery or maturity. Based on its review, the Company does not consider these

investments to be other-than-temporarily impaired at March 31, 2018. The Company will monitor the investment portfolio for future changes in issuer facts and circumstances that could result in future impairments beyond those currently identified.

During the three months ended March 31, 2018, the Company recorded no other-than-temporary impairment on debt securities.

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Unrealized losses for debt securities held to maturity and debt securities available for sale increased during the first three months of 2018 primarily due to the upward movement in market interest rates during this period (which decreases the market price of debt securities).

The following table shows the gross unrealized losses and fair values of the Company's held to maturity debt securities by investment category and length of time the individual securities have been in a continuous unrealized loss position at March 31, 2018.

|                                       | Debt Securities Held to Maturity |                   |                      |                   |            |                   |
|---------------------------------------|----------------------------------|-------------------|----------------------|-------------------|------------|-------------------|
|                                       | Less than 12 Months              |                   | 12 Months or Greater |                   | Total      |                   |
|                                       | Fair Value                       | Unrealized Losses | Fair Value           | Unrealized Losses | Fair Value | Unrealized Losses |
|                                       | (In thousands)                   |                   |                      |                   |            |                   |
| Debt securities:                      |                                  |                   |                      |                   |            |                   |
| States and political subdivisions     | \$64,701                         | (1,393 )          | 4,768                | (187 )            | 69,469     | (1,580 )          |
| Public utilities                      | 408,005                          | (7,032 )          | 33,205               | (1,376 )          | 441,210    | (8,408 )          |
| Corporate                             | 1,833,024                        | (32,380 )         | 420,683              | (17,455 )         | 2,253,707  | (49,835 )         |
| Residential mortgage-backed           | 389,982                          | (5,863 )          | 187,700              | (10,032 )         | 577,682    | (15,895 )         |
| Home equity                           | 2,609                            | (8 )              | —                    | —                 | 2,609      | (8 )              |
| Total temporarily impaired securities | \$2,698,321                      | (46,676 )         | 646,356              | (29,050 )         | 3,344,677  | (75,726 )         |

The following table shows the gross unrealized losses and fair values of the Company's available for sale debt securities by investment category and length of time the individual securities have been in a continuous unrealized loss position at March 31, 2018.

|                                       | Debt Securities Available for Sale |                   |                      |                   |            |                   |
|---------------------------------------|------------------------------------|-------------------|----------------------|-------------------|------------|-------------------|
|                                       | Less than 12 Months                |                   | 12 Months or Greater |                   | Total      |                   |
|                                       | Fair Value                         | Unrealized Losses | Fair Value           | Unrealized Losses | Fair Value | Unrealized Losses |
|                                       | (In thousands)                     |                   |                      |                   |            |                   |
| Debt securities:                      |                                    |                   |                      |                   |            |                   |
| States and political subdivisions     | \$549                              | (25 )             | —                    | —                 | 549        | (25 )             |
| Public utilities                      | 17,841                             | (128 )            | —                    | —                 | 17,841     | (128 )            |
| Corporate                             | 1,133,923                          | (24,410 )         | 290,548              | (18,926 )         | 1,424,471  | (43,336 )         |
| Residential mortgage-backed           | —                                  | —                 | 1,067                | (36 )             | 1,067      | (36 )             |
| Home equity                           | 1,482                              | —                 | —                    | —                 | 1,482      | —                 |
| Total temporarily impaired securities | \$1,153,795                        | (24,563 )         | 291,615              | (18,962 )         | 1,445,410  | (43,525 )         |

The following table shows the gross unrealized losses and fair values of the Company's held to maturity investments by investment category and length of time the individual securities have been in a continuous unrealized loss position at December 31, 2017.

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|                                       | Securities Held to Maturity |                   |                      |                   |            |                   |
|---------------------------------------|-----------------------------|-------------------|----------------------|-------------------|------------|-------------------|
|                                       | Less than 12 Months         |                   | 12 Months or Greater |                   | Total      |                   |
|                                       | Fair Value                  | Unrealized Losses | Fair Value           | Unrealized Losses | Fair Value | Unrealized Losses |
|                                       | (In thousands)              |                   |                      |                   |            |                   |
| Debt securities:                      |                             |                   |                      |                   |            |                   |
| States and political subdivisions     | \$6,308                     | (14 )             | 4,869                | (86 )             | 11,177     | (100 )            |
| Public utilities                      | 68,368                      | (407 )            | 34,091               | (487 )            | 102,459    | (894 )            |
| Corporate                             | 248,844                     | (1,296 )          | 431,591              | (6,580 )          | 680,435    | (7,876 )          |
| Residential mortgage-backed           | 130,015                     | (738 )            | 192,399              | (5,478 )          | 322,414    | (6,216 )          |
| Home equity                           | 2,830                       | (4 )              | —                    | —                 | 2,830      | (4 )              |
| Total temporarily impaired securities | \$456,365                   | (2,459 )          | 662,950              | (12,631 )         | 1,119,315  | (15,090 )         |

The following table shows the gross unrealized losses and fair values of the Company's available for sale investments by investment category and length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2017.

|                                       | Securities Available for Sale |                   |                      |                   |            |                   |
|---------------------------------------|-------------------------------|-------------------|----------------------|-------------------|------------|-------------------|
|                                       | Less than 12 Months           |                   | 12 Months or Greater |                   | Total      |                   |
|                                       | Fair Value                    | Unrealized Losses | Fair Value           | Unrealized Losses | Fair Value | Unrealized Losses |
|                                       | (In thousands)                |                   |                      |                   |            |                   |
| Debt securities:                      |                               |                   |                      |                   |            |                   |
| States and political subdivisions     | \$546                         | (29 )             | —                    | —                 | 546        | (29 )             |
| Corporate                             | 201,575                       | (1,134 )          | 296,845              | (9,610 )          | 498,420    | (10,744 )         |
| Residential mortgage-backed           | 1,325                         | (14 )             | 1,085                | (38 )             | 2,410      | (52 )             |
| Home equity                           | 1,653                         | —                 | —                    | —                 | 1,653      | —                 |
|                                       | 205,099                       | (1,177 )          | 297,930              | (9,648 )          | 503,029    | (10,825 )         |
| Equity securities                     | 1,246                         | (77 )             | 289                  | (43 )             | 1,535      | (120 )            |
| Total temporarily impaired securities | \$206,345                     | (1,254 )          | 298,219              | (9,691 )          | 504,564    | (10,945 )         |

Debt securities. The gross unrealized losses for debt securities are made up of 531 individual issues, or 40.1% of the total debt securities held by the Company at March 31, 2018. The market value of these bonds as a percent of amortized cost approximates 97.6%. Of the 531 securities, 120, or 22.6%, fall in the 12 months or greater aging category; and 521 were rated investment grade at March 31, 2018.





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The amortized cost and fair value of investments in debt securities at March 31, 2018, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|                                      | Debt Securities Available for Sale |            | Debt Securities Held to Maturity |            |
|--------------------------------------|------------------------------------|------------|----------------------------------|------------|
|                                      | Amortized Cost                     | Fair Value | Amortized Cost                   | Fair Value |
|                                      | (In thousands)                     |            |                                  |            |
| Due in 1 year or less                | \$106,417                          | 108,474    | 292,516                          | 297,632    |
| Due after 1 year through 5 years     | 1,263,298                          | 1,283,396  | 2,610,334                        | 2,642,441  |
| Due after 5 years through 10 years   | 1,633,364                          | 1,607,304  | 2,738,879                        | 2,713,736  |
| Due after 10 years                   | 58,048                             | 57,414     | 381,579                          | 391,176    |
|                                      | 3,061,127                          | 3,056,588  | 6,023,308                        | 6,044,985  |
| Mortgage and asset-backed securities | 26,700                             | 28,201     | 1,256,892                        | 1,257,049  |
| Total                                | \$3,087,827                        | 3,084,789  | 7,280,200                        | 7,302,034  |

## (C) Transfer of Securities

During the three months ended March 31, 2018 the Company made no transfers from the held to maturity category to securities available for sale.

## (D) Mortgage Loans and Real Estate

A financing receivable is a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in a company's statement of financial position. The Company's mortgage, participation and mezzanine loans on real estate are the only financing receivables included in the Consolidated Balance Sheets.

Credit and default risk is minimized through strict underwriting guidelines and diversification of underlying property types and geographic locations. In addition to being secured by the property, mortgage loans with leases on the underlying property are often guaranteed by the lease payments and also by the borrower. This approach has proved to result in quality mortgage loans with few defaults. Mortgage loan interest income is recognized on an accrual basis with any premium or discount amortized over the life of the loan. Prepayment and late fees are recorded on the date of collection.

Loans in foreclosure, loans considered impaired or loans past due 90 days or more are placed on a non-accrual status. If a mortgage loan is determined to be on non-accrual status, the mortgage loan does not accrue any revenue into the Condensed Consolidated Statements of Earnings. 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. The Company had no mortgage loans past due 90 days or more at March 31, 2018 or 2017 and as a result all interest income was recognized at March 31, 2018 and 2017.



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The following table represents the mortgage loan portfolio by loan-to-value ratio.

|  | March 31, 2018              |        | December 31, 2017           |        |
|--|-----------------------------|--------|-----------------------------|--------|
|  | Amount<br>(In<br>thousands) | %      | Amount<br>(In<br>thousands) | %      |
| Mortgage Loans by Loan-to-Value Ratio (1): |                             |        |                             |        |
| Less than 50%                              | \$90,863                    | 44.2   | \$82,224                    | 39.4   |
| 50% to 60%                                 | 16,176                      | 7.9    | 27,395                      | 13.1   |
| 60% to 70%                                 | 86,232                      | 41.9   | 86,849                      | 41.6   |
| 70% to 80%                                 | —                           | —      | —                           | —      |
| 80% to 90%                                 | 12,327                      | 6.0    | 6,929                       | 3.3    |
| Greater than 90%                           | —                           | —      | 5,502                       | 2.6    |
| Gross balance                              | 205,598                     | 100.0  | 208,899                     | 100.0  |
| Allowance for possible losses              | (650 )                      | (0.3 ) | (650 )                      | (0.3 ) |
| Totals                                     | \$204,948                   | 99.7   | \$208,249                   | 99.7   |

(1) Loan-to-Value Ratio is determined using the most recent appraised value. Appraisals are required at the time of funding and may be updated if a material change occurs from the original loan agreement.

All mortgage loans are analyzed quarterly in order to monitor the financial quality of these assets. Based on ongoing monitoring, mortgage loans with a likelihood of becoming delinquent are identified and placed on an internal “watch list”. Among the criteria that may indicate a potential problem include: major tenant vacancies or bankruptcies, late payments, and loan relief/restructuring requests. The mortgage loan portfolio is analyzed for the need for a valuation allowance on any loan that is on the internal watch list, in the process of foreclosure or that currently has a valuation allowance.

Mortgage loans are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When it is determined that a loan is impaired, a loss is recognized for the difference between the carrying amount of the mortgage loan and the estimated value reduced by the cost to sell. Estimated value is typically based on the loan's observable market price or the fair value of the collateral less cost to sell. Impairments and changes in the valuation allowance are reported in net realized investment gains (losses) in the Condensed Consolidated Statements of Earnings.

The following table represents the mortgage loan allowance for the periods shown.

|  | March 31,<br>2018 | December 31,<br>2017 |
|--|-------------------|----------------------|
|  | (In thousands)    |                      |

Balance, beginning of period \$ 650 650

|                        |        |     |
|------------------------|--------|-----|
| Provision              | —      | —   |
| Releases               | —      | —   |
| Balance, end of period | \$ 650 | 650 |

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The Company's direct investments in real estate are not a significant portion of its total investment portfolio and totaled approximately \$37.2 million and \$37.4 million at March 31, 2018 and December 31, 2017, respectively. The Company recognized operating income on real estate properties of approximately \$0.5 million and \$0.7 million for the first three months of 2018 and 2017, respectively.

(10) FAIR VALUES OF FINANCIAL INSTRUMENTS

For financial instruments, the FASB provides guidance which defines fair value, establishes a framework for measuring fair value under GAAP, and requires additional disclosures about fair value measurements. In compliance with this GAAP guidance, the Company has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three level hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities ("Level 1") and the lowest priority to unobservable inputs ("Level 3"). If the inputs used to measure fair value fall within different levels of the hierarchy, the category level is based on the lowest priority level input that is significant to the fair value measurement of the instrument.

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

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

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

Level 3: Fair value is based on significant unobservable inputs which reflect the entity's or third party pricing service's assumptions about the assumptions market participants would use in pricing an asset or liability. The Company's Level 3 assets are over-the-counter derivative contracts and the Company's Level 3 liabilities consist of share-based compensation obligations and certain product-related embedded derivatives. Valuations are estimated based on non-binding broker prices or internally developed valuation models or methodologies, discounted cash flow models and other similar techniques.



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The following tables set forth the Company's assets and liabilities that are measured at fair value on a recurring basis as of the date indicated:

|                                     | March 31, 2018     |               |                  |                |
|-------------------------------------|--------------------|---------------|------------------|----------------|
|                                     | Total              | Level<br>1    | Level 2          | Level 3        |
|                                     | (In thousands)     |               |                  |                |
| Debt securities, available for sale | \$3,084,789        | —             | 3,084,789        | —              |
| Equity securities                   | 18,173             | 18,173        | —                | —              |
| Derivatives, index options          | 116,356            | —             | —                | 116,356        |
| <b>Total assets</b>                 | <b>\$3,219,318</b> | <b>18,173</b> | <b>3,084,789</b> | <b>116,356</b> |
| Policyholder account balances (a)   | \$134,293          | —             | —                | 134,293        |
| Other liabilities (b)               | 13,209             | —             | —                | 13,209         |
| <b>Total liabilities</b>            | <b>\$147,502</b>   | <b>—</b>      | <b>—</b>         | <b>147,502</b> |

During the three months ended March 31, 2018, the Company had no transfers into or out of Levels 1, 2 or 3.

|                                       | December 31, 2017  |               |                  |                |
|---------------------------------------|--------------------|---------------|------------------|----------------|
|                                       | Total              | Level<br>1    | Level 2          | Level 3        |
|                                       | (In thousands)     |               |                  |                |
| Debt securities, available for sale   | \$3,041,131        | —             | 3,041,131        | —              |
| Equity securities, available for sale | 18,478             | 18,478        | —                | —              |
| Derivatives, index options            | 194,731            | —             | —                | 194,731        |
| <b>Total assets</b>                   | <b>\$3,254,340</b> | <b>18,478</b> | <b>3,041,131</b> | <b>194,731</b> |
| Policyholder account balances (a)     | \$211,159          | —             | —                | 211,159        |
| Other liabilities (b)                 | 15,242             | —             | —                | 15,242         |
| <b>Total liabilities</b>              | <b>\$226,401</b>   | <b>—</b>      | <b>—</b>         | <b>226,401</b> |

(a) Represents the fair value of certain product-related embedded derivatives that were recorded at fair value.

(b) Represents the liability for share-based compensation.



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The following tables present, by pricing source and fair value hierarchy level, the Company's assets that are measured at fair value on a recurring basis:

|                                      | March 31, 2018 |         |           |         |
|--------------------------------------|----------------|---------|-----------|---------|
|                                      | Total          | Level 1 | Level 2   | Level 3 |
|                                      | (In thousands) |         |           |         |
| Debt securities, available for sale: |                |         |           |         |
| Priced by third-party vendors        | \$3,084,789    | —       | 3,084,789 | —       |
| Priced internally                    | —              | —       | —         | —       |
| Subtotal                             | 3,084,789      | —       | 3,084,789 | —       |
| Equity securities:                   |                |         |           |         |
| Priced by third-party vendors        | 18,173         | 18,173  | —         | —       |
| Priced internally                    | —              | —       | —         | —       |
| Subtotal                             | 18,173         | 18,173  | —         | —       |
| Derivatives, index options:          |                |         |           |         |
| Priced by third-party vendors        | 116,356        | —       | —         | 116,356 |
| Priced internally                    | —              | —       | —         | —       |
| Subtotal                             | 116,356        | —       | —         | 116,356 |
| Total                                | \$3,219,318    | 18,173  | 3,084,789 | 116,356 |
| Percent of total                     | 100.0          | % 0.6   | % 95.8    | % 3.6   |

|  | December 31, 2017 |         |           |         |
|--|-------------------|---------|-----------|---------|
|  | Total             | Level 1 | Level 2   | Level 3 |
|  | (In thousands)    |         |           |         |
| Debt securities, available for sale:   |                   |         |           |         |
| Priced by third-party vendors          | \$3,041,131       | —       | 3,041,131 | —       |
| Priced internally                      | —                 | —       | —         | —       |
| Subtotal                               | 3,041,131         | —       | 3,041,131 | —       |
| Equity securities, available for sale: |                   |         |           |         |
| Priced by third-party vendors          | 18,478            | 18,478  | —         | —       |
| Priced internally                      | —                 | —       | —         | —       |
| Subtotal                               | 18,478            | 18,478  | —         | —       |
| Derivatives, index options:            |                   |         |           |         |
| Priced by third-party vendors          | 194,731           | —       | —         | 194,731 |
| Priced internally                      | —                 | —       | —         | —       |
| Subtotal                               | 194,731           | —       | —         | 194,731 |

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|                  |             |        |           |         |   |
|------------------|-------------|--------|-----------|---------|---|
| Total            | \$3,254,340 | 18,478 | 3,041,131 | 194,731 |   |
| Percent of total | 100.0       | % 0.6  | % 93.4    | % 6.0   | % |

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

|   | For the Three Months Ended March 31,<br>2018              |                                  |                 |                      |
|---|---|----------------------------------|-----------------|----------------------|
|   | Debt<br>Securities,<br>Equity<br>Available<br>for<br>Sale | Derivatives,<br>Index<br>Options | Total<br>Assets | Other<br>Liabilities |
|   | (In thousands)  |                                  |                 |                      |
| Balance at January 1, 2018  | \$—   | 194,731                          | 194,731         | 226,401              |
| Total realized and unrealized gains (losses):   |   |                                  |                 |                      |
| Included in net income  | —   | (44,394 )                        | (44,394 )       | (43,428 )            |
| Purchases, sales, issuances and settlements, net:   |   |                                  |                 |                      |
| Purchases   | —   | 22,376                           | 22,376          | 22,376               |
| Sales   | —   | —                                | —               | —                    |
| Issuances   | —   | —                                | —               | —                    |
| Settlements   | —   | (56,357 )                        | (56,357 )       | (57,847 )            |
| Transfers into (out of) Level 3   | —   | —                                | —               | —                    |
| Balance at end of period  | \$—   | 116,356                          | 116,356         | 147,502              |
| Change in unrealized gains or losses for the period included in earnings<br>(or changes in net assets) for assets held at the end of the reporting<br>period: |   |                                  |                 |                      |
| Net investment income   | \$—   | (44,337 )                        | (44,337 )       | —                    |
| Benefits and expenses   | —   | —                                | —               | (44,880 )            |
| Total   | \$—   | (44,337 )                        | (44,337 )       | (44,880 )            |

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|   | For the Three Months ended March 31, 2017    |  |                                  |                 |                      |
|---|--|--|----------------------------------|-----------------|----------------------|
|   | Debt<br>Securities,<br>Available<br>for Sale | Equity<br>Securities,<br>Available<br>for Sale | Derivatives,<br>Index<br>Options | Total<br>Assets | Other<br>Liabilities |
|   | (In thousands)                               |  |                                  |                 |                      |
| Balance at January 1, 2017  | \$ —   | 120,644  | 120,644                          | 134,693         |                      |
| Total realized and unrealized gains (losses):   |  |  |                                  |                 |                      |
| Included in net income  | —  | 61,206   | 61,206                           | 64,174          |                      |
| Purchases, sales, issuances and settlements, net:   |  |  |                                  |                 |                      |
| Purchases   | —  | 16,442   | 16,442                           | 16,442          |                      |
| Sales   | —  | —  | —                                | —               |                      |
| Issuances   | —  | —  | —                                | 230             |                      |
| Settlements   | —  | (48,444 )                                      | (48,444 )                        | (48,531 )       |                      |
| Transfers into (out of) Level 3   | —  | —  | —                                | —               |                      |
| Balance at end of period  | \$ —   | 149,848  | 149,848                          | 167,008         |                      |
| Change in unrealized gains or losses for the period included in earnings<br>(or changes in net assets) for assets held at the end of the reporting<br>period: |  |  |                                  |                 |                      |
| Net investment income   | \$ —   | 54,545   | 54,545                           | —               |                      |
| Benefits and expenses   | —  | —  | —                                | 55,095          |                      |
| Total   | \$ —   | 54,545   | 54,545                           | 55,095          |                      |

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The following table presents the valuation method for financial assets and liabilities categorized as level 3, as well as the unobservable inputs used in the valuation of those financial instruments:

|                               | March 31, 2018               |                               |   |
|-------------------------------|------------------------------|-------------------------------|---|
|                               | Fair Value<br>(In thousands) | Valuation Technique           | Unobservable Input  |
| Derivatives, index options    | \$ 116,356                   | Broker prices                 | Implied volatility<br>Inputs from broker proprietary models |
| Total assets                  | \$ 116,356                   |                               |   |
| Policyholder account balances | \$ 134,293                   | Deterministic cash flow model | Projected option cost                                       |
| Other liabilities             | 13,209                       | Black-Scholes model           | Expected term<br>Forfeiture assumptions                     |
| Total liabilities             | \$ 147,502                   |                               |   |
|                               | December 31, 2017            |                               |   |
|                               | Fair Value<br>(In thousands) | Valuation Technique           | Unobservable Input  |
| Derivatives, index options    | \$ 194,731                   | Broker prices                 | Implied volatility<br>Inputs from broker proprietary models |
| Total assets                  | \$ 194,731                   |                               |   |
| Policyholder account balances | \$ 211,159                   | Deterministic cash flow model | Projected option cost                                       |
| Other liabilities             | 15,242                       | Black-Scholes model           | Expected term<br>Forfeiture assumptions                     |
| Total liabilities             | \$ 226,401                   |                               |   |

Realized gains (losses) on debt securities are reported in the Condensed Consolidated Statements of Earnings as net investment gains (losses) with liabilities reported as expenses. Unrealized gains (losses) on available for sale debt securities are reported as other comprehensive income (loss) within the stockholders' equity section of the Condensed Consolidated Balance Sheet.

Effective January 1, 2018, the change in fair value of equity securities is reported in the Condensed Consolidated Statement of Earnings as net investment income.

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

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The carrying amounts and fair values of the Company's financial instruments are as follows:

|  | March 31, 2018                    |             | Fair Value Hierarchy Level |           |           |
|--|-----------------------------------|-------------|----------------------------|-----------|-----------|
|  | Carrying Values<br>(In thousands) | Fair Values | Level 1                    | Level 2   | Level 3   |
| <b>ASSETS</b>                                |                                   |             |                            |           |           |
| Debt securities held to maturity             | \$7,280,200                       | 7,302,034   | —                          | 7,299,770 | 2,264     |
| Debt securities available for sale           | 3,084,789                         | 3,084,789   | —                          | 3,084,789 | —         |
| Cash and cash equivalents                    | 82,924                            | 82,924      | 82,924                     | —         | —         |
| Mortgage loans                               | 204,948                           | 205,533     | —                          | —         | 205,533   |
| Policy loans                                 | 55,515                            | 94,128      | —                          | —         | 94,128    |
| Other loans                                  | 5,533                             | 5,688       | —                          | —         | 5,688     |
| Derivatives, index options                   | 116,356                           | 116,356     | —                          | —         | 116,356   |
| Equity securities                            | 18,173                            | 18,173      | 18,173                     | —         | —         |
| Short-term investments                       | —                                 | —           | —                          | —         | —         |
| Life interest in Trust                       | 8,676                             | 12,775      | —                          | —         | 12,775    |
| <b>LIABILITIES</b>                           |                                   |             |                            |           |           |
| Deferred annuity contracts                   | \$7,758,838                       | 7,252,309   | —                          | —         | 7,252,309 |
| Immediate annuity and supplemental contracts | 423,056                           | 430,398     | —                          | —         | 430,398   |

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|  | December 31, 2017 |             | Fair Value Hierarchy Level |           |           |
|--|-------------------|-------------|----------------------------|-----------|-----------|
|  | Carrying Values   | Fair Values | Level 1                    | Level 2   | Level 3   |
| (In thousands)                               |                   |             |                            |           |           |
| <b>ASSETS</b>                                |                   |             |                            |           |           |
| Investments in debt and equity securities:   |                   |             |                            |           |           |
| Securities held to maturity                  | \$7,247,024       | 7,434,104   | —                          | 7,431,810 | 2,294     |
| Securities available for sale                | 3,059,609         | 3,059,609   | 18,478                     | 3,041,131 | —         |
| Cash and cash equivalents                    | 217,624           | 217,624     | 217,624                    | —         | —         |
| Mortgage loans                               | 208,249           | 208,815     | —                          | —         | 208,815   |
| Policy loans                                 | 56,405            | 100,230     | —                          | —         | 100,230   |
| Other loans                                  | 5,431             | 5,603       | —                          | —         | 5,603     |
| Derivatives, index options                   | 194,731           | 194,731     | —                          | —         | 194,731   |
| Life interest in Trust                       | 8,676             | 12,775      | —                          | —         | 12,775    |
| <b>LIABILITIES</b>                           |                   |             |                            |           |           |
| Deferred annuity contracts                   | \$7,865,786       | 7,338,637   | —                          | —         | 7,338,637 |
| Immediate annuity and supplemental contracts | 430,494           | 443,437     | —                          | —         | 443,437   |

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

**(11) DERIVATIVE INVESTMENTS**

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

The company purchases over-the-counter index options, which are derivative financial instruments, to hedge the equity return component of its fixed-index annuity and life products. The index options act as hedges to match closely the returns on the underlying index or indices. The amounts which may be credited to policyholders are linked, in part, to the returns of the underlying index or indices. As a result, changes to policyholders' liabilities are substantially



offset by changes in the value of the options. Cash is exchanged upon purchase of the index options and no principal or interest payments are made by either party during the option periods. Upon maturity or expiration of the options, cash may be paid to the company depending on the performance of the underlying index or indices and terms of the contract.

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

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

The tables below present the fair value of derivative instruments as of March 31, 2018 and December 31, 2017, respectively.

|   | March 31, 2018             |            | Liability Derivatives                |            |
|---|----------------------------|------------|--------------------------------------|------------|
|   | Asset Derivatives          |            | Balance                              |            |
|   | Balance                    | Fair       | Sheet                                | Fair       |
|   | Sheet                      | Value      | Location                             | Value      |
|   | Location                   | (In        |                                      | (In        |
|   |                            | thousands) |                                      | thousands) |
| Derivatives not designated as hedging instruments |                            |            |                                      |            |
| Equity index options                              | Derivatives, Index Options | \$ 116,356 |                                      |            |
| Fixed-index products                              |                            |            | Universal Life and Annuity Contracts | \$ 134,293 |
| Total   |                            | \$ 116,356 |                                      | \$ 134,293 |
|   | December 31, 2017          |            | Liability Derivatives                |            |
|   | Asset Derivatives          |            | Balance                              |            |
|   | Balance                    | Fair       | Sheet                                | Fair       |
|   | Sheet                      | Value      | Location                             | Value      |
|   | Location                   | (In        |                                      | (In        |
|   |                            | thousands) |                                      | thousands) |
| Derivatives not designated as hedging instruments |                            |            |                                      |            |

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|                      |                               |            |  |
|----------------------|-------------------------------|------------|--|
| Equity index options | Derivatives, Index<br>Options | \$ 194,731 |  |
| Fixed-index products |                               |            | Universal Life and Annuity<br>Contracts \$ 211,159 |
| Total                |                               | \$ 194,731 | \$ 211,159   |

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The table below presents the effect of derivative instruments in the Condensed Consolidated Statements of Earnings for the three months ended March 31, 2018 and 2017.

| Derivatives Not Designated<br>As Hedging Instruments | Location of Gain<br>or (Loss) Recognized<br>In Income on Derivatives | March 31, March 31,<br>2018 2017   |           |
|--|--|--|-----------|
|  |  | Amount of Gain or<br>(Loss) Recognized<br>in<br>Income on<br>Derivatives<br>(In thousands) |           |
| Equity index options                                 | Net investment income  | \$(44,394)   | 61,206    |
| Fixed-index products                                 | Universal life and annuity contract interest                         | 42,885   | (63,624 ) |
|  |  | \$(1,509 )   | (2,418 )  |

## (12) SUBSEQUENT EVENTS

Based on the trend in declining international premiums, the lack of projected growth, and the recommendation of management, the company will cease accepting applications for the company's international products from foreign residents effective May 11, 2018. Subsequent events have been evaluated through the date of filing and no other reportable items were identified.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for forward-looking statements. Certain information contained herein or in other written or oral statements made by or on behalf of National Western Life Group, Inc. and its subsidiaries (the "Company") are or may be viewed as forward-looking. Although the Company has taken appropriate care in developing any such information, forward-looking information involves risks and uncertainties that could significantly impact actual results. These risks and uncertainties include, but are not limited to, matters described in the Company's SEC filings such as exposure to market risks, anticipated cash flows or operating performance, future capital needs, and statutory or regulatory related issues. However, as a matter of policy, the Company does not make any specific projections as to future earnings, nor does it endorse any projections regarding future performance that may be made by others. Whether or not actual results differ materially from forward-looking statements may depend on numerous foreseeable and unforeseeable events or developments. Also, the Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future developments, or otherwise.

Management's discussion and analysis of the financial condition and results of operations (“MD&A”) of National Western Life Group, Inc. for the three months ended March 31, 2018 follows. Where appropriate, discussion specific to the insurance operations of National Western Life Insurance Company is denoted by "National Western" or "company". This discussion should be read in conjunction with the Company's Condensed Consolidated Financial Statements and related notes beginning on page 3 of this report and with the 2017 Annual Report filed on Form 10-K with the SEC.

Overview

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

Due to the business of accepting funds to pay future obligations in later years and the underlying economics, the relevant factors affecting the company’s business and profitability include the following:

- the level of sales and premium revenues collected
- persistence of policies and contracts
- return on investments sufficient to produce acceptable spread margins over interest crediting rates
- investment credit quality which minimizes the risk of default or impairment
- levels of policy benefits and costs to acquire business
- the level of operating expenses
- effect of interest rate changes on revenues and investments including asset and liability matching
- maintaining adequate levels of capital and surplus
- actual levels of surrenders, withdrawals, claims and interest spreads
- changes in assumptions for amortization of deferred policy acquisition expenses and deferred sales inducements
- changes in the fair value of derivative index options and embedded derivatives pertaining to fixed-index life and annuity products
- pricing and availability of adequate reinsurance

litigation subject to unfavorable judicial development, including the time and expense of litigation

The Company monitors these factors continually as key business indicators. The discussion that follows in this Item 2 includes these indicators and presents information useful to an overall understanding of the Company's business performance for the three months ended March 31, 2018, incorporating required disclosures in accordance with the rules and regulations of the Securities and Exchange Commission.

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### Insurance Operations - Domestic

National Western is currently licensed to do business in all states and the District of Columbia except for New York. Products marketed are annuities, universal life insurance, fixed-index universal life, and traditional life insurance, which include both term and whole life products. The company's domestic sales have historically been more heavily weighted toward annuity products, which include single and flexible premium deferred annuities, single premium immediate annuities, and fixed-index annuities. Most of these annuities can be sold either as tax qualified or non-qualified products. Presently, 99% of National Western's life premium sales come from single premium life products. At March 31, 2018, the company maintained approximately 131,500 annuity contracts in force and 49,800 domestic life insurance policies in force representing \$3.1 billion in face amount of coverage.

National Western markets and distributes its domestic products primarily through independent national marketing organizations ("NMOs"). These NMOs assist the company in recruiting, contracting, and managing independent agents. The company's agents are independent contractors who are compensated on a commission basis. The company currently has approximately 26,900 domestic independent agents contracted.

During the third quarter of 2017, the company hired a new chief marketing officer over domestic marketing who has initiated new marketing and distribution strategies to include general agents, banks, broker/dealers, and wirehouses. This effort includes the subsequent addition of officers at the vice president level possessing industry experience and expertise in these new areas. The expansion of resources reflects the strategic opportunities identified by the company in the domestic market segment and aims to increase and balance sales between single and recurring premium life products. As discussed in the Sales section which follows, these efforts have resulted in a very strong start to the company's life sales in the first quarter of 2018 with domestic life insurance sales increasing 38% over the comparable prior year quarter.

### Insurance Operations - International

The company does not conduct business or maintain offices or employees in any other country, but historically has accepted applications at its home office in Austin, Texas, and issued policies from there to non-U.S. residents. The company's international clientele consists mainly of foreign nationals in upper socioeconomic classes. Insurance products issued during the current period are primarily to residents of countries in South America and the Caribbean based upon applications received in the company's home office.

Issuing policies to residents of countries in these different regions provides diversification that helps to minimize large fluctuations that could arise due to various economic, political, and competitive pressures that may occur from one country to another. Products issued to international residents are almost entirely universal life and traditional life insurance products. However, certain annuity and investment contracts are also available. At March 31, 2018, the company had approximately 60,000 international life insurance policies in force representing approximately \$16.4 billion in face amount of coverage.

International applications are submitted by independent contractor consultants and broker-agents. The company has approximately 2,500 independent international consultants and brokers currently contracted.

There are some inherent risks of accepting international applications, which are not present within the domestic market, that are reduced substantially by the company in several ways. As previously described, National Western accepts applications from foreign nationals in upper socioeconomic classes who have substantial financial resources. This customer base coupled with the company's conservative underwriting practices have historically resulted in claims experience due to natural causes, similar to that in the United States. The company minimizes exposure to foreign currency risks by requiring payment of premiums, claims and other benefits entirely in United States dollars

(except for a small block of business in Haiti whose policies are denominated in Haitian gourdes). National Western's fifty plus years of experience with the international products and its longstanding independent consultant and broker-agent relationships further serve to minimize risks.

The company ceased accepting applications from several markets during the first half of 2017 and from residents of Venezuela during the first quarter of 2018 due to the unsettled political, economic, civil, and social climate existing in that country. As noted in Note (12) Subsequent Events in the Notes to Condensed Consolidated Financial Statements, the company will cease accepting applications for the company's international products from foreign residents effective May 11, 2018.



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## SALES

## Life Insurance

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

|                   | Three<br>Months<br>Ended<br>March 31,<br>2018 2017<br>(In<br>thousands) |       |
|-------------------|---|-------|
| International:    |   |       |
| Universal life    | \$290   | 327   |
| Traditional life  | 404   | 438   |
| Equity-index life | 2,222   | 1,581 |
|                   | 2,916   | 2,346 |
| Domestic:         |   |       |
| Universal life    | 8   | 2     |
| Traditional life  | 27  | 38    |
| Equity-index life | 5,771   | 4,179 |
|                   | 5,806   | 4,219 |
| Totals            | \$8,722   | 6,565 |

Life insurance sales, as measured by annualized first year premiums, increased 33% in the first quarter of 2018 as compared to the first quarter of 2017. By market segment, the domestic life insurance line of business increased 38% while the international life insurance line of business posted a 24% increase from the comparable results of the first quarter of 2017. Increasing domestic life insurance business has been a particular point of emphasis by company management.

The company's domestic operations life insurance product portfolio includes single premium universal life ("SPUL") and equity-index universal life ("EIUL") products as well as hybrids of the EIUL and SPUL products, combining features of these core products. Equity-index universal life products continue to be the predominant product sold in the domestic life market. Most of these sales are single premium mode products (one year, five year, or ten year) designed for transferring accumulated wealth tax efficiently into life insurance policies with limited underwriting due to lesser net insurance amounts at risk (face amount of the insurance policy less cash premium contributed). These products were designed and implemented several years ago targeting the accumulated savings of the Baby Boomer segment of the population entering their retirement years. The wealth transfer life products have been valuable offerings for the company's distributors as evidenced by comprising 99% of total domestic life sales in the first three

months of 2018.

The company's international life business consists of applications accepted from residents of various regions outside of the United States, the volume of which typically varies based upon changes in the socioeconomic climates of these regions. Historically, the company experienced a simultaneous combination of rising and declining sales in various countries; however, the appeal of the company's dollar-denominated life insurance products served to overcome many of the local and national difficulties.

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Applications submitted by independent contractors of Latin America comprised the majority of the company's international life insurance sales. The company's mix of international life sales by geographic region is as follows for the periods shown:

|   | Three Months<br>Ended March<br>31,<br>2018    2017 |        |
|---|--|--------|
| Percentage of International Life Sales: |  |        |
| Ecuador                                 | 21.5 %   | 13.0 % |
| Colombia                                | 18.1   | 7.8    |
| Peru                                    | 16.1   | 20.8   |
| Venezuela                               | 15.9   | 26.6   |
| Chile                                   | 13.2   | 8.5    |
| Other                                   | 15.2   | 23.3   |
| Totals                                  | 100.0%   | 100.0% |

Year-to-date, the company has accepted new business from residents outside of the United States with Ecuador, Colombia, Peru, Venezuela and Chile comprising the regions with contributions of 10% or more of total international sales.

The average new policy face amounts since 2012 are as shown in the following table.

|                                   | Average New Policy<br>Face Amount<br>DomesticInternational |         |
|-----------------------------------|--|---------|
| Year ended December 31, 2012      | 254,900  | 380,200 |
| Year ended December 31, 2013      | 286,000  | 384,000 |
| Year ended December 31, 2014      | 286,600  | 382,600 |
| Year ended December 31, 2015      | 274,500  | 342,500 |
| Year ended December 31, 2016      | 308,700  | 336,500 |
| Year ended December 31, 2017      | 317,200  | 306,300 |
| Three months ended March 31, 2018 | 341,200  | 286,700 |

The company's efforts have been directed toward maintaining its competitive advantages in accepting applications from upper socio-economic residents of international countries and to its wealth transfer strategies for domestic life sales. In both of these strategies the company's portfolio of fixed-index (equity indexed) life insurance products plays an important role. Fixed-index life products accounted for 92% of total life sales in the first three months of 2018, as compared to 88% for the same period in 2017.

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

|                       | Insurance In Force as of<br>March 31, |            |
|-----------------------|---------------------------------------|------------|
|                       | 2018                                  | 2017       |
|                       | (\$ in thousands)                     |            |
| Universal life:       |                                       |            |
| Number of policies    | 39,480                                | 42,960     |
| Face amounts          | \$3,892,540                           | 4,679,630  |
| Traditional life:     |                                       |            |
| Number of policies    | 31,730                                | 33,380     |
| Face amounts          | \$3,430,210                           | 3,478,190  |
| Fixed-index life:     |                                       |            |
| Number of policies    | 38,680                                | 38,550     |
| Face amounts          | \$9,090,480                           | 9,299,690  |
| Rider face amounts    | \$3,119,610                           | 3,017,790  |
| Total life insurance: |                                       |            |
| Number of policies    | 109,890                               | 114,890    |
| Face amounts          | \$19,532,840                          | 20,475,300 |

At March 31, 2018, the company's face amount of life insurance in force was comprised of \$16.4 billion from the international line of business and \$3.1 billion from the domestic line of business. At March 31, 2017, these amounts were \$17.5 billion and \$3.0 billion for the international and domestic lines of business, respectively.

Annuities

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

|                          | Three Months<br>Ended March 31, |         |
|--------------------------|---------------------------------|---------|
|                          | 2018                            | 2017    |
|                          | (In thousands)                  |         |
| Fixed-index annuities    | \$103,199                       | 136,722 |
| Other deferred annuities | 4,050                           | 7,427   |
| Immediate annuities      | 410                             | 687     |
| Totals                   | \$107,659                       | 144,836 |

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The company's mix of annuity sales has historically shifted with interest rate levels and the relative performance of the equity market. With the decline in interest rates subsequent to the subprime crisis, sales of fixed-index products have become proportionately greater generally accounting for 90% or more of all annuity sales the past several years. During the first three months of 2018, this percentage approached 96% reflecting the ongoing bull market run in equities since bottoming out in 2009. For all fixed-index products, the company purchases over the counter call options to hedge the equity return feature. The options are purchased relative to the issuance of the annuity contracts in such a manner to minimize timing risk. Generally, the index return during the indexing period (if the underlying index increases) becomes a component in a formula (set forth in the annuity), the result of which is credited as interest to contract holders electing the index formula crediting method at the beginning of the indexing period. The formula result can never be less than zero with these products. The company does not deliberately mismatch or under hedge for the equity feature of the products. Fixed-index products also provide the contract holder the alternative to elect a fixed interest rate crediting option.

With the advent of a low interest rate policy engineered by the Federal Reserve in response to the subprime financial crisis, company management evaluated the potential ramifications of continuing a high level of annuity sales in a depressed interest rate environment. Under the auspices of the company's enterprise risk management ("ERM") processes, taking into consideration the Federal Reserve's announced intention to maintain interest rates at historically reduced levels over a prolonged period of time, the decision was made beginning in 2012 to curtail new sales to desired levels in order to minimize the level of assets added at low yield rates. While National Western does not subsidize its interest crediting rates on new policies in order to obtain market share, the Company's ERM considerations determined that managing to a lower level of annuity sales was prudent given the environment.

Annuity sales beginning in 2017 declined further relative to prior year levels reflecting the impact of two regulatory changes. The first was the Department of Labor's "fiduciary rule" on standards for retirement investment advice. The uncertainty associated with the timing and ultimate requirements of the rule served to decrease activity for annuity sales involving qualified funds as insurance carriers, marketing organizations and independent distributors sought to develop strategies for operating under the fiduciary rule guidelines. The second change impacting the level of annuity sales occurred late in 2016 when the state of California mandated more restrictive annuity product features for policies sold in the state. This required the company to refile products complying with the new standards for state approval. California regulators were slow to process and approve product filings received from insurance carriers in the aftermath of imposing these restrictive product features.

The level of annuity business in force requires a focused discipline on asset/liability analysis. The company monitors its asset/liability matching within the self-constraints of desired capital levels and risk tolerance. The company's capital level remains substantially above industry averages and regulatory targets. Management has performed analyses of the capital strain associated with incrementally higher levels of annuity new business and determined that the company's capital position is more than sufficient to handle an increase in sales activity when a more favorable rate environment returns.

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

|                          | Annuities In Force as<br>of<br>March 31,<br>2018      2017<br>(\$ in thousands) |           |
|--------------------------|---|-----------|
| Fixed-index annuities    |   |           |
| Number of policies       | 75,110  | 74,730    |
| GAAP annuity reserves    | \$5,936,435   | 5,812,950 |
| Other deferred annuities |   |           |
| Number of policies       | 42,920  | 46,200    |
| GAAP annuity reserves    | \$1,723,462   | 1,878,563 |
| Immediate annuities      |   |           |
| Number of policies       | 13,500  | 14,170    |
| GAAP annuity reserves    | \$359,615   | 369,502   |
| Total annuities          |   |           |
| Number of policies       | 131,530   | 135,100   |
| GAAP annuity reserves    | \$8,019,512   | 8,061,015 |

## Impact of Recent Business Environment

The Company's business is generally aided by an economic environment experiencing growth, whether moderate or vibrant, characterized by metrics which indicate improving employment data and increases in personal income. Recently, the final measure of U.S. Gross Domestic Product (GDP) fourth quarter growth was revised upward to 2.9% and preliminary first quarter growth was reported at 2.3%. The April unemployment rate was reported to be under 4% for the first time in eighteen years. The general expectation moving forward is that economic growth should increase throughout 2018 as real business investment spending continues to accelerate, helping productivity and working to keep inflation from approaching worrisome levels for the Federal Reserve. With this backdrop, consumer spending is expected to remain healthy.

As noted previously, the Department of Labor's (DOL) fiduciary rule served as a sales impediment for life insurers who offer equity-indexed annuity products. On March 15, 2018, the Fifth Circuit Court of Appeals vacated the DOL's fiduciary rule. The appellate judges ruled that the DOL exceeded its statutory authority under the Employee Retirement Income Security Act ("ERISA") when they promulgated the rule. In particular, the judges criticized a key provision of the fiduciary rule, the best-interest-contract exemption ("BICE") which required sellers of equity-indexed annuities to sign a legally binding agreement to act in a client's best interests. The majority opinion stated that the BICE replaced former exemptions with "a web of duties and legal vulnerabilities" that went outside the DOL's authority under ERISA. Subsequently, AARP (and the States of California, New York, and Oregon) filed a motion to intervene as a defendant in order to defend the fiduciary rule measure in court. This motion to intervene was denied by the Fifth Circuit Court of Appeals on May 2, 2018. It is uncertain what effect, if any, the appellate court's ruling and challenges to this ruling will have upon future sales of equity-indexed annuities and the Company's business.

With regard to the credit market, industry analysts and observers generally agree that a sudden jump in interest rate levels, while presently a highly unlikely scenario, would be harmful to life insurers with interest-sensitive products as

it could provide an impetus for abnormal levels of product surrenders and withdrawals at the same time fixed debt securities held by insurers declined in market value. Currently, the consensus view of the Federal Reserve's course of action is predicated on the thesis that the U.S. economy is in a position to absorb a series of interest rate hikes without impeding ongoing economic growth. A progression of carefully measured increases in interest rates would be beneficial to financial service institutions, including life insurance companies. After the rate increase in December 2017, the current interest rate path is for another three interest rate hikes in 2018. The capital markets appear to remain healthy with credits spreads between high yield and treasuries tight by historical measures. It is uncertain what direction and at what pace interest rate movements may occur in the future and what impact, if any, such movements would have on the Company's business, results of operations, cash flows or financial condition.

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The U.S life insurance sector today is faced with an interest rate, economic and regulatory environment making strategic long-term planning decisions more challenging and vulnerable to inaccurate assessments. In an environment such as this, the need for a strong capital position that can cushion against unexpected bumps is critical for stability and ongoing business activity. The Company's operating strategy continues to be focused on maintaining capital levels substantially above regulatory and rating agency requirements. Our business model is predicated upon steady growth in invested assets while managing the block of business within profitability objectives. A key premise of our financial management is maintaining a high quality investment portfolio, well matched in terms of duration with policyholder obligations, that continues to outperform the industry with respect to adverse impairment experience. This discipline enables the Company to sustain resources more than adequate to fund future growth and absorb abnormal periods of cash outflows.

**RESULTS OF OPERATIONS**

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

**Consolidated Operations**

Revenues. The following details Company revenues.

|   | Three Months<br>Ended March 31,<br>2018      2017<br>(In thousands) |         |
|---|---|---------|
| Universal life and annuity contract charges   | \$38,520  | 41,364  |
| Traditional life premiums                     | 4,145   | 4,221   |
| Net investment income (excluding derivatives) | 105,139   | 110,536 |
| Other revenues                                | 4,997   | 4,505   |
| Operating revenues                            | 152,801   | 160,626 |
| Derivative gain (loss)                        | (44,394 )   | 61,206  |
| Net realized investment gains (losses)        | 611   | 2,585   |
| Total revenues                                | \$109,018   | 224,417 |





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Universal life and annuity contract charges - Revenues for universal life and annuity contracts were lower for the first three months in 2018 compared to 2017. Revenues for universal life and annuity products consist of policy charges for the cost of insurance, administration charges, surrender charges assessed against policyholder account balances, and amortization of deferred premium loads less reinsurance premiums, as shown in the following table.

|  | Three Months<br>Ended March 31,<br>2018      2017<br>(In thousands) |          |
|--|---|----------|
| Contract Revenues:                           |   |          |
| Cost of insurance and administrative charges | \$32,313  | 33,508   |
| Surrender charges                            | 8,988   | 12,268   |
| Other charges                                | 1,279   | (165 )   |
| Gross contract revenues                      | 42,580  | 45,611   |
| Reinsurance premiums                         | (4,060 )  | (4,247 ) |
| Net contract revenues                        | \$38,520  | 41,364   |

Cost of insurance charges typically trend with the size of the universal life insurance block in force and the amount of new business issued during the period. Universal life insurance in force during the three months ended March 31, 2018 averaged approximately \$18.5 billion while for the same period of 2017 it averaged \$19.4 billion. Accordingly, for the three months ended March 31, 2018, cost of insurance charges decreased to \$26.8 million from \$26.9 million at March 31, 2017. Administrative charges pertaining to new business issued declined to \$5.5 million for the three months ended March 31, 2018 versus \$6.6 million for the three months ended March 31, 2017 due to a lower number of international life insurance policies issued.

Surrender charges assessed against policyholder account balances upon withdrawal decreased in the first three months of 2018 versus the comparable prior year period. While the company earns surrender charge income that is assessed upon policy terminations, the company's overall profitability is enhanced when policies remain in force and additional contract revenues are realized and the company continues to make an interest rate spread equivalent to the difference it earns on its investment and the amount that it credits to policyholders. In the first three months of 2018, lapse rates on international life insurance policies were better than the prior year while lapse rates for domestic insurance and annuity policies increased somewhat. The international life insurance lapse rate increased noticeably in the countries from which National Western ceased accepting applications from residents in the fourth quarter of 2015. While peaking in 2017, the international lapse rate decreased substantially. Surrender charge income recognized is also dependent upon the duration of policies at the time of surrender (i.e. later duration policy surrenders having a lower surrender charge assessed and earlier duration surrenders having a higher surrender charge).

Other charges include the amortization into income of the premium load on single premium life insurance products which is deferred at the inception of the policy. As these products have become a substantial portion of domestic life insurance sales over the past several years, the amortization of accumulated deferrals has eclipsed current period premium loads deferred.

Traditional life premiums - Traditional life premiums were slightly lower in the three months ended March 31, 2018 compared to the same periods in 2017 reflecting a slight decrease in sales and the lapsation of life insurance policies noted above. Traditional life insurance premiums for products such as whole life and term life are recognized as revenues over the premium-paying period. The company's life insurance sales focus has historically been primarily

centered around universal life products, although additional term products have been added to the company's portfolio recently. Universal life products, especially the company's equity indexed universal life products which offer the opportunity for consumers to acquire life insurance protection and receive credited interest linked in part to an outside market index, have been more popular product offerings in the company's markets representing 92% of new life insurance sales for 2018 thus far.

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Net investment income - To ensure the Company will be able to honor future commitments to policyholders and provide a financial return, the funds received as premium payments and deposits are invested in high quality investments, primarily fixed maturity debt securities. The income from these investments is closely monitored by the Company due to its significant impact on the business. A detail of net investment income (with and without index option gains and losses) is provided below.

|   | Three Months<br>Ended March 31,<br>2018      2017<br>(In thousands) |         |
|---|---|---------|
| Gross investment income:                      |   |         |
| Debt and equities                             | \$ 100,055  | 103,441 |
| Mortgage loans                                | 3,086   | 3,289   |
| Policy loans                                  | 819   | 883     |
| Short-term investments                        | 521   | 65      |
| Other invested assets                         | 1,059   | 3,149   |
| <br>  |   |         |
| Total investment income                       | 105,540   | 110,827 |
| Less: investment expenses                     | 401   | 291     |
| <br>  |   |         |
| Net investment income (excluding derivatives) | 105,139   | 110,536 |
| Derivative gain (loss)                        | (44,394 )   | 61,206  |
| <br>  |   |         |
| Net investment income                         | \$ 60,745   | 171,742 |

For the three months ended March 31, 2018, debt and equity securities generated approximately 95% of total net investment income, excluding derivative gain (loss). The Company's strategy is to invest substantially all of its cash flows in fixed debt securities consistent with its guidelines for credit quality, duration, and diversification. The lower level of investment income from debt and equity securities through the first quarter of 2018 versus 2017, reflects higher yielding debt securities maturing or being called by borrowers and being replaced with lower yielding securities in the current interest rate environment. In addition, investment yields on new bond purchases during the first three months of 2018 approximated 3.83% remaining slightly below the portfolio's weighted average yield of 3.93% at March 31, 2018.

Effective January 1, 2018, new accounting guidance requires that changes in fair values of equity securities be included in the Consolidated Statements of Earnings. For the quarter ended March 31, 2018 an unrealized loss of \$(0.5) million is included in net investment income (in the Debt and equities line item in the above table) reflecting the change in fair value during the period.

Mortgage loan investment income for the three months ended March 31, 2018 decreased versus the comparable period in 2017 reflecting higher yielding loans maturing or paying off and prepayment fees received in 2017. The portfolio balance increased from \$174.5 million at December 31, 2016 to \$208.2 million at December 31, 2017 as the Company identified this as an area of investment focus. The mortgage loan portfolio balance decreased slightly to \$204.9 million at March 31, 2018 reflecting seasonal competition in loan origination efforts (competing mortgage lenders are typically more active during the first calendar quarter of the year). During the three months ended March 31, 2018 the Company originated new mortgage loans in the amount of \$0.0 million compared to \$8.3 million in the comparable period of 2017.

Other invested asset investment income during the first three months of 2017 reflects additional proceeds as various profit participation loans paid out during the period. These loans, generally underwritten in conjunction with an underlying mortgage loan, enhance the Company's returns on its lending due the opportunity to participate in profit generation from the supporting venture.

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In order to evaluate underlying profitability and results from ongoing operations, net investment income performance is analyzed excluding derivative gain (loss), which is a common practice in the insurance industry. Net investment income and average invested assets shown below includes cash and cash equivalents. Net investment income performance is summarized as follows:

|  | Three Months Ended March |   |            |   |
|--|--------------------------|---|------------|---|
|  | 31,                      |   | 2017       |   |
|  | 2018                     |   |            |   |
|  | (In thousands)           |   |            |   |
| Excluding derivatives:                     |                          |   |            |   |
| Net investment income                      | \$ 105,139               |   | 110,536    |   |
| Average invested assets, at amortized cost | \$ 10,730,096            |   | 10,598,469 |   |
| Annual yield on average invested assets    | 3.92                     | % | 4.19       | % |
| Including derivatives:                     |                          |   |            |   |
| Net investment income                      | \$ 60,745                |   | 171,742    |   |
| Average invested assets, at amortized cost | \$ 10,885,639            |   | 10,678,848 |   |
| Annual yield on average invested assets    | 2.23                     | % | 6.43       | % |

The yield on average invested assets during the first quarter, excluding derivatives, declined from 2017 as yields obtained on new fixed maturity debt securities investments during the first three months of 2018 and the remainder of 2017 were below the total weighted average yield of the portfolio. During 2017, the average yield on bond purchases to fund insurance operations was 3.57% representing a 1.19% spread over treasury rates. Insurance operation bond purchases through the first quarter of 2018 had a higher average yield of 3.83%; however, spreads decreased to 1.06% over treasury rates during this period. While treasury rates increased in the first quarter, the demand for fixed income securities tightened the spread margin over treasury rates.

The bond yield rates during both 2017 and the first quarter of 2018 are below the weighted average bond portfolio rate. The weighted average quality of new purchases during the first three months of the current year was "BBB+" matching the overall "BBB+" quality rating of purchases during 2017. The composite duration of purchases during the first three months of 2018 was approximately the same as that for 2017 purchases. The Company's general investment strategy is to purchase debt securities with maturity dates approximating ten years in the future. Accordingly, an appropriate measure for benchmarking the direction of interest rate levels for the Company's debt security purchases is the ten year treasury bond rate. After ending 2017 at a rate of 2.41%, the daily closing yield of the ten year treasury bond ranged from a low of approximately 2.45% to a high of roughly 2.95% during the first three months of 2018, and ended the first calendar quarter at 2.74%.

The pattern in average invested asset yield, including derivatives, incorporates increases and decreases in the fair value of index options purchased by the company to support its fixed-index products. Fair values of the purchased call options decreased during the first quarter of 2018 and increased during the comparable 2017 period, corresponding to the movement in equity market indices in these time frames. Refer to the derivatives discussion below for a more detailed explanation of these instruments.

Other revenues - Other revenues primarily pertain to the Company's two nursing home operations in Reno, Nevada and San Marcos, Texas, and the operations of Braker P III ("BP III"), a new subsidiary created at the end of 2016 to own and manage a commercial office building it acquired. Revenues associated with the nursing operations were \$4.4 million and \$4.4 million for the three months ended March 31, 2018 and 2017, respectively. Level nursing home revenues reflect stable census figures at the facilities thus far in 2018 and a steady mix of payor sources by patient

types. Revenues associated with BP III were \$0.6 million and \$0.3 million in the first quarter of 2018 and 2017, respectively. The increased revenues in 2018 reflect tenant leases that have been subsequently entered into.

Derivative gain (loss) - Index options are derivative financial instruments used to hedge the equity return component of the company's fixed-index products. Derivative gain or loss includes the amounts realized from the sale or expiration of the options. Since the index options do not meet the requirements for hedge accounting under GAAP, they are marked to fair value on each reporting date and the resulting unrealized gain or loss is also reflected as a component of net investment income.

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Gains and losses from index options are substantially due to changes in equity market conditions. Index options are intended to act as hedges to match the returns on the product's underlying reference index and the rise or decline in the index relative to the index level at the time of the option purchase which causes option values to likewise rise or decline. As income from index options fluctuates with the underlying index, the contract interest expense to policyholder accounts for the company's fixed-index products also fluctuates in a similar manner and direction. For the three months ended March 31, 2018, the reference indices decreased and the Company recorded an overall loss from index options as shown below.

|   | Three Months<br>Ended March 31,<br>2018      2017<br>(In thousands) |         |
|---|---|---------|
| Derivatives:  |   |         |
| Unrealized gain (loss)                              | \$ (84,310)   | 31,255  |
| Realized gain (loss)                                | 39,916  | 29,951  |
| Total gain (loss) included in net investment income | \$ (44,394)   | 61,206  |
| Total contract interest                             | \$ (1,818 )   | 109,893 |

The economic impact of option performance in the Company's financial statements is not generally determined solely by the option gain or loss included in net investment income as there is a corresponding amount recorded in the contract interest expense line. The Company's profitability with respect to these options is largely dependent upon the purchase cost of the option remaining within the financial budget for acquiring options embedded in the product pricing. Option prices vary with interest rates, volatility, and dividend yields among other things. As option prices vary, the Company manages for the variability by making offsetting adjustments to product caps, participation rates, and management fees. For the periods shown, the Company's option costs have been close to or within the product pricing budgets.

The financial statement investment spread, the difference between investment income and interest credited to contractholders, is subject to variations from option performance during any given period. For example, many of the company's equity-index annuity products provide for the collection of asset management fees. These asset management fees are assessed when returns on expiring options are positive, and they are collected prior to passing any additional returns above the assessed management fees to the policy contractholders. During periods of positive returns, the collected asset management fees serve to increase the financial statement spread by increasing option realized gains reported as investment income in an amount greater than interest credited to policy contractholders which is reported as contract interest expense. Asset management fees collected in the first three months of 2018 and 2017 were approximately \$6.1 million and \$6.6 million, respectively.

Net realized investment gains (losses) - Realized gains (losses) on investments include proceeds from bond calls and sales as well as impairment write-downs on investments in debt securities and real estate. The net gains reported for the three months ended March 31, 2018 consisted of gross gains of \$0.6 million offset by gross losses of \$0.0 million. The net gains reported for the three months ended March 31, 2017 consisted of gross gains of \$2.6 million offset by gross losses of \$0.0 million. No other-than-temporary credit impairment losses were recorded during the three months ended March 31, 2018 and 2017.

The Company records impairment write-downs when a decline in value is considered to be other-than-temporary and full recovery of the investment is not expected. Impairments due to credit factors are recorded in the Company's



Condensed Consolidated Statements of Earnings while non-credit (liquidity) impairment losses are included in Condensed Consolidated Statements of Comprehensive Income (Loss). No impairment or valuation write-downs were recorded in the Company's Condensed Consolidated Statements of Earnings for the three months ended March 31, 2018 and 2017.

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Benefits and Expenses. The following table details benefits and expenses.

|   | Three Months<br>Ended March 31,<br>2018      2017<br>(In thousands) |         |
|---|---|---------|
| Life and other policy benefits                    | \$21,401  | 19,757  |
| Amortization of deferred policy acquisition costs | 32,229  | 34,212  |
| Universal life and annuity contract interest      | (1,818 )  | 109,893 |
| Other operating expenses                          | 23,633  | 25,092  |
| Totals  | \$75,445  | 188,954 |

Life and other policy benefits - Death claim benefits, the largest component of policy benefits, were \$10.5 million in the first three months of 2018 compared to \$11.7 million for the first three months of 2017. Death claim amounts are generally subject to variation from period to period. For the first three months of 2018, the number of life insurance claims increased 7% from the comparable period in 2017 while the average dollar amount per claim was level. The death claim amount was slightly lower in 2018 due to higher cash values on universal life claims compared to the prior year quarter (cash values serve to reduce the company's out-of-pocket benefit expense). The company's overall mortality experience has generally been consistent with or better than its product pricing assumptions. Mortality exposure is managed through reinsurance treaties under which the Company's retained maximum net amount at risk on any one life is capped at \$500,000.

Life and other policy benefits also includes policy liabilities held associated with the company's traditional life products, including riders such as the company's withdrawal benefit rider ("WBR"), a popular rider to its equity-indexed annuity products. The increase associated with these policy liabilities was \$8.0 million and \$5.5 million in the quarters ended March 31, 2018 and 2017, respectively. From time to time as part of the unlocking of deferred policy acquisition costs, the company has recorded a prospective unlocking adjustment which has affected WBR reserves held. No such unlocking adjustments were recorded in the first quarters of 2018 or 2017.

Amortization of deferred policy acquisition costs - Life insurance companies are required to defer certain expenses that vary with, and are primarily related to, the cost of acquiring new business. The majority of these acquisition expenses consist of commissions paid to agents, underwriting costs, and certain marketing expenses. Recognition of these deferred policy acquisition costs ("DPAC") as an expense in the Condensed Consolidated Financial Statements occurs over future periods in relation to the expected emergence of profits priced into the products sold. This emergence of profits is based upon assumptions regarding premium payment patterns, mortality, persistency, investment performance, and expense patterns. Companies are required to review universal life and annuity contract assumptions periodically to ascertain whether actual experience has deviated significantly from that assumed. If it is determined that a significant deviation has occurred, the emergence of profits pattern is to be "unlocked" and reset based upon the actual experience. DPAC balances are also adjusted each period to reflect current policy lapse or termination rates, expense levels and credited rates on policies compared to anticipated experience ("true-up") with the adjustment reflected in current period amortization expense. In accordance with GAAP guidance, the Company must also write-off deferred acquisition costs and unearned revenue liabilities upon internal replacement of certain contracts as well as annuitizations of deferred annuities.

The following table identifies the effects of unlocking adjustments on DPAC balances recorded through amortization expense separate from recurring amortization expense components for the three months ended March 31, 2018 and 2017.

| Amortization of DPAC          | Three Months<br>Ended March<br>31,<br>2018    2017<br>(In thousands) |        |
|-------------------------------|--|--------|
|                               | Unlocking adjustments  | \$—    |
| Other amortization components | 32,229   | 34,212 |
| Totals                        | \$32,229   | 34,212 |

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The Company is required to evaluate its emergence of profits continually and management believes that the current amortization patterns of deferred policy acquisition costs are reflective of actual experience. It is the company's intent, absent intervening events or experience, to annually perform any necessary DPAC balance unlockings in the third calendar quarter of the year.

As the DPAC balance is an asset on the Company's Condensed Consolidated Balance Sheets, GAAP provides for an earned interest return on the unamortized balance each period. The earned interest serves to increase the DPAC balance and reduce other amortization component expense. The rate at which the DPAC balance earns interest is the average credited interest rate on the company's universal life and annuity policies in force, including credited interest on equity-indexed policies. The amount of earned interest on DPAC balances was \$9.6 million and \$8.0 million in the quarters ended March 31, 2018 and 2017, respectively, decreasing other amortization component expense.

Universal life and annuity contract interest - The company closely monitors its credited interest rates on interest sensitive policies, taking into consideration such factors as profitability goals, policyholder benefits, product marketability, and economic market conditions. As long term interest rates change, the company's credited interest rates are often adjusted accordingly, taking into consideration the factors described above. The difference between yields earned on investments over policy credited rates is often referred to as the "interest spread".

The company's approximated average credited rates through the first three months, excluding and including equity-indexed products, were as follows:

|                         | March 31,<br>2018<br>(Excluding<br>fixed-index<br>products) | March 31,<br>2017<br>(Including<br>fixed-index<br>products) | March 31,<br>2018<br>(Including<br>fixed-index<br>products) | March 31,<br>2017<br>(Including<br>fixed-index<br>products) |
|-------------------------|---|---|---|---|
| Annuity                 | 2.14%   | 2.23%   | 0.05 %  | 3.79%   |
| Interest sensitive life | 3.38%   | 3.55%   | (0.67)%   | 8.30%   |

Contract interest reported in financial statements also encompasses the performance of the index options associated with the company's fixed-index products. As previously noted, the market value changes of these derivative features resulted in net realized and unrealized gains/(losses) of \$(44.4) million and \$61.2 million being included in net investment income for the three months ended March 31, 2018 and 2017, respectively. These returns similarly increased/(decreased) the computed average credited rates for the periods shown above. Policyholders of equity-indexed products cannot receive an interest credit below 0% according to the policy contract terms. The negative percentage shown in the table above is the result of including unrealized option losses in the calculation of the average credited rate.

Generally, the impact of the market value change of index options on asset values aligns closely with the movement of the embedded derivative liability held for the company's fixed-index products such that the net effect upon pretax earnings is negligible (i.e. net realized and unrealized gains/(losses) included in net investment income approximate the change in contract interest associated with the corresponding embedded derivative liability change). However, other aspects of the embedded derivatives can cause deviations to occur between the change in index option asset values included in net investment income and the change in the embedded derivative liability included in contract interest. As noted in the discussion of net investment income, the collection of asset management fees in a period can cause investment income to increase marginally higher than contract interest expense since these collected fees are deducted from indexed interest credited to policyholders. During the three months ended March 31, 2018 and 2017,

asset management fees collected were \$6.1 million and \$6.6 million, respectively.

Accounting rules require the embedded derivative liability to include a projection of asset management fees estimated to be collected in the succeeding fiscal year. The change in this projection, plus or minus, is included in contract interest for the period being reported on. In the three month periods ended March 31, 2018 and 2017, contract interest was increased \$2.5 million and \$0.3 million, respectively, for these projection changes.

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Contract interest expense also includes reserve changes for immediate annuities, two tier annuities, excess death benefit reserves, excess annuitizations, and amortization of deferred sales inducement balances. These items are offset by policy charges assessed for policies having the withdrawal benefit rider (WBR). As changes in these items collectively impact contract interest expense, financial statement interest spread is also affected. For the three month periods ended March 31, 2018 and 2017 the changes in these items increased contract interest expense by \$3.9 million and \$8.3 million, respectively. The lower contract interest charge in the first quarter of 2018 reflects higher WBR charges assessed (which reduces contract interest expense) and smaller reserve increases associated with immediate and two-tier annuities due to decreases in the size of these blocks of business.

Similar to deferred policy acquisition costs, the company defers sales inducements in the form of first year credited interest bonuses on annuity products that are directly related to the production of new business. These bonus interest charges are deferred and amortized using the same methodology and assumptions used to amortize other capitalized acquisition costs and the amortization is included in contract interest. In addition, deferred sales inducement balances are also reviewed periodically to ascertain whether actual experience has deviated significantly from that assumed (unlock) and are adjusted to reflect current policy lapse or termination rates, expense levels and credited rates on policies compared to anticipated experience (true-up). These adjustments, plus or minus, are included in contract interest expense. No unlocking adjustments were recorded during the first quarter of 2018 or 2017.

Other operating expenses - Other operating expenses consist of general administrative expenses, licenses and fees, commissions not subject to deferral, nursing home expenses, real estate expenses, and compensation costs. These expenses for the three months ended March 31, 2018 and 2017 are summarized in the table that follows.

|                            | Three Months<br>Ended March<br>31,<br>2018    2017<br>(In thousands) |        |
|----------------------------|--|--------|
| General insurance expenses | \$8,355  | 8,755  |
| Nursing home expenses      | 3,956  | 4,322  |
| Compensation expenses      | 6,167  | 6,117  |
| Commission expenses        | 2,322  | 2,565  |
| Real estate expenses       | 1,214  | 673    |
| Taxes, licenses and fees   | 1,619  | 2,660  |
| Totals                     | \$23,633   | 25,092 |

General insurance expenses include software amortization expense associated with the company's proprietary policy administration system which was phased into production over the past couple years as well as other acquired software. Expenses pertaining to these items were \$2.6 million and \$2.3 million in the first quarter of 2018 and 2017, respectively. This category also includes employee benefit plan expenses for the various employee health and retirement plans the company sponsors. Related expenses for the first quarter of 2018 and 2017 were \$1.5 million and \$2.3 million, respectively.

Compensation expenses include share-based compensation costs related to outstanding vested and nonvested stock options and stock appreciation rights ("SARs"), restricted stock units ("RSUs") and performance share units ("PSUs"). The related share-based compensation costs move in tandem not only with the number of awards outstanding but also with the movement in the market price of the Company's Class A common stock as a result of marking the stock options, SARs, and RSUs to fair value under the liability method of accounting. Consequently, the related expense

amount varies positive or negative in any given period. For the three-month periods shown, share-based compensation expense was \$(0.5) million in 2018 and \$0.8 million in 2017. The Company's Class A common share price decreased from \$331.02 at December 31, 2017 to \$304.88 at March 31, 2018. No performance share awards were granted in the first quarter of 2018. During the quarter ended March 31, 2017, the Company awarded 11,512 SARs, 4,334 RSUs, and 4,425 PSUs to directors and officers.

Real estate expenses pertain to the commercial building operated by Braker P III. The building was acquired at year-end 2016 and the company relocated to this facility during the fourth quarter of 2017.

Taxes, licenses and fees include premium taxes and licensing fees paid to state insurance departments, guaranty fund assessments, the company portion of social security and Medicare taxes, real estate taxes, state income taxes, and other state and municipal taxes. Premium tax expense decreased to \$0.9 million in the first quarter of 2018 from \$1.4 million in the 2017 first quarter due to recoveries of overpaid taxes and the reduction of related accrual liabilities. Other state taxes decreased \$0.3 million in the first quarter of 2018 from 2017 due to a favorable resolution of a contingent state tax liability.

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**Federal Income Taxes.** Federal income taxes on earnings from operations reflect an effective tax rate of 20.0% for the three months ended March 31, 2018 compared to 33.6% for the three months ended March 31, 2017. The Federal corporate tax rate decreased to 21% effective in 2018 under the Tax Cuts and Jobs Act ("Tax Act") passed in December 2017. The Company's effective tax rate is typically lower than the Federal statutory rate due to tax-exempt investment income related to municipal securities and dividends-received deductions on income from stocks, absent other permanent tax items. While the Company's overall effective tax rate remains close to the statutory rate level, the Company's current tax expense remains elevated due to another provision of the Tax Act which capped the amount of tax reserves a life insurer is able to deduct in arriving at its taxable income. This provision requires a recalculation of the reserves at January 1, 2018, limited to the greater of net surrender value or 92.81% of the reserve method prescribed by the National Association of Insurance Commissioners which covers such contracts as of the date the reserve is determined. Accordingly, the Company reduced their reserves as of January 1, 2018 by \$399 million. The effect of limiting the tax reserve deductible in the current tax computation serves to increase the Company's taxable income by approximately \$50 million per year through 2025. At the Federal statutory rate of 21%, the impact upon current tax expense is approximately a \$2.6 million increase per quarter.

## Segment Operations

## Summary of Segment Earnings

A summary of segment earnings/(losses) for the three months ended March 31, 2018 and 2017 is provided below. The segment earnings/(losses) exclude realized gains and losses on investments, net of taxes.

|                            | Domestic<br>Life<br>Insurance<br>(In thousands) | International<br>Life<br>Insurance | Annuities | All<br>Others | Totals |
|----------------------------|---|------------------------------------|-----------|---------------|--------|
| Segment earnings (losses): |   |                                    |           |               |        |
| Three months ended:        |   |                                    |           |               |        |
| March 31, 2018             | \$396   | 10,072                             | 12,445    | 3,479         | 26,392 |
| March 31, 2017             | \$(156)   | 9,370                              | 7,846     | 4,798         | 21,858 |



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## Domestic Life Insurance Operations

A comparative analysis of results of operations for the Company's domestic life insurance segment is detailed below.

|   | Three Months<br>Ended March 31,<br>2018    2017<br>(In thousands) |               |
|---|---|---------------|
| Premiums and contract revenues:                     |   |               |
| Premiums and contract charges                       | \$9,601   | 8,849         |
| Net investment income                               | 663   | 19,590        |
| Other revenues                                      | —   | 13            |
| <b>Total revenues</b>                               | <b>10,264</b>   | <b>28,452</b> |
| Benefits and expenses:                              |   |               |
| Life and other policy benefits                      | 4,809   | 4,919         |
| Amortization of deferred policy acquisition costs   | 2,675   | 2,789         |
| Universal life insurance contract interest          | (2,861 )  | 16,247        |
| Other operating expenses                            | 5,147   | 4,732         |
| <b>Total benefits and expenses</b>                  | <b>9,770</b>  | <b>28,687</b> |
| Segment earnings (loss) before Federal income taxes | 494   | (235 )        |
| Provision (benefit) for Federal income taxes        | 98  | (79 )         |
| <b>Segment earnings (loss)</b>                      | <b>\$396</b>  | <b>(156 )</b> |

Revenues from domestic life insurance operations include life insurance premiums on traditional type products and contract revenues from universal life insurance. Revenues from traditional products are simply premiums collected, while revenues from universal life insurance consist of policy charges for the cost of insurance, policy administration fees, and surrender charges assessed during the period. A comparative detail of premiums and contract revenues is provided below.

|                                     | Three Months<br>Ended March 31,<br>2018    2017<br>(In thousands) |              |
|-------------------------------------|---|--------------|
| Universal life insurance revenues   | \$10,758  | 9,705        |
| Traditional life insurance premiums | 1,073   | 1,277        |
| Reinsurance premiums                | (2,230 )  | (2,133)      |
| <b>Totals</b>                       | <b>\$9,601</b>  | <b>8,849</b> |

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The company's domestic life insurance in force in terms of policy count has been declining for some time. The pace of new policies issued has lagged the number of policies terminated from death or surrender by roughly a two-to-one rate over the past several years causing a declining level of insurance in force from which contract charge revenue is received. Consequently, the number of domestic life insurance policies in force has declined from 51,600 at December 31, 2016 to 50,200 at December 31, 2017, and to 49,800 at March 31, 2018. Policy lapse rates in the first quarter of 2018 approximated 6.45% compared to 6.00% and 7.45% in 2017 and 2016, respectively.

Universal life insurance revenues are also generated with the issuance of new business based upon amounts per application and percentages of the face amount (volume) of insurance issued. The number of domestic life policies issued in the first three months of 2018 was 25% higher than in the comparable period for 2017 and the volume of insurance issued was 42% more than that in 2017. Universal life insurance revenues also include surrender charge income realized on terminating policies and, in the case of domestic universal life, amortization into income of the premium load on single premium policies which the company began deferring in 2013.

Premiums collected on universal life products are not reflected as revenues in the Company's Condensed Consolidated Statements of Earnings in accordance with GAAP. Actual domestic universal life premiums collected are detailed below.

Three Months  
Ended March  
31,  
2018    2017  
(In thousands)

Universal life insurance:

|                                |          |        |
|--------------------------------|----------|--------|
| First year and single premiums | \$40,358 | 29,464 |
| Renewal premiums               | 4,699    | 5,007  |

|        |          |        |
|--------|----------|--------|
| Totals | \$45,057 | 34,471 |
|--------|----------|--------|

During the past couple of years the company has achieved some success in growing its domestic life insurance business. Sales have been substantially weighted toward single premium policies which do not have much in the way of recurring premium payments. These products are targeting wealth transfer strategies involving the movement of accumulated wealth in alternative investment vehicles, including annuities, into life insurance products. As a result, renewal premium levels have not been exhibiting a corresponding level of increase.

Net investment income for this segment of business, excluding derivative gain/(losses), has been gradually increasing due to the increased new business activity described above (single premium policies) and a higher level of investments needed to support the corresponding growth in policy obligations, especially those for single premium policies. The increase in net investment income has been partially muted by lower investment yields from debt security investment purchases during this time frame. Net investment income also includes the gains and losses on index options purchased to back the index crediting mechanism on fixed-index universal products.

A detail of net investment income for domestic life insurance operations is provided below.

Three Months  
Ended March  
31,  
2018    2017

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(In thousands)

|   |          |        |
|---|----------|--------|
| Net investment income (excluding derivatives) | \$9,497  | 8,932  |
| Derivative gain (loss)                        | (8,834 ) | 10,658 |
| Net investment income                         | \$663    | 19,590 |

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Life and policy benefits for a smaller block of business are subject to variation from quarter to quarter. Claim activity during the first three months of 2018 was in line with historical trends but was higher compared to the same period for 2017. The number of incurred claims during the first three months of 2018 increased 10% compared to the first three months of 2017 while the average net claim amount increased to \$25,600 from \$24,700. The low face amount per claim relative to current issued amounts of insurance per policy reflects the older block of domestic life insurance policies sold which were final expense type products (i.e. purchased to cover funeral costs). The increase in the average net claim amount reflects claims from more recent policy sales (single premium wealth transfer products) which have much higher face amounts of insurance coverage per policy. GAAP reporting requires that claims be recorded after any cash value amounts that have been accumulated in the policies. While domestic claims increased in the first quarter of 2018 compared to 2017, the accumulated cash values on the claims incurred was substantially higher in the current period. The company's overall mortality experience for this segment has been better than pricing assumptions.

As noted previously in the discussion of Results of Operations, the company records true-up adjustments to DPAC balances each period to reflect current policy lapse or termination rates, expense levels and credited rates on policies as compared to anticipated experience with the adjustment reflected in current period amortization expense. To the extent required, the company may also record unlocking adjustments to DPAC balances. The following table identifies the effects of unlocking adjustments on domestic life insurance DPAC balances recorded through amortization expense separate from recurring amortization expense components for the three months ended March 31, 2018 and 2017.

| Amortization of DPAC          | Three<br>Months<br>Ended March<br>31,<br>2018 2017<br>(In<br>thousands) |       |
|-------------------------------|---|-------|
| Unlocking adjustments         | \$—   | —     |
| Other amortization components | 2,675   | 2,789 |
| Totals                        | \$2,675   | 2,789 |

As noted above, in the three months ended March 31, 2018 and 2017, the company made no unlocking adjustments to its DPAC balance for this segment.

As indicated in the discussion concerning net investment income, contract interest expense includes the fluctuations that are the result of the effect upon the embedded derivative for the performance of underlying equity indices associated with fixed-index universal life products. The amounts realized on purchase call options approximate the amounts the company credits to policyholders' policies.

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## International Life Insurance Operations

A comparative analysis of results of operations for the company's international life insurance segment is detailed below.

|   | Three Months<br>Ended March 31,<br>2018      2017<br>(In thousands) |            |
|---|---|------------|
| Premiums and other revenues:                              |   |            |
| Premiums and contract revenues                            | \$27,917  | 31,500     |
| Net investment income                                     | 1,971   | 18,619     |
| Other revenues  | 30  | 26         |
| <br>Total revenues  | <br>29,918  | <br>50,145 |
| Benefits and expenses:                                    |   |            |
| Life and other policy benefits                            | 5,728   | 6,285      |
| Amortization of deferred policy acquisition costs         | 7,380   | 7,406      |
| Universal life insurance and annuity contract interest    | (1,150 )  | 16,382     |
| Other operating expenses                                  | 5,381   | 5,978      |
| <br>Total benefits and expenses                           | <br>17,339  | <br>36,051 |
| <br>Segment earnings (losses) before Federal income taxes | <br>12,579  | <br>14,094 |
| Provision (benefit) for Federal income taxes              | 2,507   | 4,724      |
| <br>Segment earnings (loss)                               | <br>\$10,072  | <br>9,370  |

As with domestic life operations, revenues from the international life insurance segment include both premiums on traditional type products and contract revenues from universal life insurance. A comparative detail of premiums and contract revenues is provided below.

|                                     | Three Months<br>Ended March 31,<br>2018      2017<br>(In thousands) |            |
|-------------------------------------|---|------------|
| Universal life insurance revenues   | \$26,675  | 30,670     |
| Traditional life insurance premiums | 3,072   | 2,944      |
| Reinsurance premiums                | (1,830 )  | (2,114 )   |
| <br>Totals                          | <br>\$27,917  | <br>31,500 |



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In general, universal life revenues and operating earnings are anticipated to emerge with growth in the amount of life insurance in force. The volume of international life insurance in force, primarily universal life, contracted from \$17.9 billion at December 31, 2016 to \$16.6 billion at December 31, 2017 and further decreased to \$16.4 billion at March 31, 2018. Universal life insurance revenues are also generated with the issuance of new business based upon amounts per application and percentages of the face amount (volume) of insurance issued. The number of international life policies issued in the first three months of 2018 was 7% higher than in the first three months of 2017 while the volume of insurance issued was 2% more than that issued in 2017 during the same period. These sales levels, however, were not of enough magnitude to overcome the declining block of insurance in force.

A third component of international universal life revenues include surrender charges assessed upon surrender of contracts by policyholders. In 2015, termination activity levels increased in conjunction with the company's decision to cease accepting application from residents in Brazil and certain other countries resulting in additional surrender charge fee revenues. This activity continued into 2016 and 2017 but has subsided thus far in 2018. The following table illustrates National Western's recent international life termination experience.

|                                   | Amount<br>in \$'s<br>(millions) | Annualized<br>Termination<br>Rate |   |
|-----------------------------------|---------------------------------|-----------------------------------|---|
| Volume In Force Terminations      |                                 |                                   |   |
| Three months ended March 31, 2018 | 400.0                           | 9.2                               | % |
| Year ended December 31, 2017      | 2,309.7                         | 12.2                              | % |
| Year ended December 31, 2016      | 2,340.6                         | 11.6                              | % |
| Year ended December 31, 2015      | 2,659.1                         | 12.4                              | % |
| Year ended December 31, 2014      | 1,825.5                         | 8.4                               | % |
| Year ended December 31, 2013      | 1,838.5                         | 8.6                               | % |

The higher incidence of terminations that occurred was with policies to residents of the countries from which the company discontinued accepting applications. As a result of the higher termination incidence, the company unlocked its DPAC balances for this segment of the business during 2016 to incorporate a greater lapse assumption, among other things.

As noted previously, premiums collected on universal life products are not reflected as revenues in the Company's Condensed Consolidated Statements of Earnings in accordance with GAAP. Actual international universal life premiums collected are detailed below.

|                                | Three Months<br>Ended March<br>31,<br>2018    2017<br>(In thousands) |        |
|--------------------------------|--|--------|
| Universal life insurance:      |  |        |
| First year and single premiums | \$5,338  | 3,888  |
| Renewal premiums               | 20,547   | 20,513 |
| Totals                         | \$25,885   | 24,401 |

National Western's most popular international products have been its fixed-index universal life products in which the policyholder can elect to have the interest rate credited to their policy account values linked in part to the performance of an outside equity index. Included in the totals in the above table are collected premiums for fixed-index universal life products of approximately \$17.4 million and \$15.7 million for the first three months of 2018 and 2017, respectively. The stable level of renewal premiums during 2018 compared to 2017 corresponds with the decrease in termination activity as discussed above.



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As previously noted, net investment income and contract interest include period-to-period changes in fair values pertaining to call options purchased to hedge the interest crediting feature on the fixed-index universal life products. With the growth in the fixed-index universal life block of business, the period-to-period changes in fair values of the underlying options have had an increasingly greater impact on net investment income and universal life contract interest. A detail of net investment income for international life insurance operations is provided below.

|   | Three Months<br>Ended March<br>31,<br>2018 2017<br>(In thousands) |        |
|---|---|--------|
| Net investment income (excluding derivatives) | \$8,435   | 8,605  |
| Derivative gain (loss)                        | (6,464 )  | 10,014 |
| Net investment income                         | \$1,971   | 18,619 |

For liability purposes, the embedded option in the company's policyholder obligations for this feature is bifurcated and reserved for separately. Accordingly, the impact for the embedded derivative component in the equity-index universal life product is reflected in the contract interest expense for each respective period.

Life and policy benefits primarily consist of death claims on policies. National Western's clientèle for international products are generally wealthy individuals with access to U.S. dollars and quality medical care. Consequently, the amounts of coverage purchased have historically tended to be larger amounts. In the year ended December 31, 2017, the average face amount of insurance purchased was \$306,300, and in the first three months of 2018, the average was lower at \$286,700. While life and policy benefit expense for the international life segment reflects the larger policies purchased, mortality due to natural causes is comparable to that in the United States. The company's maximum risk exposure per insured life is capped at \$500,000 through reinsurance. The average international life net claim amount in the first three months of 2018 increased to \$183,000 from \$156,000 in the first three months of 2017 while the number of claims incurred declined 16%.

The company records true-up adjustments to DPAC balances each period to reflect current policy lapse or termination rates, expense levels, and credited rates on policies as compared to anticipated experience as well as unlocking adjustments as necessary. The following table identifies the effects of unlocking adjustments on international life insurance DPAC balances recorded through amortization expense separate from recurring amortization expense components for the three months ended March 31, 2018 and 2017.

| Amortization of DPAC          | Three<br>Months<br>Ended March<br>31,<br>2018 2017<br>(In<br>thousands) |       |
|-------------------------------|---|-------|
| Unlocking adjustments         | \$—   | —     |
| Other amortization components | 7,380   | 7,406 |

Totals \$7,380 7,406

As noted in the table above, in the three months ended March 31, 2018 and 2017, the company made no unlocking adjustments to its DPAC balance for this segment.

As indicated in the discussion concerning net investment income, contract interest expense includes fluctuations that are the result of the effect upon the embedded derivative for the performance of underlying equity indices associated with fixed-index universal life products. The amounts realized on purchased call options generally approximate the amounts National Western credits to policyholders.

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## Annuity Operations

National Western's annuity operations are almost exclusively in the United States. Although some of the company's investment contracts are available to international residents, current sales are small relative to total annuity sales. A comparative analysis of results of operations for National Western's annuity segment is detailed below.

|   | Three Months<br>Ended March 31, |             |
|---|---------------------------------|-------------|
|   | 2018                            | 2017        |
|   | (In thousands)                  |             |
| Premiums and other revenues:                            |                                 |             |
| Premiums and contract revenues                          | \$5,147                         | 5,236       |
| Net investment income                                   | 53,543                          | 126,434     |
| Other revenues  | 19                              | 26          |
| <br>Total revenues                                      | <br>58,709                      | <br>131,696 |
| Benefits and expenses:                                  |                                 |             |
| Life and other policy benefits                          | 10,864                          | 8,553       |
| Amortization of deferred policy acquisition costs       | 22,174                          | 24,017      |
| Annuity contract interest                               | 2,193                           | 77,264      |
| Other operating expenses                                | 7,935                           | 10,060      |
| <br>Total benefits and expenses                         | <br>43,166                      | <br>119,894 |
| <br>Segment earnings (loss) before Federal income taxes | <br>15,543                      | <br>11,802  |
| Provision (benefit) for Federal income taxes            | 3,098                           | 3,956       |
| <br>Segment earnings (loss)                             | <br>\$12,445                    | <br>7,846   |

Premiums and contract charges primarily consist of surrender charge income recognized on terminated policies. The amount of the surrender charge income recognized is determined by the volume of surrendered contracts as well as the duration of each contract at the time of surrender given the pattern of declining surrender charge rates over time that is common to most annuity contracts. The company's lapse rate for annuity contracts in the first three months of 2018 was 7.9% which was higher than the 6.4% rate during the same period in 2017. Annuity lapse rates tend to increase with increases in interest rate levels and as contracts approach the end of their surrender charge period.

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Deposits collected on annuity contracts are not reflected as revenues in the Company's Condensed Consolidated Statements of Earnings, in accordance with GAAP. Actual annuity deposits collected for the three months ended March 31, 2018 and 2017 are detailed below.

|                          | Three Months<br>Ended March 31,<br>2018      2017<br>(In thousands) |         |
|--------------------------|---|---------|
| Fixed-index annuities    | \$108,860   | 144,960 |
| Other deferred annuities | 6,173   | 9,639   |
| Immediate annuities      | 1,251   | 1,893   |
| Totals                   | \$116,284   | 156,492 |

Fixed-index products are more attractive for consumers when interest rate levels remain low and equity markets produce positive returns. Since National Western does not offer variable products or mutual funds, fixed-index products provide an important alternative to the company's existing fixed interest rate annuity products. Fixed-index annuity deposits as a percentage of total annuity deposits were 94% and 93% for the three months ended March 31, 2018 and 2017, respectively. The percentage of fixed-index products to total annuity sales reflects the low interest rate environment and the ongoing bull market in equities.

As a selling inducement, some of the deferred products, including fixed-index annuity products, contain a first year interest bonus ranging from 1% to 7% depending upon the product, in addition to the base first year interest rate. Other products include a premium bonus ranging from 2% to 10% which is credited to the account balance when premiums are applied. These bonus rates are deferred in conjunction with other capitalized policy acquisition costs. The amounts deferred to be amortized over future periods amounted to approximately \$2.8 million and \$4.8 million during the first three months of 2018 and 2017, respectively. Amortization of deferred sales inducements is included as a component of annuity contract interest as described later in this discussion of Annuity Operations.

A detail of net investment income for annuity operations is provided below.

|   | Three Months<br>Ended March 31,<br>2018      2017<br>(In thousands) |         |
|---|---|---------|
| Net investment income (excluding derivatives) | \$82,639  | 85,900  |
| Derivative gain (loss)                        | (29,096 )   | 40,534  |
| Net investment income                         | \$53,543  | 126,434 |

As previously described, derivatives are call options purchased to hedge the equity return component of National Western's fixed-index annuity products with any gains or losses from the sale or expiration of the options, as well as period-to-period changes in fair values, reflected in net investment income. Since the embedded derivative option in the policies is bifurcated when determining the contract reserve liability, the impact of the market value change of index options on asset values generally aligns closely with the movement of the embedded derivative liability such that the net effect upon pretax earnings is generally small (i.e. net realized and unrealized gains/(losses) included in net investment income approximate the change in contract interest associated with the corresponding embedded

derivative liability change). See further discussion below regarding contract interest activity.

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Consistent with the domestic and international life segments, the company records true-up adjustments to DPAC balances each period to reflect current policy lapse or termination rates, expense levels and credited rates on policies as compared to anticipated experience as well as unlocking adjustments as necessary. The following table identifies the effects of unlocking adjustments on annuity DPAC balances recorded through amortization expense separate from recurring amortization expense components for the three months ended March 31, 2018 and 2017.

| Amortization of DPAC          | Three Months<br>Ended March<br>31, |        |
|-------------------------------|------------------------------------|--------|
|                               | 2018                               | 2017   |
|                               | (In thousands)                     |        |
| Unlocking adjustments         | \$—                                | —      |
| Other amortization components | 22,174                             | 24,017 |
| Totals                        | \$22,174                           | 24,017 |

As noted in the table above, in the three months ended March 31, 2018 and 2017, the company made no unlocking adjustments to its DPAC balance for this segment.

Annuity contract interest includes the equity component return associated with the call options purchased to hedge National Western's fixed-index annuities. The detail of fixed-index annuity contract interest as compared to contract interest for all other annuities is as follows:

|   | Three Months<br>Ended March 31, |          |
|---|---------------------------------|----------|
|   | 2018                            | 2017     |
|   | (In thousands)                  |          |
| Fixed-index annuities                   | \$(15,777)                      | 40,886   |
| All other annuities                     | 14,963                          | 34,864   |
| Gross contract interest                 | (814 )                          | 75,750   |
| Bonus interest deferred and capitalized | (2,780 )                        | (4,783 ) |
| Bonus interest amortization             | 5,787                           | 6,297    |
| Total contract interest                 | \$2,193                         | 77,264   |

The fluctuation in reported contract interest amounts for fixed-index annuities is driven by sales levels, the level of the business in force and the effect of positive or negative market returns of option values on projected interest credits. As noted above in the net investment income discussion, the amounts shown for contract interest for fixed-index annuities generally align with the derivative gains/(losses) included in net investment income as the impact of the market change of index options on asset values align closely with the movement of the embedded derivative liability held for these products. As noted in the discussion in the Consolidated Operations section, positive returns on expiring option contracts during the first three months of 2018 led to collection of asset management fees by National Western which are subtracted from contract interest credited to policyholders. This serves to lessen the increase in contract interest expense relative to the option gains reported in the Company's net investment income. Asset management fees collected during the three months ended March 31, 2018 were \$6.1 million compared to \$6.6 million in the

corresponding period of 2017.

Annuity contract interest includes true-up adjustments for the deferred sales inducement balance which are done each period similar to that done with respect to DPAC balances with the adjustment reflected in current period contract interest expense. To the extent required, the company may also record unlocking adjustments to deferred sales inducement balances in conjunction with DPAC balance unlockings. The company made no unlocking adjustments in the first quarter of 2018 or 2017.

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## Other Operations

The Company's primary business encompasses its domestic and international life insurance operations and its annuity operations. However, the Company also has small real estate, nursing home, and other investment operations through its wholly owned subsidiaries. Nursing home operations generated \$0.4 million and \$0.1 million of pre-tax operating earnings in the first three months of 2018 and 2017, respectively. Amounts for these periods also include the results of BP III which commenced operations at the beginning of 2017. BP III incurred pre-tax losses of \$(0.6) million and \$(0.4) million in the quarters ended March 31, 2018 and 2017, respectively.

The remaining pre-tax earnings of \$4.6 million and \$7.5 million in Other Operations during the three month periods represent investment income from real estate, municipal bonds, and common and preferred equities held in subsidiary company portfolios principally for tax-advantage purposes. The higher investment income during the first three months of 2017 includes payoffs on certain loans having profit participation provisions in the agreements with borrowers.

## INVESTMENTS

## General

The Company's investment philosophy emphasizes the careful handling of policyowners' and stockholders' funds to achieve security of principal, to obtain the maximum possible yield while maintaining security of principal, and to maintain liquidity in a measure consistent with current and long-term requirements of the Company.

The Company's overall conservative investment philosophy is reflected in the allocation of its investments, which is detailed below. The Company emphasizes investment grade debt securities.

|                            | March 31, 2018 |       | December 31, 2017 |       |
|----------------------------|----------------|-------|-------------------|-------|
|                            | Carrying       | %     | Carrying          | %     |
|                            | Value          |       | Value             |       |
|                            | (In            |       | (In               |       |
|                            | thousands)     |       | thousands)        |       |
| Debt securities            | \$10,364,989   | 95.9  | \$10,288,155      | 95.2  |
| Mortgage loans             | 204,948        | 1.9   | 208,249           | 1.9   |
| Policy loans               | 55,515         | 0.5   | 56,405            | 0.5   |
| Derivatives, index options | 116,356        | 1.1   | 194,731           | 1.8   |
| Real estate                | 37,224         | 0.3   | 37,420            | 0.3   |
| Equity securities          | 18,173         | 0.2   | 18,478            | 0.2   |
| Other                      | 14,509         | 0.1   | 14,408            | 0.1   |
| Totals                     | \$10,811,714   | 100.0 | \$10,817,846      | 100.0 |



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## Debt Securities

The Company maintains a diversified portfolio which consists mostly of corporate, mortgage-backed, and public utility fixed income securities. Investments in mortgage-backed securities primarily include U.S. Government agency pass-through securities and collateralized mortgage obligations ("CMO"). The Company's investment guidelines prescribe limitations by type of security as a percent of the total investment portfolio and all holdings were within these threshold limits. As of March 31, 2018 and December 31, 2017, the Company's debt securities portfolio consisted of the following classes of securities:

|  | March 31, 2018 |       | December 31, 2017 |       |
|--|----------------|-------|-------------------|-------|
|  | Carrying Value | %     | Carrying Value    | %     |
|  | (In thousands) |       | (In thousands)    |       |
| Corporate                              | \$7,481,345    | 72.2  | \$7,343,473       | 71.4  |
| Residential mortgage-backed securities | 1,272,374      | 12.3  | 1,301,877         | 12.7  |
| Public utilities                       | 1,123,901      | 10.8  | 1,149,651         | 11.2  |
| State and political subdivisions       | 463,257        | 4.5   | 467,983           | 4.5   |
| Asset-backed securities                | 12,719         | 0.1   | 13,544            | 0.1   |
| Foreign governments                    | 10,055         | 0.1   | 10,290            | 0.1   |
| U.S. Treasury                          | 1,338          | —     | 1,337             | —     |
| Totals                                 | \$10,364,989   | 100.0 | \$10,288,155      | 100.0 |

Substantially all of the Company's investable cash flows are directed toward the purchase of long-term debt securities. The Company's investment policy calls for investing in debt securities that are investment grade, meet quality and yield objectives, and provide adequate liquidity for obligations to policyholders. Debt securities with intermediate maturities are targeted by the Company as they more closely match the intermediate nature of the Company's policy liabilities and provide an appropriate strategy for managing cash flows. Long-term debt securities purchased to fund insurance company operations are summarized below.

|                        | Three Months Ended March 31, 2018 | Year Ended December 31, 2017 |
|------------------------|-----------------------------------|------------------------------|
|                        | (\$ In thousands)                 |                              |
| Cost of acquisitions   | \$276,360                         | \$840,861                    |
| Average credit quality | BBB+                              | BBB+                         |
| Effective annual yield | 3.83 %                            | 3.57 %                       |
| Spread to treasuries   | 1.06 %                            | 1.19 %                       |
| Effective duration     | 8.2 years                         | 8.1 years                    |

Rating agencies generally view mortgage-backed securities as having additional risk for insurers holding interest sensitive liabilities given the potential for asset/liability disintermediation. Consequently, the Company holds predominantly agency mortgage-backed securities. Because mortgage-backed securities are subject to prepayment and extension risk, the Company has substantially reduced these risks by investing in collateralized mortgage obligations

("CMO"), which have more predictable cash flow patterns than pass-through securities. These securities, known as planned amortization class I ("PAC I"), very accurately defined maturity ("VADM") and sequential tranches are designed to amortize in a more predictable manner than other CMO classes or pass-throughs. The Company does not purchase tranches, such as PAC II and support tranches, that subject the portfolio to greater than average prepayment risk. Using this strategy, the Company can more effectively manage and reduce prepayment and extension risks, thereby helping to maintain the appropriate matching of the Company's assets and liabilities.

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In addition to diversification, an important aspect of the Company's investment approach is managing the credit quality of its investment in debt securities. Thorough credit analysis is performed on potential corporate investments including examination of a company's credit and industry outlook, financial ratios and trends, and event risks. This emphasis is reflected in the high average credit rating of the Company's debt securities portfolio with 98.8%, as of March 31, 2018, held in investment grade securities. In the table below, investments in debt securities are classified according to credit ratings by nationally recognized statistical rating organizations.

|                                     | March 31, 2018                         |       | December 31, 2017                      |       |
|-------------------------------------|--|-------|--|-------|
|                                     | Carrying<br>Value<br>(In<br>thousands) | %     | Carrying<br>Value<br>(In<br>thousands) | %     |
| AAA                                 | \$ 107,272                             | 1.0   | \$ 114,873                             | 1.1   |
| AA                                  | 2,107,625                              | 20.3  | 2,106,243                              | 20.5  |
| A                                   | 3,221,546                              | 31.1  | 3,199,169                              | 31.1  |
| BBB                                 | 4,809,254                              | 46.4  | 4,766,525                              | 46.3  |
| BB and other below investment grade | 119,292                                | 1.2   | 101,345                                | 1.0   |
| Totals                              | \$ 10,364,989                          | 100.0 | \$ 10,288,155                          | 100.0 |

The Company's investment guidelines do not allow for the purchase of below investment grade securities. The investments held in debt securities below investment grade are the result of subsequent downgrades of the securities. These holdings are further summarized below.

Below Investment Grade Debt  
Securities

|  | Amortized<br>Cost | Carrying<br>Value | Fair<br>Value | % of<br>Invested<br>Assets |
|--|-------------------|-------------------|---------------|----------------------------|
|--|-------------------|-------------------|---------------|----------------------------|

(In thousands, except percentages)

|                |            |         |         |       |
|----------------|------------|---------|---------|-------|
| March 31, 2018 | \$ 125,340 | 119,292 | 118,476 | 1.1 % |
|----------------|------------|---------|---------|-------|

|                   |            |         |         |       |
|-------------------|------------|---------|---------|-------|
| December 31, 2017 | \$ 100,992 | 101,345 | 101,140 | 0.9 % |
|-------------------|------------|---------|---------|-------|

The Company's percentage of below investment grade securities as of March 31, 2018 compared with the percentage at December 31, 2017 increased due to downgrades of several credit issuers during the period. The Company's holdings of below investment grade securities are relatively small and as a percentage of total invested assets low compared to industry averages.

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Holdings in below investment grade securities by category as of March 31, 2018 are summarized below, including their comparable fair value as of December 31, 2017 for those debt securities rated below investment grade at March 31, 2018. The Company continually monitors developments in these industries for issues that may affect security valuation.

| Industry Category           | Below Investment Grade Debt Securities |                |                |                   |
|-----------------------------|--|----------------|----------------|-------------------|
|                             | Amortized Cost                         | Carrying Value | Fair Value     | Fair Value        |
|                             | March 31, 2018                         | March 31, 2018 | March 31, 2018 | December 31, 2017 |
|                             | (In thousands)                         |                |                |                   |
| Asset-backed securities     | \$5,601                                | 5,751          | 5,859          | 5,859             |
| Residential mortgage-backed | 1,104                                  | 1,067          | 1,068          | 1,066             |
| Oil & gas                   | 35,053                                 | 32,500         | 32,500         | 34,061            |
| Manufacturing               | 57,307                                 | 53,471         | 52,546         | 54,002            |
| Other                       | 26,275                                 | 26,503         | 26,503         | 27,186            |
| Totals                      | \$125,340                              | 119,292        | 118,476        | 122,174           |

The Company closely monitors its below investment grade holdings by reviewing investment performance indicators, including information such as issuer operating performance, debt ratings, analyst reports and other economic factors that may affect these specific investments. While additional losses are not currently anticipated, based on the existing status and condition of these securities, continued credit deterioration of some securities or the markets in general is possible, which may result in further write-downs.

Generally accepted accounting principles require that investments in debt securities be written down to fair value when declines in value are judged to be other-than-temporary. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price methodology). Refer to Note 10, Fair Values of Financial Instruments, of the accompanying Condensed Consolidated Financial Statements for further discussion.

During the three months ended March 31, 2018 the Company recorded no other-than-temporary impairment credit related write-downs on debt securities. See Note 9, Investments, of the accompanying Condensed Consolidated Financial Statements for further discussion. Since the Company's adoption of the GAAP guidance on the recognition and accounting for other-than-temporary impairments due to credit loss versus non-credit loss, the Company has recognized a total of \$0.6 million of other-than-temporary impairments of which \$0.6 million was deemed credit related and recognized as realized investment losses in earnings, and \$0.0 million, net of amortization, was deemed a non-credit related impairment and recognized in other comprehensive income.

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The Company is required to classify its investments in debt securities into one of three categories: (a) trading securities; (b) securities available for sale; or (c) securities held to maturity. The Company purchases securities with the intent to hold to maturity and accordingly does not maintain a portfolio of trading securities. Of the remaining two categories, available for sale and held to maturity, the Company makes a determination on categorization based on various factors including the type and quality of the particular security and how it will be incorporated into the Company's overall asset/liability management strategy. As shown in the table below, 29.7% of the Company's total debt securities, based on fair values, were classified as securities available for sale at March 31, 2018. These holdings in available for sale provide flexibility to the Company to react to market opportunities and conditions and to practice active management within the portfolio to provide adequate liquidity to meet policyholder obligations and other cash needs.

|                                | March 31, 2018 |                |                           |
|--------------------------------|----------------|----------------|---------------------------|
|                                | Fair Value     | Amortized Cost | Unrealized Gains (Losses) |
|                                | (In thousands) |                |                           |
| Securities held to maturity:   |                |                |                           |
| Debt securities                | \$7,302,034    | 7,280,200      | 21,834                    |
| Securities available for sale: |                |                |                           |
| Debt securities                | 3,084,789      | 3,087,827      | (3,038 )                  |
| Totals                         | \$10,386,823   | 10,368,027     | 18,796                    |

## Asset-Backed Securities

The Company holds approximately \$12.7 million in asset-backed securities as of March 31, 2018. This portfolio includes \$0.9 million of manufactured housing bonds and \$12.5 million of home equity loans (also referred to as subprime securities). The Company does not have any holdings in collateralized bond obligations ("CBO"s), collateralized debt obligations ("CDO"s), or collateralized loan obligations ("CLO"s). Principal risks in holding asset-backed securities are structural, credit, and capital market risks. Structural risks include the securities' priority in the issuer's capital structure, the adequacy of and ability to realize proceeds from collateral and the potential for prepayments. Credit risks include corporate credit risks or consumer credit risks for financing such as subprime mortgages. Capital market risks include the general level of interest rates and the liquidity for these securities in the marketplace.

The Company's exposure to the subprime sector is limited to investments in the senior tranches of subprime residential mortgage loans. The subprime sector is generally categorized under the asset-backed sector. This sector lends to borrowers who do not qualify for prime interest rates due to poor or insufficient credit history. The slowing housing market, rising interest rates, and relaxed underwriting standards for loans originated after 2005 resulted in higher delinquency rates and losses beginning in 2007. These events caused illiquidity in the market and volatility in the market prices of subprime securities. The housing market subsequently stabilized and an improvement in the prices of subprime securities occurred as the bond market regained more liquidity. All of the loans classified as subprime in the Company's portfolio as of March 31, 2018 were underwritten prior to 2005 as noted in the table below.

|                             | March 31, 2018 |            | December 31, 2017 |            |
|-----------------------------|----------------|------------|-------------------|------------|
| Investment Origination Year | Carrying Value | Fair Value | Carrying Value    | Fair Value |
|                             | (In thousands) |            |                   |            |

|           |          |        |        |        |  |
|-----------|----------|--------|--------|--------|--|
| Subprime: |          |        |        |        |  |
| 1998      | \$1,426  | 1,483  | 1,508  | 1,565  |  |
| 2003      | —        | —      | —      | —      |  |
| 2004      | 10,366   | 10,357 | 10,999 | 10,995 |  |
| Total     | \$11,792 | 11,840 | 12,507 | 12,560 |  |

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During the first quarter of 2018, the Company's exposure to the subprime sector decreased due to principal repayments. As of March 31, 2018, the Company held seven subprime issues of which two was rated A, one were rated BBB, one was rated BB, one was rated B, one was rated CCC, and one was not rated.

## Mortgage Loans and Real Estate

The Company originates loans on high quality, income-producing properties such as shopping centers, freestanding retail stores, office buildings, industrial and sales or service facilities, selected apartment buildings, motels, and health care facilities. The location of these properties is typically in major metropolitan areas that offer a potential for property value appreciation. Credit and default risk is minimized through strict underwriting guidelines and diversification of underlying property types and geographic locations. In addition to being secured by the property, mortgage loans with leases on the underlying property are often guaranteed by the lease payments and also by the borrower. This approach has proved over time to result in quality mortgage loans with few defaults. Mortgage loan interest income is recognized on an accrual basis with any premium or discount amortized over the life of the loan. Prepayment and late fees are recorded on the date of collection.

The Company targets a minimum specified yield on mortgage loan investments determined by reference to currently available debt security instrument yields plus a desired amount of incremental basis points. During the past several years, the low interest rate environment has resulted in fewer loan opportunities being available that meet the Company's required rate of return. Mortgage loans originated by the Company totaled \$59.4 million for the year ended December 31, 2017 and \$0.0 million for the three months ended March 31, 2018. Principal repayments on mortgage loans for the three months ended March 31, 2018 were \$3.4 million.

Loans in foreclosure, loans considered impaired or loans past due 90 days or more are placed on a non-accrual status. If a mortgage loan is determined to be on non-accrual status, the mortgage loan does not accrue any revenue into the Condensed Consolidated Statements of Earnings. 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. The Company currently has no loans past due 90 days which are accruing interest.

The Company held net investments in mortgage loans, after allowances for possible losses, totaling \$204.9 million and \$208.2 million at March 31, 2018 and December 31, 2017, respectively. The diversification of the portfolio by geographic region and by property type was as follows:

|                                      | March 31, 2018 |        | December 31, 2017 |        |  |
|--------------------------------------|----------------|--------|-------------------|--------|--|
|                                      | Amount         | %      | Amount            | %      |  |
|                                      | (In thousands) |        | (In thousands)    |        |  |
| Mortgage Loans by Geographic Region: |                |        |                   |        |  |
| West South Central                   | \$ 117,043     | 56.9 % | \$ 119,794        | 57.3 % |  |
| East North Central                   | 30,676         | 14.9   | 30,876            | 14.8   |  |
| East South Central                   | 14,163         | 6.9    | 14,273            | 6.8    |  |
| South Atlantic                       | 19,034         | 9.2    | 19,155            | 9.2    |  |
| West North Central                   | 12,929         | 6.3    | 12,967            | 6.2    |  |
| Pacific                              | 7,963          | 3.9    | 8,014             | 3.8    |  |
| Middle Atlantic                      | 2,196          | 1.1    | 2,215             | 1.1    |  |
| Mountain                             | 1,594          | 0.8    | 1,605             | 0.8    |  |
| New England                          | —              | —      | —                 | —      |  |

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|                               |           |        |           |        |
|-------------------------------|-----------|--------|-----------|--------|
| Gross balance                 | 205,598   | 100.0  | 208,899   | 100.0  |
| Allowance for possible losses | (650 )    | (0.3 ) | (650 )    | (0.3 ) |
| Totals                        | \$204,948 | 99.7   | \$208,249 | 99.7   |

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|                                  | March 31, 2018              |        | December 31, 2017           |        |
|----------------------------------|-----------------------------|--------|-----------------------------|--------|
|                                  | Amount<br>(In<br>thousands) | %      | Amount<br>(In<br>thousands) | %      |
| Mortgage Loans by Property Type: |                             |        |                             |        |
| Retail                           | \$85,233                    | 41.5   | \$87,805                    | 42.0   |
| Office                           | 73,855                      | 35.9   | 74,301                      | 35.6   |
| Hotel/Motel                      | 13,718                      | 6.7    | 13,782                      | 6.6    |
| Land/Lots                        | 10,492                      | 5.1    | 10,563                      | 5.1    |
| All other                        | 22,300                      | 10.8   | 22,448                      | 10.7   |
| Gross balance                    | 205,598                     | 100.0  | 208,899                     | 100.0  |
| Allowance for possible losses    | (650 )                      | (0.3 ) | (650 )                      | (0.3 ) |
| Totals                           | \$204,948                   | 99.7   | \$208,249                   | 99.7   |

The Company's direct investments in real estate are not a significant portion of its total investment portfolio and consist primarily of income-producing properties which are being operated by a wholly owned subsidiary of National Western. The Company's real estate investments totaled approximately \$37.2 million and \$37.4 million at March 31, 2018 and December 31, 2017, respectively.

The Company recognized operating income of approximately \$0.5 million and \$0.7 million on real estate properties in the first three months of 2018 and 2017, respectively. The Company monitors the conditions and market values of these properties on a regular basis and makes repairs and capital improvements to keep the properties in good condition.

#### Market Risk

Market risk is the risk of change in market values of financial instruments due to changes in interest rates, currency exchange rates, commodity prices, or equity prices. The most significant market risk exposure for National Western is interest rate risk. Substantial and sustained increases and decreases in market interest rates can affect the profitability of insurance products and fair value of investments. The yield realized on new investments generally increases or decreases in direct relationship with interest rate changes. The fair values of fixed income debt securities correlate to external market interest rate conditions as market values typically increase when market interest rates decline and decrease when market interest rates rise. However, market values may fluctuate for other reasons, such as changing economic conditions, market dislocations or increasing event-risk concerns.

#### Interest Rate Risk

A gradual increase in interest rates from current levels would generally be a positive development for the Company. Rate increases would be expected to provide incremental net investment income, produce increased sales of fixed rate products, and limit the potential erosion of the Company's interest rate spread on products due to minimum guaranteed crediting rates in products. Alternatively, a rise in interest rates would reduce the fair value of the Company's investment portfolio and if long-term rates rise dramatically within a relatively short time period the Company could be exposed to disintermediation risk. Disintermediation risk is the risk that policyholders will surrender their policies in a rising interest rate environment forcing the Company to liquidate assets when they are in an unrealized loss position.

A decline in interest rates could cause certain mortgage-backed securities in the Company's portfolio to be more likely to pay down or prepay. In this situation, the Company typically will be unable to reinvest the proceeds at comparable yields. Lower interest rates will likely also cause lower net investment income, subject the Company to reinvestment rate risks, and possibly reduce profitability through reduced interest rate margins associated with products with minimum guaranteed crediting rates. Alternatively, the fair value of the Company's investment portfolio will increase when interest rates decline.

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The correlation between fair values and interest rates for debt securities is reflected in the tables below.

|   | March 31,<br>2018                 | December 31,<br>2017 |    |  |
|---|-----------------------------------|----------------------|----|--|
|   | (In thousands except percentages) |                      |    |  |
| Debt securities - fair value  | \$ 10,386,823                     | 10,475,235           |    |  |
| Debt securities - amortized cost  | \$ 10,368,027                     | 10,211,534           |    |  |
| Fair value as a percentage of amortized cost                              | 100.18                            | % 102.58             | %  |  |
| Net unrealized gain balance   | \$ 18,796                         | 263,701              |    |  |
| Ten-year U.S. Treasury bond – (decrease) increase in yield for the period | 0.33                              | % (0.04              | )% |  |

|                                    | Net Unrealized Gain Balance |                               |  |
|------------------------------------|-----------------------------|-------------------------------|--|
|                                    | At<br>March<br>31, 2018     | At<br>December<br>31,<br>2017 | Year-to-date<br>Change in<br>Unrealized<br>Balance |
| Debt securities held to maturity   | \$ 21,834                   | 187,080                       | (165,246 )   |
| Debt securities available for sale | (3,038 )                    | 76,621                        | (79,659 )  |
| Totals                             | \$ 18,796                   | 263,701                       | (244,905 )   |

Changes in interest rates typically have a sizable effect on the fair values of the Company's debt securities. The market interest rate of the ten-year U.S. Treasury bond increased approximately 33 basis points from 2.41% at year-end 2017 to 2.74% by the end of the first three months of 2018. Therefore the decrease in the unrealized gain position of \$244.9 million was largely the result of the increase in interest rates. Given that the majority of the Company's debt securities are classified as held to maturity, which are recorded at amortized cost, changes in fair values have a lesser effect on the Company's Condensed Consolidated Balance Sheet.

The Company manages interest rate risk principally through ongoing cash flow testing as required for insurance regulatory purposes. Computer models are used to perform cash flow testing under various commonly used stress test interest rate scenarios to determine if existing assets would be sufficient to meet projected liability outflows. Sensitivity analysis allows the Company to measure the potential gain or loss in fair value of its interest-sensitive instruments and to protect its economic value and achieve a predictable spread between what is earned on invested assets and what is paid on liabilities. The Company seeks to minimize the impact of interest risk through surrender charges that are imposed to discourage policy surrenders. Interest rate changes can be anticipated in the computer models and the corresponding risk addressed by management actions affecting asset and liability instruments. However, potential changes in the values of financial instruments indicated by hypothetical interest rate changes will likely be different from actual changes experienced, and the differences could be significant.

The Company has the ability to adjust interest rates, participation rates, and asset management fees and caps, as applicable, in response to changes in investment portfolio yields for a substantial portion of its business in force. The ability to adjust these rates is subject to competitive forces in the market for the Company's products. Surrender rates could increase and new sales could be negatively affected if crediting rates are not competitive with the rates on competing products offered by other insurance companies and financial service entities. The Company designs its products with features encouraging persistency. Interest sensitive life and annuity products have surrender and withdrawal penalty provisions. Typically, surrender charge rates gradually decrease each year the contract is in force.

The Company performed detailed sensitivity analysis as of December 31, 2017, for its interest rate-sensitive assets and liabilities. The changes in market values of the Company's debt securities in the first three months of 2018 were reasonable given the expected range of results of this analysis.

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### Credit Risk

The Company is exposed to credit risk through counterparties and within its investment portfolio. Credit risk relates to the uncertainty associated with an obligor's continued ability to make timely payments of principal and interest in accordance with the contractual terms of an instrument or contract. As previously discussed, the Company manages credit risk through established investment credit policies and guidelines which address the quality of creditors and counterparties, concentration limits, diversification practices and acceptable risk levels. These policies and guidelines are regularly reviewed and approved by senior management and National Western's Board of Directors.

In connection with the Company's use of call options to hedge the equity return component of its fixed-indexed annuity and life products, the Company is exposed to the risk that a counterparty fails to perform under terms of the option contract. The Company purchases one-year option contracts from multiple counterparties and evaluates the creditworthiness of all counterparties prior to the purchase of the contracts. For consideration in contracting with a counterparty the rating required by the Company is a credit rating of "A" or higher. Accordingly, all options are purchased from nationally recognized financial institutions with a demonstrated performance for honoring their financial obligations and possessing substantial financial capacity. In addition, each counterparty is required to execute a credit support agreement obligating the counterparty to provide collateral to the Company when the fair value of the Company's exposure to the counterparty exceeds specified amounts. Counterparty credit ratings and credit exposure are monitored continuously by National Western's Investment Department with adjustments to collateral levels managed as incurred under the credit support agreements.

The Company is also exposed to credit spread risk related to market prices of investment securities and cash flows associated with changes in credit spreads. Credit spread tightening will reduce net investment income associated with new purchases of fixed debt securities and will increase the fair value of the investment portfolio. Credit spread widening will reduce the fair value of the investment portfolio and will increase net investment income on new purchases.

## LIQUIDITY AND CAPITAL RESOURCES

### Liquidity

Liquidity requirements are met primarily by funds provided from operations. Premium deposits and annuity considerations, investment income, and investment maturities and prepayments are the primary sources of funds while investment purchases, policy benefits in the form of claims, and payments to policyholders and contract holders in connection with surrenders and withdrawals as well as operating expenses are the primary uses of funds. To ensure the Company will be able to pay future commitments, the funds received as premium payments and deposits are invested in high quality investments, primarily fixed income securities. Funds are invested with the intent that the income from investments, plus proceeds from maturities, will meet the ongoing cash flow needs of the Company. The approach of matching asset and liability durations and yields requires an appropriate mix of investments. Although the Company historically has not been put in the position of having to liquidate invested assets to provide cash flow, its investments consist primarily of marketable debt securities that could be readily converted to cash for liquidity needs. The Company ("National Western") may also borrow up to \$40 million on its bank line of credit for short-term cash needs. There were no borrowings outstanding under the line of credit at March 31, 2018.

A primary liquidity concern for life insurers is the risk of an extraordinary level of early policyholder withdrawals, particularly with respect to annuity products whose funds tend to move more rapidly with interest rate changes. The Company includes provisions within its annuity and universal life insurance policies, such as surrender and market value adjustments, that help limit and discourage early withdrawals.



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The actual amounts paid by product line in connection with surrenders and withdrawals for the three months ended March 31, for each respective year, are noted in the table below.

|                  | Three Months<br>Ended March 31, |         |
|------------------|---------------------------------|---------|
|                  | 2018                            | 2017    |
|                  | (In thousands)                  |         |
| Product Line:    |                                 |         |
| Traditional Life | \$635                           | 1,311   |
| Universal Life   | 25,111                          | 38,859  |
| Annuities        | 147,086                         | 121,664 |
| Total            | \$172,832                       | 161,834 |

The above contractual withdrawals, as well as the level of surrenders experienced, were generally consistent with the Company's assumptions in asset/liability management, and the associated cash outflows did not have an adverse impact on overall liquidity. Individual life insurance policies are typically less susceptible to withdrawal than annuity reserves and deposit liabilities because policyholders may need to undergo a new underwriting process in order to obtain a new insurance policy elsewhere. Cash flow projections and tests under various market interest rate scenarios and assumptions are performed to assist in evaluating liquidity needs and adequacy. The Company currently expects available liquidity sources and future cash flows to be more than adequate to meet the demand for funds.

Cash flows from the Company's insurance operations have historically been sufficient to meet current needs. Cash flows from operating activities were \$72.9 million and \$92.4 million for the three months ended March 31, 2018 and 2017, respectively. The Company also has significant cash flows from both scheduled and unscheduled investment security maturities, redemptions, and prepayments. These cash flows totaled \$120.3 million and \$191.1 million for the three months ended March 31, 2018 and 2017, respectively. Operating and investing activity cash flow items could be reduced if interest rates rise at an accelerated rate in the future. Net cash inflows/(outflows) from the Company's universal life and investment annuity deposit product operations totaled \$(98.1) million and \$(50.0) million during the three months ended March 31, 2018 and 2017, respectively, reflecting the recent slowdown in annuity sales.

#### Capital Resources

The Company relies on stockholders' equity for its capital resources as there is no long-term debt outstanding and the Company does not anticipate the need for any long-term debt in the near future. As of March 31, 2018, the Company had no commitments beyond its normal operating and investment activities.

#### OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

It is Company practice to not enter into off-balance sheet arrangements or to issue guarantees to third parties, other than in the normal course of issuing insurance contracts. Commitments related to insurance products sold are reflected as liabilities for future policy benefits. Insurance contracts guarantee certain performances by National Western.

Insurance reserves are the means by which life insurance companies determine the liabilities that must be established to assure that future policy benefits are provided for and can be paid. These reserves are required by law and based upon standard actuarial methodologies to ensure fulfillment of commitments guaranteed to policyholders and their beneficiaries, even though the obligations may not be due for many years. Refer to Note 1 in the Notes to the

Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 for a discussion of reserving methods.



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The table below summarizes future estimated cash payments under existing contractual obligations.

|  | Payment Due by Period |                  |                  |                  |                   |
|--|-----------------------|------------------|------------------|------------------|-------------------|
|  | Total                 | Less Than 1 Year | 1 - 3 Years      | 3 - 5 Years      | More Than 5 Years |
|  | (In thousands)        |                  |                  |                  |                   |
| Loan commitments   | \$ 17,300             | 17,300           | —                | —                | —                 |
| Lease obligations  | 1,645                 | 260              | 1,039            | 346              | —                 |
| Life claims payable (1)  | 68,168                | 68,168           | —                | —                | —                 |
| Other long-term reserve liabilities reflected on the balance sheet (2) | 10,727,979            | 986,325          | 1,869,278        | 1,648,542        | 6,223,834         |
| <b>Total</b>   | <b>\$ 10,815,092</b>  | <b>1,072,053</b> | <b>1,870,317</b> | <b>1,648,888</b> | <b>6,223,834</b>  |

(1) Life claims payable include benefit and claim liabilities for which the Company believes the amount and timing of the payment is essentially fixed and determinable. Such amounts generally relate to incurred and reported death and critical illness claims including an estimate of claims incurred but not reported.

(2) Other long-term liabilities include estimated life and annuity obligations related to death claims, policy surrenders, policy withdrawals, maturities and annuity payments based on mortality, lapse, annuitization, and withdrawal assumptions consistent with the Company's historical experience. These estimated life and annuity obligations are undiscounted projected cash outflows that assume interest crediting and market growth consistent with assumptions used in amortizing deferred acquisition costs. They do not include any offsets for future premiums or deposits. Other long-term liabilities also include determinable payout patterns related to immediate annuities. Due to the significance of the assumptions used, the actual cash outflows will differ both in amount and timing, possibly materially, from these estimates.

Subsequent to acquiring a commercial office building at the end of 2016 through its wholly owned subsidiary Braker P III, LLC ("BP III"), the Company has entered into lease agreements with various tenants for available space not occupied by the Company. Total revenues recorded pertaining to these leases for the three month periods ended March 31, 2018 and 2017 amounted to \$0.6 million and \$0.3 million, respectively. Under their respective terms these leases expire at various dates from 2019 through 2025.

The table below summarizes future estimated cash receipts under all existing lease agreements, including those in addition to the BP III lease agreements discussed above.

|  | Estimated Cash Receipts by Period |                  |             |             |                   |
|--|-----------------------------------|------------------|-------------|-------------|-------------------|
|  | Total                             | Less Than 1 Year | 1 - 3 Years | 3 - 5 Years | More Than 5 Years |
|  | (In thousands)                    |                  |             |             |                   |

Real estate revenue \$43,610 5,197 13,314 9,820 15,279

## CHANGES IN ACCOUNTING PRINCIPLES AND CRITICAL ACCOUNTING POLICIES

### Changes in Accounting Principles

As described in Note 2, in the first quarter of 2018 the Company implemented ASU 2016-01, Recognition and Measurement of Financial Assets and Liabilities. Equity securities are now separately disclosed on the balance sheet and the change in the fair value runs through net investment income. This prospective adjustment resulted in a reclassification of \$4.4 million, net of tax, from other comprehensive income to retained earnings as a change in accounting. There were no other changes in accounting principles during the periods reported in this Form 10-Q.

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REGULATORY AND OTHER ISSUES

Statutory Accounting Practices

Regulations that affect the Company and the insurance industry are often the result of actions taken by the National Association of Insurance Commissioners ("NAIC"). The NAIC routinely publishes new regulations as model acts or laws which states subsequently adopt as part of their insurance regulations. Currently, the Company is not aware of any NAIC regulatory matter material to its operations or reporting of financial results.

Risk-Based Capital Requirements

The NAIC established risk-based capital ("RBC") requirements to help state regulators monitor the financial strength and stability of life insurers by identifying those companies that may be inadequately capitalized. Under the NAIC's requirements, each insurer must maintain its total capital above a calculated threshold or take corrective measures to achieve the threshold. The threshold of adequate capital is based on a formula that takes into account the amount of risk each company faces on its products and investments. The RBC formula takes into consideration four major areas of risk which are: (i) asset risk which primarily focuses on the quality of investments; (ii) insurance risk which encompasses mortality and morbidity risk; (iii) interest rate risk which involves asset/liability matching issues; and (iv) other business risks. Statutory laws prohibit public dissemination of certain RBC information. However, current statutory capital and surplus is significantly in excess of the threshold RBC requirements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES  
ABOUT MARKET RISK

This information is included in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, in the Investments section.

ITEM 4. CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing, and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

There were no changes in the Company's internal controls over financial reporting, as defined in Rules 13a-15(f) and 15d-15(e) under the Exchange Act, during the quarter ended March 31, 2018 that materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting. Internal controls over financial reporting change as the Company modifies or enhances its systems and processes to meet business needs. Any significant changes in controls are evaluated prior to implementation to help ensure continued effectiveness of internal controls and the control environment.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 8(A) "Legal Proceedings" of the accompanying Condensed Consolidated Financial Statements included in this Form 10-Q.

ITEM 1A. RISK FACTORS

There have been no substantial changes relative to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

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## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Effective August 22, 2008, National Western adopted and implemented a limited stock buy-back program associated with the company's 2008 Incentive Plan which provides Option Holders the additional alternative of selling shares acquired through the exercise of options directly back to the company. This program succeeded a similar buy-back program implemented March 10, 2006 associated with the company's 1995 Stock Option and Incentive Plan. Option Holders may elect to sell such acquired shares back to the company at any time within ninety (90) days after the exercise of options at the prevailing market price as of the date of notice of election. These plans and programs were assumed by National Western Life Group, Inc. from National Western in 2015 pursuant to the terms of the holding company reorganization.

Purchased shares are reported in the Company's Condensed Consolidated Financial Statements as authorized and unissued. The following table sets forth the Company's repurchase of its Class A common shares from Option Holders for the quarter ended March 31, 2018.

| Period                                     | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May yet Be Purchased Under the Plans or Programs |
|--|----------------------------------|------------------------------|--|--|
| January 1, 2018 through January 31, 2018   | —                                | —                            | N/A  | N/A  |
| February 1, 2018 through February 28, 2018 | —                                | —                            | N/A  | N/A  |
| March 1, 2018 through March 31, 2018       | 15,018                           | 316.65                       | N/A  | N/A  |
| Total                                      | 15,018                           | 316.65                       | N/A  | N/A  |

At March 31, 2018, there were 3,000 stock options vested and outstanding under a grant dated June 20, 2008. These options expire on June 20, 2018 and will be forfeited by the option holders unless exercised prior to this date.

ITEM 4. Removed and Reserved.

## ITEM 6. EXHIBITS

(a) Exhibits

Exhibit 31(a) - Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 31(b) - Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit - Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350,  
32(a) as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

NATIONAL WESTERN LIFE GROUP, INC.  
(Registrant)

Date: May 10, 2018 /S/ Ross R. Moody  
Ross R. Moody  
Chairman of the Board, President and  
Chief Executive Officer  
(Authorized Officer)

Date: May 10, 2018 /S/ Brian M. Pribyl  
Brian M. Pribyl  
Senior Vice President,  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)  
(Principal Accounting Officer)