National Western Life Group, Inc.
Form 10-Q
November 07, 2018

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2018
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to __________

Commission File Number: 000-55522

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

DELAWARE	47-3339380
(State of Incorporation)	(I.R.S. Employer Identification Number)
10801 N. MOPAC EXPY BLDG 3	
AUSTIN, TEXAS 78759-5415	(512) 836-1010
(Address of Principal Executive Offices) (Zip Code)	(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 x No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 x Accelerated filer o Non-accelerated filer (Do not check if a smaller reporting company) o
Smaller reporting company o Emerging growth company o
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. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x
As of November 6, 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) September 30, 2018	December 31, 2017
Investments:		
Debt securities held to maturity, at amortized cost (fair value: $7,186,631 and $7,434,104)	$ 7,281,031	7,247,024
Debt securities available for sale, at fair value (cost: $3,013,889 and $2,964,510)	2,965,788	3,041,131
Mortgage loans, net of allowance for possible losses ($650 and $650)	200,876	208,249
Policy loans	54,474	56,405
Derivatives, index options	136,435	194,731
Equity securities, at fair value (cost: $13,962 and $12,890)	19,661	18,478
Other long-term investments	54,861	51,828
Total investments	10,713,126	10,817,846
Cash and cash equivalents	155,381	217,624
Deferred policy acquisition costs	842,601	819,511
Deferred sales inducements	137,488	135,570
Accrued investment income	101,063	96,818
Federal income tax receivable	—	—
Other assets	142,181	137,725
Total assets	$ 12,091,840	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)

LIABILITIES AND STOCKHOLDERS' EQUITY	(Unaudited) September 30, 2018	December 31, 2017
LIABILITIES:		
Future policy benefits:		
Universal life and annuity contracts	$ 9,799,833	9,962,589
Traditional life reserves	135,522	135,895
Other policyholder liabilities	129,529	128,009
Deferred Federal income tax liability	18,356	25,408
Federal income tax payable	2,005	2,701
Other liabilities	123,578	138,318
Total liabilities	10,208,823	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 (loss)	(34,272)	14,281
Retained earnings	1,875,537	1,776,141
Total stockholders' equity	1,883,017	1,832,174
Total liabilities and stockholders' equity	$ 12,091,840	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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NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
For the Three Months Ended September 30, 2018 and 2017
(Unaudited)
(In thousands, except per share amounts)

	2018	2017
Premiums and other revenues:		
Universal life and annuity contract charges	$38,287	40,268
Traditional life premiums	4,209	5,285
Net investment income	175,553	151,691
Other revenues	5,111	4,672
Net realized investment gains (losses):		
Total other-than-temporary impairment (“OTTI”) gains (losses)	3	26
Portion of OTTI (gains) losses recognized in other comprehensive income	(3)	(26)
Net OTTI losses recognized in earnings	—	—
Other net investment gains (losses)	2,275	2,074
Total net realized investment gains (losses)	2,275	2,074
Total revenues	225,435	203,990
Benefits and expenses:		
Life and other policy benefits	5,744	21,015
Amortization of deferred policy acquisition costs	26,775	18,722
Universal life and annuity contract interest	124,145	107,799
Other operating expenses	24,037	22,596
Total benefits and expenses	180,701	170,132
Earnings before Federal income taxes	44,734	33,858
Federal income taxes	9,093	12,045
Net earnings	$35,641	21,813
Basic earnings per share:		
Class A	$10.08	$ 6.17
Class B	$5.04	$ 3.08
Diluted earnings per share:		
Class A	$10.08	$ 6.17
Class B	$5.04	$ 3.08

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

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NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
For the Nine Months Ended September 30, 2018 and 2017
(Unaudited)
(In thousands, except per share amounts)

	2018	2017
Premiums and other revenues:		
Universal life and annuity contract charges	$116,753	122,329
Traditional life premiums	13,282	13,639
Net investment income	358,100	466,045
Other revenues	15,396	13,714
Net realized investment gains (losses):		
Total other-than-temporary impairment ("OTTI") gains (losses)	9	69
Portion of OTTI (gains) losses recognized in other comprehensive income	(9)	(69)
Net OTTI losses recognized in earnings	—	—
Other net investment gains (losses)	5,582	10,906
Total net realized investment gains (losses)	5,582	10,906
Total revenues	509,113	626,633
Benefits and expenses:		
Life and other policy benefits	44,607	58,626
Amortization of deferred policy acquisition costs	90,073	85,992
Universal life and annuity contract interest	183,316	299,862
Other operating expenses	72,467	74,031
Total benefits and expenses	390,463	518,511
Earnings before Federal income taxes	118,650	108,122
Federal income taxes	23,668	37,288
Net earnings	$94,982	70,834
Basic earnings per share:		
Class A	$26.86	$20.03
Class B	$13.43	$10.02
Diluted earnings per share:		
Class A	$26.86	$20.03
Class B	$13.43	$10.02

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 September 30, 2018 and 2017
(Unaudited)
(In thousands)

	2018	2017
Net earnings	$35,641	21,813
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	(1,416)	2,212
Net unrealized liquidity gains (losses)	—	9
Reclassification adjustment for net amounts included in net earnings	(936)	(988)
Net unrealized gains (losses) on securities	(2,352)	1,233
Foreign currency translation adjustments	20	166
Benefit plans:		
Amortization of net prior service cost and net gain (loss)	2,801	(910)
Other comprehensive income (loss)	469	489
Comprehensive income (loss)	$36,110	22,302

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 Nine Months Ended September 30, 2018 and 2017
(Unaudited)
(In thousands)

	2018	2017
Net earnings	$94,982	70,834
Other comprehensive income, net of effects of deferred costs and taxes:		
Unrealized gains (losses) on securities:		
Net unrealized holding gains (losses) arising during period	(51,238)	15,479
Net unrealized liquidity gains (losses)	2	22
Reclassification adjustment for net amounts included in net earnings	(2,533)	(2,746)
Net unrealized gains (losses) on securities	(53,769)	12,755
Foreign currency translation adjustments	1,227	(5)
Benefit plans:		
Amortization of net prior service cost and net gain (loss)	8,403	(2,730)
Other comprehensive income (loss)	(44,139)	10,020
Comprehensive income (loss)	$50,843	80,854

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 Nine Months Ended September 30, 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 (losses) on non-impaired securities:		
Balance at beginning of period	33,664	22,813
Change in unrealized gains (losses) during period, net of tax	(53,771)	12,733
Cumulative effect of change in accounting principle, net of tax (See Note 2)	(4,414)	—
Balance at end of period	(24,521)	35,546
Unrealized losses on impaired held to maturity securities:		
Balance at beginning of period	(10)	(203)
Amortization	7	45
Other-than-temporary impairments, non-credit, net of tax	—	—
Additional credit loss on previously impaired securities	—	—
Change in shadow deferred policy acquisition costs	(4)	(23)
Balance at end of period	(7)	(181)
Unrealized losses on impaired available for sale securities:		
Balance at beginning of period	(1)	(1)
Other-than-temporary impairments, non-credit, net of tax	—	—
Change in shadow deferred policy acquisition costs	(1)	—
Recoveries, net of tax	—	—
Balance at end of period	(2)	(1)

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NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES
IN STOCKHOLDERS' EQUITY (continued)
For the Nine Months Ended September 30, 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	1,227	(5)
Balance at end of period	4,450	2,656
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	8,403	(2,730)
Balance at end of period	(14,192)	(17,448)
Accumulated other comprehensive income (loss) at end of period	(34,272)	20,572
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	94,982	70,834
Stockholder dividends	—	—
Balance at end of period	1,875,537	1,740,358
Total stockholders' equity	$1,883,017	1,802,682

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 Nine Months Ended September 30, 2018 and 2017
(Unaudited)
(In thousands)

	2018	2017
Cash flows from operating activities:		
Net earnings	$94,982	70,834
Adjustments to reconcile net earnings to net cash from operating activities:		
Universal life and annuity contract interest	183,316	299,862
Surrender charges and other policy revenues	(28,429)	(33,682)
Realized (gains) losses on investments	(5,582)	(10,905)
Accretion/amortization of discounts and premiums, investments	(86)	308
Depreciation and amortization	8,769	7,379
(Increase) decrease in value of equity securities	(254)	—
(Increase) decrease in value of derivatives	(35,581)	(138,552)
(Increase) decrease in deferred policy acquisition and sales inducement costs	31,645	19,895
(Increase) decrease in accrued investment income	(4,245)	(3,793)
(Increase) decrease in other assets	(12,489)	(7,762)
Increase (decrease) in liabilities for future policy benefits	(11,566)	6,616
Increase (decrease) in other policyholder liabilities	1,520	(6,319)
Increase (decrease) in Federal income tax liability	(696)	(8,647)
Increase (decrease) in deferred Federal income tax	4,680	(14,370)
Increase (decrease) in other liabilities	(3,882)	12,530
Net cash provided by operating activities	222,102	193,394
Cash flows from investing activities:		
Proceeds from sales of:		
Debt securities held to maturity	—	—
Debt securities available for sale	13,098	22,184
Other investments	2,749	5,405
Proceeds from maturities and redemptions of:		
Debt securities held to maturity	360,036	303,081
Debt securities available for sale	168,638	222,379
Derivatives, index options	160,094	151,298
Property and equipment	8	2,731
Purchases of:		
Debt securities held to maturity	(391,548)	(377,821)
Debt securities available for sale	(228,172)	(191,510)
Equity securities	(1,678)	(1,160)
Derivatives, index options	(63,524)	(55,780)
Other investments	(5,581)	(329)
Property and equipment	(3,070)	(1,697)

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NATIONAL WESTERN LIFE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
For the Nine Months Ended September 30, 2018 and 2017
(Unaudited)
(In thousands)

	2018	2017
Principal payments on mortgage loans	32,374	24,199
Cost of mortgage loans acquired	(24,803)	(38,166)
Decrease (increase) in policy loans	1,931	1,233
Net cash provided by/(used in) investing activities	20,552	66,047
Cash flows from financing activities:		
Deposits to account balances for universal life and annuity contracts	442,795	546,966
Return of account balances on universal life and annuity contracts	(749,245)	(687,087)
Net cash provided by (used in) financing activities	(306,450)	(140,121)
Effect of foreign exchange	1,553	(7)
Net increase (decrease) in cash and cash equivalents	(62,243)	119,313
Cash and cash equivalents at beginning of period	217,624	51,247
Cash and cash equivalents at end of period	$155,381	170,560
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid (received) during the period for:		
Interest	$30	30
Income taxes	$19,683	60,304
Noncash operating activities:		
Deferral of sales inducements	$(8,152)	(9,696)

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

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 September 30, 2018, and the results of its operations and its cash flows for the three and nine months ended September 30, 2018 and September 30, 2017. Such adjustments are of a normal recurring nature. The results of operations for the nine months ended September 30, 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.nwlgi.com or the Securities and Exchange Commission internet site at 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 and nine months ended September 30, 2018 and September 30, 2017.

Affected Line Item in the Statements of Earnings	Amount Reclassified From Accumulated Other Comprehensive Income	
	Three Months Ended	Nine Months Ended

	September 30,		September 30,	
	2018	2017	2018	2017
	(In thousands)			
Other net investment gains (losses)	$1,185	1,519	3,206	4,224
Net OTTI losses recognized in earnings	—	—	—	—
Earnings before Federal income taxes	1,185	1,519	3,206	4,224
Federal income taxes	249	532	673	1,478
Net earnings	$936	987	2,533	2,746

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

(2) NEW ACCOUNTING PRONOUNCEMENTS

Recent accounting pronouncements not yet adopted

In August, the FASB issued ASU 2018-12 Financial Services-Insurance (Topic 944) - Targeted Improvements to the Accounting for Long-Duration Contracts. This update aimed at improving the Codification as it relates to long-duration contracts which will improve the timeliness of recognizing changes in the liability for future policy benefits, simplify accounting for certain market-based options, simplify the amortization of deferred acquisition costs, and improve the effectiveness of required disclosures. Amendments include the following:

A. Require insurance entity to (1) review and update assumptions used to measure cash flows at least annually (with changes recognized in net income) and (2) update discount rate assumption at each reporting date (with changes recognized in other comprehensive income).

B. Require insurance entity to measure all market risk benefits associated with deposit (i.e. account balance) contracts at fair value, with change in fair value attributable to change in instrument-specific credit risk recognized in other comprehensive income.

C. Simplify amortization of deferred acquisition costs and other balances amortized in proportion to premiums, gross profits, or gross margins and require those balances be amortized on constant level basis over expected term of related contract. Deferred acquisition costs are required to be written off for unexpected contract terminations but are not subject to impairment test.

D. Require insurance entity to add disclosures of disaggregated rollforwards of beginning to ending balances of the liability for future policy benefits, policyholder account balances, market risk benefits, separate account liabilities, and deferred acquisition costs. Insurance entity must also disclose information about significant inputs, judgments, assumptions, and methods used in measurement, including changes in those inputs, judgments, and assumptions, and the effect of those changes on measurement.

These update will need to be applied retrospectively to the earliest period presented in the financial statements for periods beginning after December 15, 2020, with early adoption permitted. The Company is currently evaluating the impact of the new guidance on its consolidated financial statements.

In August, the FASB issued a new Concepts Statement No. 8 Conceptual Framework for Financial Reporting - Chapter 8, Notes to Financial Statements. This was issued as part of a disclosure framework project aimed at improving disclosures in financial statements. This issuance provides conceptual guidance that may be followed when determining items to include as disclosures in the notes to financial statements. In conjunction with this issuance, the FASB also issued two accounting standard updates (“ASU”) which identified a particular FASB Topic and evaluated its disclosures through the new conceptual framework of Concepts Statement No. 8, Chapter 8. This process resulted in the issuance of the following two ASUs.

In August, FASB issued ASU 2018-13 Fair Value Measurement (Topic 820) Disclosure Framework - Changes to the Disclosure requirements for Fair Value Measurement. This update removed disclosures for 1) amount of and reasons for transfers between Level 1 and Level 2 for fair value hierarchy, 2) policy for timing of transfers between levels, 3) valuation process for Level 3 fair value measurements. This update also added disclosure requirement as follows: 1) changes in unrealized gains and losses for the period included in OCI for recurring Level 3 fair value measurements held at end of reporting period; 2) range and weighted average (or other reasonable quantitative measurement) of significant unobservable inputs used to develop Level 3 fair value measurements.

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

In August, FASB issued ASU 2018-14 Compensation-Retirement Benefits - Defined Benefit Plans-General (Subtopic 715-20) Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans. This update removed disclosures for 1) amounts in AOCI expected to be recognized as components of net periodic benefit cost over the next fiscal year, 2) amount and timing of plan assets expected to be returned to the employer, 3) related party disclosures about the amount of future annual benefits covered by insurance and annuity contracts and significant transactions between the employer or related parties and the plan, 4) the effects of a one-percentage-point change in assumed health care cost trend rates on the (a) aggregate of the service and interest cost components of the net periodic benefit costs and (b) benefit obligation for postretirement health care benefits. This update also added disclosures as follow: 1) weighted-average interest crediting rates for cash balance plans and other plans with promised crediting rates, 2) explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. Finally, this update clarified that the following information for defined benefit pension plans should be disclosed: 1) projected benefit obligation (PBO) and fair value of plan assets for plans with PBO in excess of plan assets. 2) accumulated benefit obligation (ABO) and fair value of plan assets for plans with ABOs in excess of plan assets.

In August, the SEC released a final rule updating disclosure requirements, Disclosure Update and Simplification, which resulted in the additional interim disclosure of an analysis of changes in stockholders’ equity to be required for the current and comparative quarter and year-to-date interim periods. Registrants will be required to provide an analysis of changes in each caption of stockholders’ equity and noncontrolling interests, which will need to be accompanied by dividends per share and in the aggregate for each class of shares. The disclosure must be presented in the form of a reconciliation, either as a separate statement or in the footnotes. The amendments will be effective for interim periods beginning after November 5, 2018.

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. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. The Company does not expect a material effect on the results of operations or financial position with the adoption of this ASU.

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

In June 2018, the FASB released ASU 2018-07 Compensation - Stock Compensation (Topic 718) - Improvements to Nonemployee Share-Based Payment Accounting. This update largely aligns the accounting for share-based payment awards issued to employees and nonemployees. Previously, nonemployee stock compensation was accounted for under Subtopic 505-50 but will now fall under Topic 718. Changes to the accounting for nonemployee awards include 1) measurement based on fair value of the equity instrument at grant date, rather than previous requirement to measure based on the more reliable option of the fair value of the consideration or the fair value of the equity instrument, 2) initial measurement at grant date, rather than the earlier of the date at which commitment for performance is reached or performance is complete, and 3) when performance conditions are present, the probability of satisfying performance conditions should be considered in measurement rather than the previous requirement to measure at the lowest aggregate fair value. The amendments in the new guidance are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal period. The Company does not expect a material effect on the results of operations or financial position with the adoption of this ASU.

In February 2016, the FASB issued new guidance on leasing transactions (ASU 2016-02, Leases - Topic 842). The new guidance is effective for the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and requires a modified retrospective transition approach (subject to optional practical expedients). The new guidance requires a lessee to recognize assets and liabilities for leases with lease terms of more than 12 months. Leases would be classified as finance or operating leases and both types of leases will be recognized on the balance sheet. Lessor accounting will remain largely unchanged from current guidance except for certain targeted changes. The new guidance will also require new qualitative and quantitative disclosures. Early adoption is permitted. The Company does not expect a significant impact to the financial statements resulting from this change.

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.

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.

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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.

(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. In the third quarter of 2018, National Western declared a $3.0 million dividend to NWLGI which was subsequently paid on October 17, 2018. During the second quarter of 2017 National Western declared and paid a $4.0 million dividend to NWLGI. During the third quarter of 2017 National Western declared a $3.0 million dividend payable to NWLGI which was subsequently paid on October 16, 2017.

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NWLGI did not declare or pay cash dividends on its common shares during the nine months ended September 30, 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. The Company currently has no share-based compensation awards outstanding that could be redeemed for shares of common stock.

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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 September 30,			
	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	$35,641		21,813	
Dividends - Class A shares	—		—	
Dividends - Class B shares	—		—	
Undistributed income	$35,641		21,813	
Allocation of net income:				
Dividends	$—	—	—	—
Allocation of undistributed income	34,633	1,008	21,196	617
Net income	$34,633	1,008	21,196	617
Denominator:				
Basic earnings per share - weighted-average shares	3,436	200	3,436	200
Effect of dilutive stock options	—	—	—	—
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,436	200	3,436	200
Basic Earnings Per Share	$10.08	5.04	6.17	3.08
Diluted Earnings Per Share	$10.08	5.04	6.17	3.08

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	Nine Months Ended September 30,			
	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	$94,982		70,834	
Dividends - Class A shares	—		—	
Dividends - Class B shares	—		—	
Undistributed income	$94,982		70,834	
Allocation of net income:				
Dividends	$—	—	—	—
Allocation of undistributed income	92,296	2,686	68,831	2,003
Net income	$92,296	2,686	68,831	2,003
Denominator:				
Basic earnings per share - weighted-average shares	3,436	200	3,436	200
Effect of dilutive stock options	—	—	—	—
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,436	200	3,436	200
Basic Earnings Per Share	$26.86	13.43	20.03	10.02
Diluted Earnings Per Share	$26.86	13.43	20.03	10.02

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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 Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Service cost	$28	27	84	81
Interest cost	225	240	675	718
Expected return on plan assets	(325)	(306)	(975)	(920)
Amortization of prior service cost	—	—	—	—
Amortization of net loss	131	159	393	477
Net periodic benefit cost	$59	120	177	356

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 September 30, 2018. As of September 30, 2018, the company had $0.1 million 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 non-qualified defined benefit plans.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Service cost	$90	204	270	612
Interest cost	213	347	639	1,041
Amortization of prior service cost	15	15	45	45
Amortization of net loss	176	818	528	2,455
Net periodic benefit cost	$494	1,384	1,482	4,153

The company expects to contribute $2.0 million to these plans in 2018. As of September 30, 2018, the company has contributed $1.6 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 Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			

Interest cost	$40	35	120	104
Amortization of prior service cost	26	25	78	77
Amortization of net loss	38	10	113	31
Net periodic benefit cost	$104	70	311	212

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. As disclosed in the Form 10-Q filed for the quarter ended March 31, 2018, National Western discontinued accepting applications for the company's international products from foreign residents in May 2018. A summary of segment information as of September 30, 2018 and December 31, 2017 for the Condensed Consolidated Balance Sheet items and for the three and nine months ended September 30, 2018 and September 30, 2017 for the Condensed Consolidated Statement of Earnings is provided below.

Condensed Consolidated Balance Sheet Items:

	September 30, 2018				
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Deferred policy acquisition costs and sales inducements	$117,900	241,823	620,366	—	980,089
Total segment assets	1,217,781	1,227,365	8,922,137	365,195	11,732,478
Future policy benefits	1,045,922	918,658	7,970,775	—	9,935,355
Other policyholder liabilities	14,556	21,898	93,075	—	129,529

	December 31, 2017				
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In 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 September 30, 2018				
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Premiums and contract revenues	$10,060	26,839	5,597	—	42,496
Net investment income	26,912	19,731	123,525	5,385	175,553
Other revenues	11	5	11	5,084	5,111
Total revenues	36,983	46,575	129,133	10,469	223,160
Life and other policy benefits	5,839	6,609	(6,704)	—	5,744
Amortization of deferred policy acquisition costs	2,978	6,307	17,490	—	26,775
Universal life and annuity contract interest	22,355	30,596	71,194	—	124,145
Other operating expenses	5,215	4,982	8,719	5,121	24,037
Federal income taxes (benefit)	122	(322)	7,714	1,101	8,615
Total expenses	36,509	48,172	98,413	6,222	189,316
Segment earnings (loss)	$474	(1,597)	30,720	4,247	33,844

	Nine Months Ended September 30, 2018				
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Premiums and contract revenues	$29,775	82,218	18,042	—	130,035
Net investment income	41,131	32,305	263,983	20,681	358,100
Other revenues	12	39	48	15,297	15,396
Total revenues	70,918	114,562	282,073	35,978	503,531
Life and other policy benefits	15,751	16,872	11,984	—	44,607
Amortization of deferred acquisition costs	8,362	21,023	60,688	—	90,073
Universal life and annuity contract interest	29,401	37,046	116,869	—	183,316
Other operating expenses	15,368	15,991	25,741	15,367	72,467
Federal income taxes (benefit)	405	4,701	13,290	4,100	22,496
Total expenses	69,287	95,633	228,572	19,467	412,959

Segment earnings (loss)	$1,631	18,929	53,501	16,511	90,572

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	Three Months Ended September 30, 2017				
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Premiums and contract revenues	$9,907	30,353	5,293	—	45,553
Net investment income	17,385	15,711	114,123	4,472	151,691
Other revenues	11	26	26	4,609	4,672
Total revenues	27,303	46,090	119,442	9,081	201,916
Life and other policy benefits	3,483	8,437	9,095	—	21,015
Amortization of deferred acquisition costs	2,517	(21,585)	37,790	—	18,722
Universal life and annuity contract interest	14,119	9,112	84,568	—	107,799
Other operating expenses	4,086	5,661	8,714	4,135	22,596
Federal income taxes (benefit)	1,061	15,473	(7,007)	1,792	11,319
Total expenses	25,266	17,098	133,160	5,927	181,451
Segment earnings (loss)	$2,037	28,992	(13,718)	3,154	20,465

	Nine Months Ended September 30, 2017				
	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
			(In thousands)		
Premiums and contract revenues	$27,822	91,563	16,583	—	135,968
Net investment income	51,998	48,581	346,031	19,435	466,045
Other revenues	30	73	90	13,521	13,714
Total revenues	79,850	140,217	362,704	32,956	615,727
Life and other policy benefits	13,850	19,399	25,377	—	58,626
Amortization of deferred acquisition costs	8,300	(7,874)	85,566	—	85,992
Universal life and annuity contract interest	41,576	36,871	221,415	—	299,862
Other operating expenses	13,975	18,846	28,588	12,622	74,031
Federal income taxes (benefit)	740	25,125	605	7,001	33,471
Total expenses	78,441	92,367	361,551	19,623	551,982
Segment earnings (loss)	$1,409	47,850	1,153	13,333	63,745

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Premiums and Other Revenues:				
Premiums and contract revenues	$42,496	45,553	130,035	135,968
Net investment income	175,553	151,691	358,100	466,045
Other revenues	5,111	4,672	15,396	13,714
Realized gains (losses) on investments	2,275	2,074	5,582	10,906
Total condensed consolidated premiums and other revenues	$225,435	203,990	509,113	626,633

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Federal Income Taxes:				
Total segment Federal income taxes	$8,615	11,319	22,496	33,471
Taxes on realized gains (losses) on investments	478	726	1,172	3,817
Total condensed consolidated Federal income taxes	$9,093	12,045	23,668	37,288

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Net Earnings:				
Total segment earnings	$33,844	20,465	90,572	63,745
Realized gains (losses) on investments, net of taxes	1,797	1,348	4,410	7,089
Total condensed consolidated net earnings	$35,641	21,813	94,982	70,834

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	September 30, 2018	December 31, 2017
	(In thousands)	
Assets:		
Total segment assets	$11,732,478	12,011,696
Other unallocated assets	359,362	213,398
Total condensed consolidated assets	$12,091,840	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 non-qualified 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 stock options granted were under the 1995 Plan and 2008 Plan. Employee stock options and SARs granted prior to 2016 vest 20% annually following three years of service following the grant date. Employee SARs granted 2016 forward vest 33.3% annually following one year of service from the date of the grant. 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 and nine months ended September 30, 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			
	September 30, 2018		September 30, 2017	
	Officer	Director	Officer	Director
SARs	—	—	—	—
RSUs	—	—	—	—
PSUs	—	—	—	—

	Nine Months Ended			
	September 30, 2018		September 30, 2017	
	Officer	Director	Officer	Director
SARs	—	—	11,715	—
RSUs	—	—	2,725	1,660
PSUs	—	—	4,526	—

The Company uses the current fair value method to measure compensation cost for awards granted under the share-based plans. As of September 30, 2018 and 2017, the liability balance was $15.5 million and $16.6 million, respectively. A summary of awards by type and related activity is detailed below.

		Options Outstanding	
	Shares Available For Grant	Shares	Weighted-Average Exercise Price
Stock Options:			
Balance at January 1, 2018	291,000	18,018	$ 242.07

Exercised	—	(18,018)	$ 242.07
Forfeited	—	—	$ —
Expired	—	—	$ —
Stock options granted	—	—	$ —
Balance at September 30, 2018	291,000	—	$ —

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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	(2,984)	(1,494)	—
Forfeited	(1,780)	(556)	—
Granted	—	—	—
Balance at September 30, 2018	87,903	9,671	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 share-based compensation exercised was $2.2 million and $1.0 million for the nine months ended September 30, 2018 and 2017, respectively. The total share-based compensation paid was $2.2 million and $1.0 million for the nine months ended September 30, 2018 and 2017, respectively. The total fair value of stock options and SARs vested during the nine months ended September 30, 2018 and 2017 was $0.8 million and $0.6 million, respectively. For the nine months ended September 30, 2018 and 2017, the total cash received from the exercise of stock options under the Plans was $0.0 million and $0.0 million, respectively.

The following table summarizes information about SARs outstanding at September 30, 2018. There were no options outstanding as of September 30, 2018.

	SARs Outstanding		
	Number Outstanding	Weighted-Average Remaining Contractual Life	Number Exercisable
Exercise prices:			
114.64 (SARs)	10,500	0.4 years	10,500
132.56 (SARs)	19,818	3.2 years	15,915
210.22 (SARs)	25,300	5.2 years	10,800
216.48 (SARs)	11,649	7.4 years	7,589
311.16 (SARs)	10,427	8.4 years	3,444
310.55 (SARs)	203	8.6 years	67
334.34 (SARs)	10,006	9.2 years	—
Totals	87,903		48,315
Aggregate intrinsic value	$9,886		$ 7,103

(in thousands)

The aggregate intrinsic value in the table above is based on the closing Class A stock price of $319.20 per share on September 30, 2018.

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The SARs shown above with exercise price of $114.64 have a remaining contractual life of less than one year. The holders for this grant have until the end of the contractual life of February 19, 2019 to exercise these holdings or otherwise forfeit the grants held.

In estimating the fair value of the share-based awards outstanding at September 30, 2018 and December 31, 2017, the Company employed the Black-Scholes option pricing model with assumptions detailed below.

	September 30, 2018		December 31, 2017	
Expected term	0.4 to 9.2 years		0.3 to 10.0 years	
Expected volatility weighted-average	21.55	%	21.55	%
Expected dividend yield	0.11	%	0.11	%
Risk-free rate weighted-average	2.63	%	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 $1.7 million and $2.4 million for the three and nine months ended September 30, 2018 and $1.3 million and $5.6 million for the three and nine months ended September 30, 2017, respectively. The related tax expense/(benefit) recognized was $(0.4) million and $(0.5) million for the three and nine months ended September 30, 2018 and $(0.5) million and $(2.0) million for the three and nine months ended September 30, 2017, respectively.

As of September 30, 2018, the total compensation cost related to non-vested share-based awards not yet recognized was $4.0 million. This amount is expected to be recognized over a weighted-average period of 1.2 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 Plaintiffs' 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 May 14, 2018, National Western filed its Opposition to Plaintiffs' Brief. Plaintiffs filed a Motion to Strike on May 22, 2018, which National Western opposed on June 4, 2018. On August 6, 2018, the Court issued an Opinion and Order dismissing plaintiffs' case without prejudice and plaintiffs filed a Notice of Appeal to the First Circuit Court of Appeals on September 4, 2018. The company continues to hold an accrual of $2.9 million for this matter as of September 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. On May 16, 2018 the Court issued an Order granting the Pleas and dismissing Robert L. Moody, Jr.'s claims with prejudice, and plaintiff then filed a Motion to Transfer Venue ("MTTV").

Defendants filed an Application for Fees, seeking to recover defendants' legal costs and expenses from plaintiff, and a Response to the MTTV on June 8, 2018. In response plaintiff filed a Motion to Vacate, a Response to the Application for Fees, and their own Request for Attorney's Fees on July 5, 2018. Defendants filed a Response to the Motion to Vacate and to plaintiff's Request for Attorney's Fees on July 11, 2018, and the Court heard oral arguments on July 16, 2018. Plaintiff filed supplemental briefing in support of their July 5, 2018 filings on July 25, 2018, and defendants filed their response to plaintiff's supplemental briefing on July 27, 2018. On August 8, 2018 the Court issued an Order denying plaintiff's Motion to Vacate. Pursuant to the Court's instructions, on October 5, 2018, defendants filed an Order Granting Application for Expenses. Defendants then filed a Motion for Entry of Final Judgment and a Request for Submission Date on Motion for Entry of Final Judgment on October 11, 2018, which the Court set as October 30, 2018. Plaintiff filed his Objection to Proposed Final Judgment and Objection to Proposed Order on Attorneys' Fees on October 25, 2018, to which defendants filed a response on October 30, 2018.

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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.

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 $4.3 million commitments to fund new loans and $6.2 million in commitments to extend credit relating to existing loans at September 30, 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 Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Available for sale debt securities:				
Realized gains on disposal	$1,191	1,529	3,212	4,137

Realized losses on disposal	(6)	—	(6)	—
Held to maturity debt securities:				
Realized gains on disposal	1,090	555	2,395	4,059
Realized losses on disposal	—	—	(19)	(34)
Equity securities realized gains (losses)	—	(10)	—	87
Real estate gains (losses)	—	—	—	2,657
Totals	$2,275	2,074	5,582	10,906

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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.

The Company uses the specific identification method in computing realized gains and losses. For the three months ended September 30, 2018 and 2017 the percentage of gains on bonds due to the call of securities was 97.3% and 100.0%, respectively. For the nine months ended September 30, 2018 and 2017 the percentage of gains on bonds due to the call of securities was 98.7% and 88.0%, 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 Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Total other-than-temporary impairment gains (losses) on debt securities	$3	26	9	69
Portion of loss (gain) recognized in comprehensive income	(3)	(26)	(9)	(69)
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 Months Ended September 30, 2018	Nine Months Ended September 30, 2018	Year Ended December 31, 2017
	(In thousands)		
Beginning balance, cumulative credit losses related to other-than-temporary impairments	$627	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	627

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(B) Debt Securities

The table below presents amortized costs and fair values of debt securities held to maturity at September 30, 2018.

	Debt Securities Held to Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
U.S. Treasury	$1,341	113	—	1,454
States and political subdivisions	457,379	8,136	(5,147)	460,368
Public utilities	964,889	5,251	(16,305)	953,835
Corporate	4,655,058	26,262	(92,282)	4,589,038
Residential mortgage-backed	1,198,121	8,228	(28,752)	1,177,597
Home equity	3,496	53	(9)	3,540
Manufactured housing	747	52	—	799
Totals	$7,281,031	48,095	(142,495)	7,186,631

The table below presents amortized costs and fair values of debt securities available for sale at September 30, 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 Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
States and political subdivisions	$571	5	—	576
Foreign governments	9,971	36	—	10,007
Public utilities	84,947	1,119	(609)	85,457
Corporate	2,895,100	17,156	(66,875)	2,845,381
Residential mortgage-backed	16,854	836	(59)	17,631
Home equity	6,446	290	—	6,736
Totals	$3,013,889	19,442	(67,543)	2,965,788

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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 Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair 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 Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair 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 September 30, 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.

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During the three and nine months ended September 30, 2018, the Company recorded no other-than-temporary impairment on debt securities.

Unrealized losses for debt securities held to maturity and debt securities available for sale increased during the first nine 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 September 30, 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	$113,773	(4,819)	6,297	(328)	120,070	(5,147)
Public utilities	530,455	(13,676)	39,437	(2,629)	569,892	(16,305)
Corporate	2,499,421	(65,166)	471,244	(27,116)	2,970,665	(92,282)
Residential mortgage-backed	649,298	(14,345)	215,053	(14,407)	864,351	(28,752)
Home equity	—	—	2,218	(9)	2,218	(9)
Total temporarily impaired securities	$3,792,947	(98,006)	734,249	(44,489)	4,527,196	(142,495)

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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 September 30, 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	$—	—	—	—	—	—
Public utilities	38,807	(609)	—	—	38,807	(609)
Corporate	1,570,824	(42,632)	357,876	(24,243)	1,928,700	(66,875)
Residential mortgage-backed	—	—	933	(59)	933	(59)
Home equity	—	—	—	—	—	—
Total temporarily impaired securities	$1,609,631	(43,241)	358,809	(24,302)	1,968,440	(67,543)

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.

	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)

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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 723 individual issues, or 55.8% of the total debt securities held by the Company at September 30, 2018. The market value of these bonds as a percent of amortized cost approximates 96.9%. Of the 723 securities, 142, or 19.6%, fall in the 12 months or greater aging category; and 714 were rated investment grade at September 30, 2018.

The amortized cost and fair value of investments in debt securities at September 30, 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	$103,995	106,063	326,104	331,101
Due after 1 year through 5 years	1,137,368	1,141,487	2,729,171	2,727,219
Due after 5 years through 10 years	1,663,318	1,609,872	2,646,213	2,570,349
Due after 10 years	85,909	83,999	377,179	376,026
	2,990,590	2,941,421	6,078,667	6,004,695
Mortgage and asset-backed securities	23,299	24,367	1,202,364	1,181,936

Total	$3,013,889	2,965,788	7,281,031	7,186,631

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(C) Transfer of Securities

During the three and nine months ended September 30, 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 September 30, 2018 or 2017 and as a result all interest income was recognized at September 30, 2018 and 2017.

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

	September 30, 2018		December 31, 2017	
	Amount (In thousands)	%	Amount (In thousands)	%
Mortgage Loans by Loan-to-Value Ratio (1):				
Less than 50%	$67,837	33.7	$82,224	39.4
50% to 60%	23,666	11.7	27,395	13.1
60% to 70%	97,899	48.6	86,849	41.6
70% to 80%	6,716	3.3	—	—
80% to 90%	5,408	2.7	6,929	3.3
Greater than 90%	—	—	5,502	2.6
Gross balance	201,526	100.0	208,899	100.0
Allowance for possible losses	(650)	(0.3)	(650)	(0.3)

Totals	$200,876	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.

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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.

	September 30, 2018	December 31, 2017
	(In thousands)	
Balance, beginning of period	$ 650	650
Provision	—	—
Releases	—	—
Balance, end of period	$ 650	650

The Company's direct investments in real estate are not a significant portion of its total investment portfolio and totaled approximately $36.8 million and $37.4 million at September 30, 2018 and December 31, 2017, respectively. The Company recognized operating income on real estate properties of approximately $1.7 million and $2.1 million for the first nine 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.

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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.

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:

	September 30, 2018			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale	$2,965,788	—	2,965,788	—
Equity securities	19,661	19,661	—	—
Derivatives, index options	136,435	—	—	136,435
Total assets	$3,121,884	19,661	2,965,788	136,435
Policyholder account balances (a)	$147,357	—	—	147,357
Other liabilities (b)	15,479	—	—	15,479
Total liabilities	$162,836	—	—	162,836

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During the three and nine months ended September 30, 2018, the Company made no transfers into or out of Levels 1, 2 or 3.

	December 31, 2017			
	Total	Level 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
Total assets	$3,254,340	18,478	3,041,131	194,731
Policyholder account balances (a)	$211,159	—	—	211,159
Other liabilities (b)	15,242	—	—	15,242
Total liabilities	$226,401	—	—	226,401

(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.

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:

	September 30, 2018			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale:				
Priced by third-party vendors	$2,965,788	—	2,965,788	—
Priced internally	—	—	—	—
Subtotal	2,965,788	—	2,965,788	—
Equity securities:				
Priced by third-party vendors	19,661	19,661	—	—
Priced internally	—	—	—	—
Subtotal	19,661	19,661	—	—
Derivatives, index options:				
Priced by third-party vendors	136,435	—	—	136,435
Priced internally	—	—	—	—
Subtotal	136,435	—	—	136,435
Total	$3,121,884	19,661	2,965,788	136,435

Percent of total	100.0	%	0.6	%	95.0	%	4.4	%

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	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
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.

	Three Months Ended September 30, 2018				
	Debt Securities, Available for Sale	Equity Securities	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Balance at July 1, 2018	$—	—	102,007	102,007	133,013
Total realized and unrealized gains (losses):					
Included in net income	—	—	69,683	69,683	65,316
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	19,026	19,026	19,026
Sales	—	—	—	—	—
Issuances	—	—	—	—	—
Settlements	—	—	(54,281)	(54,281)	(54,519)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	136,435	136,435	162,836
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	65,927	65,927	—
Benefits and expenses	—	—	—	—	67,640
Total	$—	—	65,927	65,927	67,640

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	Three Months Ended September 30, 2017				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Balance at July 1, 2017	$—	—	149,341	149,341	173,356
Total realized and unrealized gains (losses):					
Included in net income	—	—	45,130	45,130	48,927
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	19,847	19,847	19,847
Sales	—	—	—	—	—
Issuances	—	—	—	—	531
Settlements	—	—	(50,782)	(50,782)	(50,799)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	163,536	163,536	191,862
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	16,436	16,436	—
Benefits and expenses	—	—	—	—	17,195
Total	$—	—	16,436	16,436	17,195

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	Nine Months Ended September 30, 2018				
	Debt Securities, Available for Sale	Equity Securities	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Beginning balance, January 1, 2018	$—	—	194,731	194,731	226,401
Total realized and unrealized gains (losses):					
Included in net income	—	—	35,581	35,581	32,496
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	63,303	63,303	63,303
Sales	—	—	—	—	—
Issuances	—	—	—	—	—
Settlements	—	—	(157,180)	(157,180)	(159,364)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	136,435	136,435	162,836
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	42,200	42,200	—
Other operating expenses	—	—	—	—	44,621
Total	$—	—	42,200	42,200	44,621

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	Nine Months Ended September 30, 2017				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Beginning balance, January 1, 2017	$—	—	120,644	120,644	134,693
Total realized and unrealized gains (losses):					
Included in net income	—	—	138,552	138,552	152,569
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	55,226	55,226	55,226
Sales	—	—	—	—	—
Issuances	—	—	—	—	1,275
Settlements	—	—	(150,886)	(150,886)	(151,901)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	163,536	163,536	191,862
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	83,540	83,540	—
Other operating expenses	—	—	—	—	87,894
Total	$—	—	83,540	83,540	87,894

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:

	September 30, 2018		
	Fair Value	Valuation Technique	Unobservable Input
	(In thousands)		
Derivatives, index options	$136,435	Broker prices	Implied volatility Inputs from broker proprietary models
Total assets	$136,435		
Policyholder account balances	$147,357	Deterministic cash flow model	Projected option cost
Other liabilities	15,479	Black-Scholes model	Expected term

			Forfeiture assumptions
Total liabilities	$162,836		

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	December 31, 2017		
	Fair Value (In thousands)	Valuation Technique	Unobservable Input
Derivatives, index options	$194,731	Broker prices	Implied volatility 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 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:

	September 30, 2018				
			Fair Value Hierarchy Level		
	Carrying Values	Fair Values	Level 1	Level 2	Level 3
	(In thousands)				
ASSETS					
Debt securities held to maturity	$7,281,031	7,186,631	—	7,184,713	1,918
Debt securities available for sale	2,965,788	2,965,788	—	2,965,788	—
Cash and cash equivalents	155,381	155,381	155,381	—	—
Mortgage loans	200,876	200,591	—	—	200,591
Policy loans	54,474	87,686	—	—	87,686
Other loans	9,053	9,429	—	—	9,429
Derivatives, index options	136,435	136,435	—	—	136,435
Equity securities	19,661	19,661	19,661	—	—
Life interest in Trust	8,676	12,775	—	—	12,775
LIABILITIES					
Deferred annuity contracts	$7,611,248	7,127,224	—	—	7,127,224
Immediate annuity and supplemental contracts	415,905	417,079	—	—	417,079

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	December 31, 2017				
			Fair Value Hierarchy Level		
	Carrying Values	Fair Values	Level 1	Level 2	Level 3
	(In thousands)				
ASSETS					
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
LIABILITIES					
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 September 30, 2018 and December 31, 2017, respectively.

	September 30, 2018 Asset Derivatives Balance Sheet Location	Fair Value (In thousands)	Liability Derivatives Balance Sheet Location	Fair Value (In thousands)
Derivatives not designated as hedging instruments				
Equity index options	Derivatives, Index Options	$ 136,435		
Fixed-index products			Universal Life and Annuity Contracts	$ 147,357
Total		$ 136,435		$ 147,357

	December 31, 2017 Asset Derivatives Balance Sheet Location	Fair Value (In thousands)	Liability Derivatives Balance Sheet Location	Fair Value (In thousands)
Derivatives not designated as hedging instruments				

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