KANSAS CITY LIFE INSURANCE CO
Form 10-K
February 26, 2010

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

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2009 or

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

For the transition period from_______to______

Commission file number 2-40764

KANSAS CITY LIFE INSURANCE COMPANY
(Exact Name of registrant as specified in its charter)

Missouri (State or other jurisdiction of incorporation or organization)	44-0308260 (I.R.S. Employer Identification No.)
3520 Broadway, Kansas City, Missouri (Address of principal executive offices)	64111-2565 (Zip Code)

816-753-7000
Registrant's telephone number, including area code

Securities registered pursuant to section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
$1.25 par value common stock	NASDAQ Capital Market LLC

Securities registered pursuant to section 12(b) of the Act:
None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes [ ] No [X]

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 [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on it corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the proceeding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [ ] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.
[ ]

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

Large accelerated filer [ ] Accelerated filer [X]

Non-accelerated filer [ ] Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes [ ] No [X]

As of December 31, 2009, 11,565,091 shares of Kansas City Life Insurance Company's common stock par value $1.25 were outstanding, and the aggregate market value of the common stock (based upon the average of bid and ask price according to Company records) on June 30, 2009 of Kansas City Life Insurance Company held by non-affiliates was approximately $98,854,311.

2

KANSAS CITY LIFE INSURANCE COMPANY
TABLE OF CONTENTS

The information required by Items 9 through 13 is incorporated by reference from the Company's definitive Proxy Statement to be filed with the Commission pursuant to Regulation 14A within 120 days after December 31, 2009.

Talbe of Contents

PART I

Item 1. BUSINESS

Kansas City Life Insurance Company (Kansas City Life) was incorporated under the assessment laws of Missouri in 1895 as the Bankers Life Association. In 1900, its present corporate title was adopted and it was reorganized as a legal reserve company in 1903. Kansas City Life, the parent company, and wholly owned subsidiaries Sunset Life Insurance Company of America (Sunset Life) and Old American Insurance Company (Old American) comprise the consolidated entity (the Company). The Company also has several non-insurance subsidiaries that individually are not material.

Kansas City Life markets individual insurance products, including traditional, interest sensitive and variable products through a nationwide sales force of independent general agents and third-party marketing arrangements. Traditional insurance products that Kansas City Life markets consist of term insurance, whole life insurance, matured endowments, life disability products and immediate annuities, including various supplementary contract payment options. The interest sensitive products that are marketed are universal life, variable universal life, fixed deferred annuities and variable annuities. Kansas City Life also markets group insurance products, which include life, dental, vision and disability products through a nationwide sales force of independent general agents, group brokers and third-party marketing arrangements. The Company offers investment products and broker-dealer services through its subsidiary Sunset Financial Services, Inc. (SFS) for both proprietary and non-proprietary variable insurance products, mutual funds and other securities. Kansas City Life operates in 48 states and the District of Columbia.

Sunset Life is a life insurance company that maintains its current block of business, but does not produce new sales. Sunset Life is included in the Individual Insurance segment and its individual insurance products include traditional and interest sensitive products. Sunset Life operates in 43 states and the District of Columbia.

Old American sells final expense life insurance products nationwide through a general agency system, with exclusive territories, using direct response marketing to supply agents with leads. Old American's administrative and accounting operations are part of the Company's home office but it operates and maintains a separate and independent field force and is included as a separate segment. Old American operates in 46 states and the District of Columbia.

The Company has three reportable business segments: Individual Insurance, Group Insurance and Old American. The Individual Insurance segment consists of individual insurance products for both Kansas City Life and Sunset Life. The Individual Insurance segment generated approximately 54% of consolidated insurance revenues for the year ended December 31, 2009. Also during 2009, the Group Insurance segment and the Old American segment accounted for 20% and 26% of consolidated insurance revenues, respectively.

The Company and its subsidiaries are subject to state regulations in their states of domicile and in the states in which they do business. Although the federal government generally does not regulate the business of insurance, federal initiatives often have an impact on the business in a variety of ways, including the taxation of insurance companies and the tax treatment of insurance products. In addition, the Company is a stock life insurance company and is subject to the rules and regulations of the United States Securities and Exchange Commission (SEC). SFS is a registered broker-dealer, which is regulated by the Financial Industry Regulatory Authority (FINRA) and the SEC.

The Company and its subsidiaries had 447 full-time employees as of December 31, 2009. The Company considers relations with its employees to be good.

The Company operates in the life insurance sector of the financial services industry in the United States. This industry is highly competitive with respect to pricing, selection of products and quality of service. No single competitor or any small group of competitors dominates any of the markets in which the Company operates. General economic conditions may affect future results.

Access to Public Filings

Additional information about the Company beyond what is included in this Form 10-K is available at the Company's website: www.kclife.com. You may also read and copy these materials at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549, or obtain them by calling the SEC at 1-800-SEC-0300. The SEC also maintains an Internet website that contains reports, Proxy and other information statements and other information regarding issuers that file electronically with the SEC at www.sec.gov. You may also access the SEC website through a link on the Company's website. We will provide a copy of any of our reports free of charge upon request.

Table of Contents

None of the information on the Company's website that is not otherwise expressly set forth or incorporated by reference in the Form 10-K is a part of this Form 10-K.

Table of Contents

Item 1A. RISK FACTORS

The operating results of life insurance companies have historically been subject to significant fluctuations. The factors which could affect the Company's future results include, but are not limited to, general economic conditions and the known trends and uncertainties which are discussed more fully below.

The Company operates in a mature, highly competitive industry, which could limit its ability to grow sales or maintain its position in the industry and negatively affect profitability.

Life insurance is a mature and highly competitive industry. In recent years, the industry has experienced little growth in life insurance sales, though the aging population has increased the demand for retirement savings products. The Company encounters significant competition in all lines of business from other insurance companies, many of which have greater financial resources, a greater market share, a broader range of products, lower product prices, better name recognition, greater actual or perceived financial strength, higher claims-paying ratings, the ability to assume a greater level of risk, lower operating or financing costs, or lower profitability expectations.

Changes in the business environment and competition could negatively affect the Company's ability to maintain or increase its profitability.

In recent years, there has been substantial consolidation and convergence among companies in the financial services industry, resulting in increased competition from large, well-capitalized financial services firms. Furthermore, many of these larger competitors may have lower operating costs and an ability to absorb greater risk while maintaining their financial strength ratings, thereby allowing them to price their products more competitively. The Company expects consolidation to continue, thereby increasing competitive pressures.

Changes in demographics, particularly the aging of the population and the decline in the number of agents in the industry, affect the demand for life insurance products. Also, as technology evolves, customers and agents may be able to compare products of any particular company with any other, which could lead to increased competition as well as changes in agent or customer behavior, including persistency that differs from past behavior.

The Company may be unable to attract agencies and sales representatives.

The Company sells insurance and annuity products through independent agents and agencies. These agencies and sales representatives are not captive and may sell products of the Company's competitors. The Company's ability to compete is dependent upon, among other things, its ability to attract and retain agents and agencies to market its insurance products, its ability to develop competitive and profitable products, its ability to maintain low unit costs, and its maintenance of strong financial strength ratings. Sales and the results of operations and financial condition could be adversely affected if the Company is unsuccessful in attracting and retaining agencies and sales representatives.

The Company's ability to maintain competitive unit costs is dependent upon the level of new sales.

The Company's ability to maintain competitive unit costs is dependent upon a number of factors, such as the level of new sales, persistency (continuation or renewal) of existing business, and expense management. A decrease in sales or the amount of total existing business without a corresponding reduction in expenses may result in higher unit costs, which would affect the Company's operating results.

The Company's ability to grow depends in large part upon the continued availability of capital.

The Company deploys significant amounts of capital to support its sales and acquisition efforts. Although the Company believes it has sufficient capital to fund its immediate growth and capital needs, the amount of capital available could vary in the future due to a variety of circumstances, some of which are neither predictable nor foreseeable, nor within the Company's control. A lack of sufficient capital could impair the Company's ability to grow.

Adverse capital and credit market conditions may significantly affect the Company's ability to meet liquidity needs, as well access to capital and cost of capital.

The capital and credit markets experienced extreme volatility and disruption in recent periods. The volatility and disruption reached unprecedented levels and the markets exerted downward pressure on availability of liquidity and credit for certain issuers. Although the Company has not issued new equity or debt securities in recent years, including 2009 and 2008, the

Table of Contents

Company's results of operations, financial condition, cash flows and statutory capital position could be materially adversely affected by future disruptions in the capital and credit markets.

The Company's level of cash and investments, along with expected cash inflows from investments and operations, is believed to be adequate to meet anticipated short-term and long-term benefit and expense payment obligations. However, withdrawal and surrender levels may differ from anticipated levels for a variety of reasons such as changes in economic conditions or changes in the Company's claims-paying ability or financial strength ratings. A downgrade in the Company's financial strength or credit ratings may increase policy surrenders and withdrawals, reduce new sales and may result in terminated relationships with distributors such as agents, general agents and third-party administrators. A downgrade could also impact existing liabilities and increase the Company's cost of capital. Any of these occurrences could adversely affect the Company's profitability and financial condition. In the event that the Company's current internal sources of liquidity do not satisfy the needs, additional financing may be required and, in such case, the Company may not be able to successfully obtain additional financing on favorable terms, or at all. The availability of additional financing will depend on a variety of factors such as market conditions, the general availability of credit, the volume of trading activities, the overall availability of credit to the financial services industry, the Company's credit ratings and credit capacity, as well as the possibility that customers or lenders could develop a negative perception of long- or short-term financial prospects if the Company incurs large investment losses or if the level of business activity decreased due to a market downturn. Similarly, access to funds may be impaired if regulatory authorities or rating agencies take negative actions against the Company.

Disruptions, uncertainty or volatility in the capital and credit markets may also limit the Company's access to external sources of liquidity, which could be required to operate its business. Such market conditions could limit the Company's ability to replace, in a timely manner, maturing liabilities; satisfy capital requirements; fund redemption requests on insurance or other financial products; generate fee income and market-related revenue; meet liquidity needs, and access the capital necessary to grow the business. As such, the Company could be forced to delay raising capital, utilize available internal resources or bear an unattractive cost of capital, which could decrease the Company's profitability and significantly reduce financial flexibility and liquidity.

The Company may be unable to complete additional acquisitions.

One of the Company's growth strategies is to acquire other life insurance companies and/or blocks of business. The Company's previous acquisitions have increased earnings by allowing the Company to realize certain operating efficiencies or increase sales. There can be no assurance, however, that suitable acquisitions that present opportunities for continued growth and operating efficiencies will continue to be available to the Company. Further, sufficient capital to fund acquisitions may not be available at the time opportunities become available.

The Company may not realize its anticipated financial results from its acquisitions.

The completion of an acquisition may be more costly or take longer than expected. There may be unforeseen liabilities that arise in connection with businesses that the Company acquires. Additionally, in connection with its acquisitions, the Company assumes or otherwise becomes responsible for the obligations of policies and other liabilities of other insurers. Any regulatory, legal, financial, or other adverse development affecting the other insurer could also have an adverse effect on the Company.

The Company's policy claims fluctuate from period to period, resulting in earnings volatility.

The Company's financial results may fluctuate from period to period due to fluctuations in policy claims incurred by the Company. However, the Company reinsures a significant amount of the mortality risk on fully underwritten and newly issued individual life insurance contracts. The Company regularly reviews retention limits for continued appropriateness and they may be changed in the future. If the Company was to experience significant adverse mortality or morbidity experience, a significant portion of that expense would be reimbursed by reinsurers.

Significant adverse mortality experience may result in the loss of, or higher prices for, reinsurance.

Prolonged or severe adverse mortality or morbidity experience could result in increased reinsurance costs, and ultimately, reinsurers not being willing to offer coverage. If the Company was unable to maintain its current level of reinsurance or purchase new reinsurance protection in amounts that are considered sufficient, the Company would either have to be willing to accept an increase in net exposures or revise pricing to reflect higher reinsurance premiums. If this were to occur, the Company may be exposed to reduced profitability and cash flow strain or may not be able to price new business at competitive rates.

Table of Contents

The Company’s results may be negatively affected should actual experience differ from management’s assumptions and estimates.

In the conduct of business, the Company makes certain assumptions regarding the mortality, persistency, expenses, interest rates, tax liability, business mix, or other factors appropriate to the type of business it expects to experience in future periods. These assumptions are also used to estimate the amounts of deferred policy acquisition costs, value of business acquired, policy reserves and accruals, future earnings, and various components of the Company’s balance sheet. These assumptions are used in the operations of the Company’s business in making decisions crucial to the success of the Company, including the pricing of products and expense structures relating to products. The Company’s actual experience and changes in estimates are reflected in the Company’s financial statements. The Company’s actual experience may vary from period to period, and from established assumptions, potentially resulting in variability in the financial statements.

The Company’s reserves for future policy benefits may prove to be inadequate.

The Company establishes and carries, as a liability, reserves based on estimates of how much will be needed to pay for future benefits and claims. The assumptions and estimates used in connection with establishing and carrying reserves are inherently uncertain. If actual experience is significantly different from assumptions or estimates, reserves may prove to be inadequate in relation to estimated future benefits and claims. As a result, a charge to earnings would be incurred in the quarter in which the Company increases reserves.

The pattern of amortizing Deferred Acquisition Costs (DAC) and Value of Business Acquired (VOBA) may change, impacting both the level of the asset and the timing of the Company’s net income (loss).

Amortization of DAC and VOBA depend on the actual and expected profits generated by the lines of business that incurred the costs. Expected profits are dependent on assumptions regarding a number of factors, including investment returns, benefit payments, expenses, mortality and policy lapse. Due to the uncertainty associated with establishing these assumptions, the Company cannot determine the exact pattern of profit emergence. As a result, amortization of DAC and VOBA will vary from period-to-period as actual profits replace expected profits and future expected profits are re-projected based on the current status of the lines of business. To the extent that actual experience emerges less favorably than expected or expectations for future profits decrease, the DAC and VOBA assets may be reduced. This would likely result in reduced profitability in the current period.

Assumptions and estimates involve judgment and are subject to changes and revision over time.

The calculations the Company uses to estimate various components of its financial statements are necessarily complex and involve analyzing and interpreting large quantities of data. The Company employs various techniques for such calculations and, from time to time, will develop and implement more sophisticated systems and procedures capable of facilitating the calculation of more precise estimates. Accordingly, the Company’s results may be affected, positively or negatively, by actual results differing from assumptions, by changes in estimates, and by changes resulting from implementing new administrative systems and procedures that facilitate the calculation of more precise estimates.

The Company’s reinsurers could fail to meet assumed obligations or be subject to adverse developments that could affect the Company.

The Company follows the insurance practice of reinsuring a portion of the risks under the policies written by the Company (known as ceding). The Company cedes material amounts of insurance to other insurance companies through reinsurance. This reinsurance makes the assuming reinsurer liable to the Company for the reinsured portion of the risk. However, reinsurance does not discharge the Company from its primary obligation to pay policyholders for losses insured under the policies that are issued. Therefore, the failure of one or more of the Company's reinsurers could negatively impact the Company's earnings and financial position.

The Company's ability to compete is dependent on the availability of reinsurance, cost of reinsurance or other substitute capital market solutions.

Premium rates charged by the Company are based, in part, on the assumption that reinsurance will be available at a certain cost. Under certain reinsurance agreements, the reinsurer may increase the rate it charges the Company for the reinsurance. Therefore, if the cost of reinsurance were to increase or if reinsurance were to become unavailable or if alternatives to reinsurance were not available, the Company could be adversely affected.

Recently, access to reinsurance has become more costly for the Company, as well as the insurance industry in general. In recent years, the number of life reinsurers has decreased as the reinsurance industry has consolidated. The decreased number of participants in the life reinsurance market results in increased concentration risk for insurers, including the Company. If the reinsurance market further contracts, the Company's ability to continue to offer its products on terms favorable to the Company could be adversely impacted.

The use of reinsurance introduces variability in the Company's financial statements.

The timing of premium payments to and receipt of expense allowances from reinsurers may differ from the Company's receipt of customer premium payments and incurrence of expenses. Reinsurance may introduce variability in certain components of the Company's financial statements.

The Company's investments are subject to market and credit risks.

The Company's invested assets, primarily including fixed income securities, are subject to customary risks of credit defaults and changes in fair values. The value of the Company's commercial mortgage loan and real estate portfolios also depend on the financial condition of the tenants occupying the properties which the Company has financed. Factors that may affect the overall default rate on and fair value of the Company's invested assets includes interest rate levels, financial market performance, and general economic conditions, as well as particular circumstances affecting the businesses of individual borrowers and tenants.

Interest rate fluctuations could negatively affect the Company's spread income or otherwise impact its business.

Because the profitability of fixed annuity and interest-sensitive whole life, universal life and the fixed portion of variable universal life insurance business depends in part on interest rate spreads, interest rate fluctuations could negatively affect profitability. Changes in interest rates may reduce both the profitability and the return on invested capital.

Some of the Company's products, principally fixed annuities and interest-sensitive whole life, universal life and the fixed portion of variable universal life insurance, have interest rate guarantees that expose the Company to the risk that changes in interest rates will reduce the spread, or the difference between the amounts the Company is required to credit to policyholders under contracts and the amounts earned by the Company on general account investments. Declines in spread or instances where the returns on the general account investments are not sufficient to support the interest rate guarantees on these products could have a material adverse effect on the results of operations. In periods of increasing interest rates, the Company may not be able to replace the assets in the general account with higher yielding assets needed to fund the higher crediting rates that may be necessary to keep interest sensitive products competitive. The Company, therefore, may have to accept a lower spread and profitability or face a decline in sales and loss of existing contracts from non-renewed maturities or early withdrawals or surrenders. In periods of declining interest rates, the Company has to reinvest the cash received from interest or return of principal on investments in lower yielding instruments then available. Moreover, issuers of fixed-income securities and borrowers may prepay these obligations in order to borrow at lower market rates, which exacerbates the risk for the Company of having to reinvest at lower rates.

The Company is entitled to reset the interest rates it credits on fixed-rate annuities but only at limited, pre-established intervals. Because many of the Company's policies have guaranteed minimum interest or crediting rates, spreads could decrease and potentially become negative. Increases in interest rates may cause increased surrenders and withdrawals of insurance products. In periods of increasing interest rates, policy loans and surrenders and withdrawals of life insurance policies and annuity contracts may increase as policyholders seek to buy products with higher returns. These outflows may require investment assets to be sold at a time when the prices of those assets are lower because of the increase in market interest rates, which may result in realized investment losses.

Changes in interest rates may also impact the business in other ways. Lower interest rates may result in lower sales of certain of the Company's insurance products. Higher interest rates may create a less favorable environment for the origination of mortgage loans. Higher interest rates may also result in lower sales of variable products.

While the Company develops and maintains asset/liability management programs and procedures designed to mitigate the effect on spread income in rising or falling interest rate environments, no assurance can be given that changes in interest rates will not affect such spreads. Additionally, the Company's asset/liability management programs incorporate assumptions about the relationship between short-term and long-term interest rates (i.e., the slope of the yield curve) and relationships between risk-adjusted and risk-free interest rates, market liquidity, and policyholder behavior in periods of changing interest rates and other factors. The effectiveness of the Company's asset/liability management programs and procedures may be negatively affected whenever actual results differ from these assumptions.

Table of Contents

The Company’s valuation of fixed maturity and equity securities may include methodologies, estimations and assumptions which are subject to differing interpretations and could result in changes to investment valuations that may have a material adverse effect on the results of operations or financial condition.

Fixed maturity securities, equity securities, and short-term investments are reported at fair value on the consolidated balance sheet and represent the majority of total cash and invested assets. FASB Accounting Standards Codification (ASC) 820 establishes a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The level in the fair value hierarchy is based on the priority of the inputs to the respective valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and lowest priority to unobservable inputs (Level 3). An asset or liability’s classification within the fair value hierarchy is based on the lowest level of significant input to its valuation.

During periods of market disruption, including periods of significantly rising or high interest rates, rapidly widening credit spreads or illiquidity, it may be difficult to value certain securities if trading becomes less frequent and/or market data becomes less observable. There may be certain asset classes such as certain residential mortgage-backed securities, collateralized debt obligations and asset-backed securities that were previously acquired and valued in active markets with significant observable data and that are required to be valued in illiquid markets with little observable data. In such cases, more securities may be classified in Level 3 and, therefore, require more subjectivity and management judgment. As such, valuations may include inputs and assumptions that are less observable or require greater estimation as well as valuation methods which are more complex or require greater estimation, thereby resulting in values which may be less than the value at which the investments may or could be ultimately sold. Further, rapidly changing credit and equity market conditions could materially impact the valuation of securities as reported with the consolidated financial statements and the period-to-period changes in value could vary significantly. Decreases in value could have a material adverse effect on the Company’s results of operations or financial condition.

The determination of the amount of realized and unrealized impairments and allowances established on the Company’s investments is highly subjective and could materially impact results of operations or financial position.

The determination of the amount of impairments and allowances vary by investment type and is based upon the Company’s evaluation and assessment of known and inherent risks associated with the respective asset class. Such evaluations and assessments are revised as conditions change and new information becomes available. There can be no assurance that the assumptions, methodologies and judgments employed in these evaluations and assessments will be deemed to be accurate or sufficient. As a result, additional impairments may need to be realized or allowances provided for in the future. Further, historical trends may not be indicative of future impairments or allowances.

Additionally, the Company considers a wide range of factors about security issuers and uses its best judgment in evaluating the cause of the decline in the fair value of the security and in assessing the prospects for recovery. Inherent in management’s evaluation of the security are assumptions and estimates about the operations of the issuer, its future earnings potential and the ability and timeliness of the security’s recovery in fair value.

The Company could be forced to sell investments at a loss to meet policyholder withdrawals.

Many of the products offered by the Company allow policyholders and contract holders to withdraw their funds under defined circumstances. The Company manages liabilities and configures the investment portfolio so as to provide and maintain sufficient liquidity to support anticipated withdrawal demands and contract benefits and maturities. While the Company owns a significant amount of liquid assets, a certain portion of investment assets are relatively illiquid. If the Company experiences unanticipated withdrawal or surrender activity, the Company could exhaust all other sources of liquidity and be forced to liquidate other assets, perhaps on unfavorable terms. If the Company is forced to dispose of assets on unfavorable terms, it could have an adverse effect on the Company’s results of operations and financial condition.

Equity market volatility could negatively impact the Company’s business.

The amount of policy fees received from variable products is affected by the performance of the equity markets, increasing or decreasing as markets rise or fall. Equity market volatility also affects the profitability of products accounted for under fair value measures, as increases and decreases in volatility can increase or decrease the fair value of liabilities.

The amortization of deferred policy acquisition costs relating to variable products incorporate various assumptions about the overall performance of equity markets. The rate of amortization of deferred policy acquisition costs could change if equity market performance is significantly different than assumed.

Table of Contents

Computer viruses or network security breaches could affect the data processing systems of the Company or its business partners and could damage business and adversely affect the Company's financial condition and results of operations.

Computer viruses could affect the data processing systems of the Company or its business partners, destroying valuable data or making it difficult to conduct business. In addition, despite the Company's implementation of network security measures, its servers could be subject to physical and electronic break-ins, and similar disruptions from unauthorized tampering with its computer systems. The Company retains confidential information in its computer systems, and relies on sophisticated computer technologies to maintain the security of those systems. Anyone who is able to circumvent the Company's security measures and penetrate the Company's computer systems could access, view, misappropriate, alter, or delete any information in the systems, including personally identifiable customer information and proprietary business information. In addition, an increasing number of states require that customers be notified if a security breach results in the disclosure of personally identifiable customer information. Any compromise of the security of the Company's computer systems that results in inappropriate disclosure of personally identifiable customer information could damage the Company's reputation in the marketplace, deter people from purchasing the Company's products, subject the Company to significant civil and criminal liability and require the Company to incur significant technical, legal and other expenses.

Insurance companies are highly regulated and are subject to numerous legal restrictions and regulations.

The Company is subject to government regulation in each of the states in which business is conducted. Such regulation is vested in state agencies having broad administrative and, in some instances, discretionary power dealing in with many aspects of the Company's business. This may include, among other things, premium rates and increases thereto, reserve requirements, marketing practices, advertising, privacy, policy forms, reinsurance reserve requirements, acquisitions, mergers, and capital adequacy. Government regulation of insurers is concerned primarily with the protection of policyholders and other customers rather than share owners. Interpretations of regulations by regulators may change and statutes, regulations and interpretations may be applied with retroactive impact, particularly in areas such as accounting or reserve requirements.

The Company cannot predict whether or in what manner regulatory reforms will be enacted and, if so, whether the enacted reforms will positively or negatively affect the Company or whether any effects will be material. Moreover, although with respect to some financial regulations and guidelines, states defer to the interpretation of the insurance department of the state of domicile, neither the action of the domiciliary state nor action of the National Association of Insurance Commissioners (NAIC) is binding on a state. Accordingly, a state could choose to follow a different interpretation.

Other types of regulation that could affect the Company include insurance company investment laws and regulations, state statutory accounting practices, anti-trust laws, minimum solvency requirements, state securities laws, federal privacy laws, insurable interest laws, federal money laundering and anti-terrorism laws. Further, because the Company owns and operates real property, state, federal and local environmental laws could affect the Company. The Company cannot predict what form any future changes in these or other areas of regulation affecting the insurance industry might take or what effect, if any, such proposals might have on the Company if enacted into law.

Publicly held companies in general and the financial services industry, in particular, are sometimes the target of law enforcement investigations and the focus of increased regulatory scrutiny.

The financial services industry has become the focus of increased scrutiny by regulatory and law enforcement authorities relating to allegations of improper special payments, price-fixing, bid-rigging and other alleged misconduct, including payments made by insurers and other financial services providers to brokers and the practices surrounding the placement of insurance business and sales of other financial products.

New accounting rules or changes to existing accounting rules could negatively impact the Company.

Like all publicly traded companies, the Company is required to comply with accounting principles generally accepted in the United States of America (GAAP). A number of organizations are instrumental in the development and interpretation of GAAP, such as the SEC, the Public Company Accounting Oversight Board (PCAOB), the Financial Accounting Standards Board (FASB), and the American Institute of Certified Public Accountants (AICPA).

GAAP is subject to constant review by these organizations and others in an effort to address emerging accounting rules and issue interpretative accounting guidance on a continual basis. The Company can give no assurance that future changes to GAAP or the required adherence to International Financial Reporting Standards (IFRS) will not have a negative impact on the Company.

Table of Contents

In addition, the Company is required to comply with statutory accounting principles (SAP). SAP and various components of SAP (such as statutory actuarial reserving methodology) are subject to constant review by the NAIC and its taskforces and committees as well as state insurance departments to address emerging issues and otherwise improve or alter financial reporting. Various proposals are typically pending before committees and taskforces of the NAIC, some of which, if enacted, may negatively affect the Company and some of which could positively impact the Company. The NAIC also typically works to reform state regulation in various areas, including reforms relating to life insurance reserves and the accounting for such reserves. The Company cannot predict whether or in what manner reforms will be enacted and, if so, whether the enacted reforms will positively or negatively affect the Company. Although, states generally defer to the interpretation of the insurance department of the state of domicile with regards to regulations and guidelines, neither the action of the domiciliary state nor action of the NAIC is binding on a state. Accordingly, a state could choose to follow a different interpretation. The Company can give no assurance that future changes to SAP or components of SAP will not have a negative impact on the Company.

Changes to tax law or interpretations of existing tax law could adversely affect the Company and its ability to compete with non-insurance products or reduce the demand for certain insurance products.

Under the Internal Revenue Code of 1986, as amended (the Code), income tax payable by policyholders on investment earnings is deferred during the accumulation period of certain life insurance and annuity products. This favorable tax treatment may give certain of the Company's products a competitive advantage over other non-insurance products. To the extent that the Code is revised to reduce the tax-deferred status of life insurance and annuity products or to increase the tax-deferred status of competing products, all life insurance companies, including the Company, would be adversely affected with respect to their ability to sell such products. Further, depending upon grandfathering provisions, life insurance companies would be affected by the surrenders of existing annuity contracts and life insurance policies. Changes in tax law, which have reduced the federal income tax rates on corporate dividends in certain circumstances, could make the tax advantages of investing in certain life insurance or annuity products less attractive. Additionally, changes in tax law based on proposals to establish new tax-advantaged retirement and life savings plans, if enacted, could reduce the tax advantage of investing in certain life insurance or annuity products. The Company cannot predict what changes to tax law or interpretations of existing tax law may ultimately be enacted or whether such changes could adversely affect the Company.

A rating downgrade could adversely affect the Company's ability to compete and increase the number or value of policies surrendered.

The Company's financial strength rating, which is intended to measure its ability to meet policyholder obligations, is an important factor affecting public confidence in most of the Company's products and, as a result, the Company's competitiveness. Rating organizations periodically review the financial performance and condition of insurers, including the Company, and downgrades of insurance companies have occurred with increasing frequency.

A downgrade in the Company's rating could adversely affect the Company's ability to sell its products, retain existing business, and compete for attractive acquisition opportunities. Rating organizations assign ratings based upon several factors. While most of the factors relate to the rated company, some of the factors relate to the views of the rating organization, general economic conditions and circumstances outside the rated company's control. In addition, rating organizations use various models and formulas to assess the strength of a rated company, and from time to time rating organizations have, in their discretion, altered the models. Changes to the models could impact the rating organizations' judgment of the rating to be assigned to the rated company. The Company cannot predict what actions rating organizations may take or what actions the Company may be required to take in response to the actions of the rating organizations, which could adversely affect the Company.

Financial services companies are frequently the targets of litigation, including class action litigation, which could result in substantial judgments.

A number of civil jury verdicts have been returned against insurers, broker-dealers, and other providers of financial services involving sales or claims practices, alleged agent misconduct, failure to properly supervise representatives, relationships with agents or other persons with whom the insurer does business, and other matters. Often these lawsuits have resulted in the award of substantial judgments that are disproportionate to the actual damages, including material amounts of punitive non-economic compensatory damages. In some states, juries, judges, and arbitrators have substantial discretion in awarding punitive and non-economic compensatory damages, which creates the potential for unpredictable material adverse judgments or awards in any given lawsuit or arbitration. Arbitration awards are subject to very limited appellate review. In addition, in some class actions and other lawsuits, companies have made material settlement payments.

The Company, like other financial services companies, is involved in litigation and arbitration in the ordinary course of business. Although the Company cannot predict the outcome of any litigation or arbitration, the results could have a negative impact on the financial condition or results of operations of the Company.

The Company is exposed to the risks of climate change, natural disasters, pandemics, or other acts that could adversely affect the Company's operations.

While the Company has implemented risk management and contingency plans and taken preventive measures and other precautions, no predictions of specific scenarios can be made nor can assurance be given that there are not scenarios that could have an adverse effect on the Company. Climate change, a natural disaster, a pandemic, or an outbreak of an easily communicable disease could adversely affect the mortality or morbidity experience of the Company or its reinsurers. A pandemic could also have an adverse effect on lapses and surrenders of existing policies, as well as sales of new policies. In addition, a pandemic could result in large areas being subject to quarantine, with the result that economic activity slows or ceases, adversely affecting the marketing or administration of the Company's business. These effects, in turn, could have an adverse financial effect on the Company. The possible macroeconomic effects of climate change, natural disasters or pandemics could also adversely affect the Company's asset portfolio, as well as many other variables.

The Company is dependent on the performance of others.

The Company's results may be affected by the performance of others because the Company has entered into various arrangements involving other parties. For example, most of the Company's products are sold through independent distribution channels, and variable annuity deposits are invested in funds managed by third parties. Additionally, the Company's operations are dependent on various technologies, some of which are provided by other parties.

As with all financial services companies, the Company's ability to conduct business is dependent upon consumer confidence in the industry and its products. Actions of competitors and financial difficulties of other companies in the industry could undermine consumer confidence and adversely affect retention of existing business and future sales of the Company's insurance and investment products.

Risk management policies and procedures may leave the Company exposed to unidentified or unanticipated risk, which could negatively affect business or result in losses.

The Company has devoted significant resources to develop risk management policies and procedures and will continue to do so in the future. However, the Company's policies and procedures used to identify, monitor and manage risks may not be fully effective. Many of the methods of managing risk and exposures are based upon the use of observed historical market behavior or statistics based on historical models. As a result, these methods may not effectively identify or evaluate the magnitude of existing or future exposures, which could be significantly greater than the historical measures indicate. An example of such risks include the risk of pandemics, which could cause a large number of deaths. Other risk management methods depend upon the evaluation of information regarding markets, clients, catastrophe occurrence or other matters that are publicly available or otherwise accessible to us, which may not always be accurate, complete, up-to-date or properly evaluated. Management of operational, legal and regulatory risks requires, among other things, policies and procedures to record properly and verify a large number of transactions and events, and these policies and procedures may not be fully effective. Additional risks and uncertainties not currently known or that the Company currently deems to be immaterial, may adversely affect the business, financial condition and/or operating results.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

The Company's home office is located at 3520 Broadway in Kansas City, Missouri. The Company owns and wholly occupies two five-story buildings on an eight-acre site.

The Company owns various other properties held for investment.

Item 3. LEGAL PROCEEDINGS

The life insurance industry, including the Company and its subsidiaries, has been subject to an increase in litigation in recent years. Such litigation has been pursued on behalf of purported classes of insurance purchasers, often questioning the conduct of insurers in the marketing of their products.

Table of Contents

In addition to the above, the Company and its subsidiaries are defendants in, or subject to, other claims or legal actions. Some of these claims and legal actions are in jurisdictions where juries are given substantial latitude in assessing damages, including punitive damages. Although no assurances can be given and no determinations can be made at this time, management believes that the ultimate liability, if any, with respect to these other claims and legal actions would not have a material effect on the Company's business, results of operations or financial position.

Table of Contents

PART II

Item 4. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

STOCKHOLDER INFORMATION

CORPORATE HEADQUARTERS
Kansas City Life Insurance Company
3520 Broadway
Post Office Box 219139
Kansas City, Missouri 64121-9139
Telephone: (816) 753-7000
Fax: (816) 753-4902
Internet: http://www.kclife.com
E-mail: kclife@kclife.com

NOTICE OF ANNUAL MEETING
The annual meeting of stockholders will be held at 9 a.m. on Thursday, April 22, 2010 at Kansas City Life's corporate headquarters.

TRANSFER AGENT
William A. Schalekamp, Secretary
Kansas City Life Insurance Company
Post Office Box 219139
Kansas City, Missouri 64121-9139

10-K REQUEST
Stockholders may request a free copy of Kansas City Life's Form 10-K, as filed with the Securities and Exchange Commission, by writing to Secretary, Kansas City Life Insurance Company.

SECURITY HOLDERS
As of January 31, 2010, Kansas City Life had approximately 2,500 security holders, including individual participants in security position listings.

Table of Contents

STOCK AND DIVIDEND INFORMATION
Stock Quotation Symbol
NASDAQ—KCLI

The following table presents the high and low prices for the Company's common stock for the periods indicated and the dividends declared per share during such periods.

	High	Low	Dividend Paid
2009:			
First quarter	$ 44.63	$ 15.20	$ 0.27
Second quarter	40.22	19.70	0.27
Third quarter	37.75	25.39	0.27
Fourth quarter	33.31	25.00	0.27
			$ 1.08
2008:			
First quarter	$ 49.15	$ 39.36	$ 0.27
Second quarter	52.85	41.51	0.27
Third quarter	57.93	41.16	0.27
Fourth quarter	53.93	33.06	0.27
			$ 1.08

A quarterly dividend of $0.27 per share was paid February 10, 2010.

NASDAQ market quotations are compiled according to Company records and may reflect inter-dealer prices, without markup, markdown or commission and may not necessarily represent actual transactions.

Table of Contents

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased Open Market/ Benefit Plans		Average Purchase Price Paid per Share	Total Number of Shares Purchased as a Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
1/01/09 - 1/31/09	-1	$	-	-	1,000,000
	24,5862	$	36.17		
2/1/09 - 2/28/09	-1	$	-	-	1,000,000
	17,1912	$	27.92		
3/1/09 - 3/31/09	-1	$	-	-	1,000,000
	143,7692	$	17.64		
4/1/09-4/30/09	-1	$	-	-	1,000,000
	35,9362	$	24.89		
5/1/09-5/31/09	-1	$	-	-	1,000,000
	144,4802	$	23.17		
6/1/09-6/30/09	-1	$	-	-	1,000,000
	45,5602	$	23.34		
7/1/09-7/31/09	-1	$	-	-	1,000,000
	114,3382	$	26.49		
8/1/09-8/31/09	-1	$	-	-	1,000,000
	5722	$	33.13		
9/1/09-9/30/09	-1	$	-	-	1,000,000
	-2				
10/1/09 - 10/31/09	-1	$	-	-	1,000,000
	-2	$	-		
11/1/09 - 11/30/09	66,8711	$	27.52	66,871	933,129
	2762	$	28.59		
12/1/09 - 12/31/09	17,3021	$	27.82	17,302	915,827
	2	$	-		
Total	610,881			84,173	

1On January 26, 2009, the Company's Board of Directors authorized the repurchase of up to 1,000,000 shares of its common stock. Under this program in 2009, the Company acquired 84,173 shares at an average price of $27.58. Under a similar program, the Company purchased 181,661 shares in 2008 at an average price of $45.38; and 90,341 shares in 2007 at an average price of $45.59. The 2009 repurchase program expired January 24, 2010. On January 25, 2010, the Company's Board of Directors authorized the repurchase of up to 1,000,000 shares of its common stock through January 24, 2011.

2Included in this column are the total shares purchased from benefit plans sponsored by the Company during the consecutive months of January through December of 2009.

Table of Contents

The Company filed two Form S-8s, with the SEC on July 9, 2009. The first Form S-8 was to register an additional 1,100,000 shares of the common shares and plan interests relating to the Thirty-First Amendment and Restatement of the Kansas City Life Insurance Company Savings and Profit Sharing Plan, as amended for which securities of the same class were registered on a registration statement on Form S-8 previously filed and effective on June 20, 2000. The second Form S-8 was to register an additional 200,000 shares of the Company's common stock issued to the Kansas City Life Deferred Compensation Plan (the "Plan"), as amended and the Company's Deferred Compensation Obligations issued in accordance with and pursuant to the Plan. In conjunction with these filings, an additional 114,138 shares of the Company's common stock were issued from treasury and became outstanding.

The Company filed two Form S-3s, with the SEC on July 27, 2009. The first form S-3 was to register an additional 20,000 shares of common stock contributed to a grantor (rabbi) trust established in connection with the Company's Pre-2005 Agent's Deferred Compensation Plan and the Company's deferred compensation obligations issued in accordance with and pursuant to the Pre-2005 Agent's Deferred Compensation Plan. The second Form S-3 was to register an additional 38,000 shares of common stock contributed to a grantor (rabbi) trust established in connection with the Company's Agent's Deferred Compensation Plan and the Company's deferred compensation obligations issued in accordance with and pursuant to the Agent's Deferred Compensation Plan.

During the third quarter of 2009, the Company discontinued purchase and sale transactions of the Company's common stock with employee and agent benefit plans sponsored by the Company. The Company's benefit plans instead conduct such transactions in the open market. Until the implementation of the Form S-8s and Form S-3s, as identified above, the Company had conducted these transactions as purchases and sales of treasury stock. Accordingly, in 2009, the benefit plans purchased 312,236 shares of treasury stock and sold 526,432 shares of treasury stock for a net change in treasury stock of $2.1 million.

Table of Contents

Item 5. SELECTED FINANCIAL DATA
Amounts in thousands, except share data.

	Year Ended December 31				
	2009	2008	2007	2006	2005
Income Statement Data:					
Revenues:					
Insurance revenues	$ 241,664	$ 236,173	$ 231,894	$ 235,264	$ 238,503
Net investment income	177,428	177,419	190,405	196,280	194,608
Realized investment gains (losses)	(10,076)	(52,271)	5,426	5,621	6,113
Other revenues	10,579	13,005	11,499	11,349	10,312
Total revenues	$ 419,595	$ 374,326	$ 439,224	$ 448,514	$ 449,536
Net income (loss)	$ 10,732	$ (17,050)	$ 35,661	$ 36,918	$ 36,184
Per Common Share Data:					
Net income (loss), basic and diluted	$ 0.93	$ (1.47)	$ 3.01	$ 3.11	$ 3.03
Cash dividends to stockholders	$ 1.08	$ 1.08	$ 3.08	$ 1.08	$ 1.08
Stockholders' equity	$ 54.33	$ 46.11	$ 58.17	$ 57.72	$ 57.07

	December 31				
	2009	2008	2007	2006	2005
Balance Sheet Data:					
Assets	$ 4,176,185	$ 3,967,091	$ 4,352,108	$ 4,457,795	$ 4,555,379
Notes payable	-	2,900	10,400	14,700	27,282
Stockholders' equity	628,363	527,107	684,401	684,304	680,219
Life insurance in force	$ 30,683,571	$ 30,300,286	$ 31,135,142	$ 31,261,016	$ 30,949,501

Table of Contents

Item 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Amounts are stated in thousands, except share data, or as otherwise noted.

Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to provide in narrative form the perspective of the management of Kansas City Life Insurance Company (the Company) on its financial condition, results of operations, liquidity and certain other factors that may affect its future results for the three years ended December 31, 2009. This discussion should be read in conjunction with the consolidated financial statements and accompanying notes included in this document.

Overview

Kansas City Life Insurance Company is a financial services company that is predominantly focused on sales and administration of life and annuity insurance products. The consolidated entity (the Company) primarily consists of three life insurance companies. Kansas City Life Insurance Company (Kansas City Life) is the parent company. Sunset Life Insurance Company of America (Sunset Life) and Old American Insurance Company (Old American) are wholly-owned subsidiaries.

Kansas City Life markets individual insurance products, including traditional, interest sensitive and variable products through a nationwide sales force of independent general agents and third-party marketing arrangements. Kansas City Life also markets group insurance products, which include life, dental, vision and disability products through a nationwide sales force of independent general agents, group brokers and third-party marketing arrangements. Kansas City Life operates in 48 states and the District of Columbia.

Sunset Life is a life insurance company that maintains its current block of business, but does not produce new sales. Sunset Life is included in the Individual Insurance segment and its individual insurance products include traditional and interest sensitive products. Sunset Life operates in 43 states and the District of Columbia.

Old American sells final expense life insurance products nationwide through a general agency system, with exclusive territories, using direct response marketing to supply agents with leads. Old American's administrative and accounting operations are part of the Company's home office but it operates and maintains a separate and independent field force. Old American operates in 46 states and the District of Columbia.

The Company offers investment products and broker-dealer services through its subsidiary Sunset Financial Services, Inc. (SFS) for both proprietary and non-proprietary variable insurance products, mutual funds and other securities.

The Company operates in the life insurance sector of the financial services industry in the United States. This industry is highly competitive with respect to pricing, selection of products and quality of service. No single competitor or any small group of competitors dominates any of the markets in which the Company operates. General economic conditions may affect future results.

The Company earns revenues primarily from premiums received from the sale of life, immediate annuity and accident and health policies, from earnings on its investment portfolio and from the sale of investment assets. Revenues from the sale of traditional life insurance and immediate annuity products and accident and health products are reported as premium income for financial statement purposes. Considerations for supplementary contracts with life contingencies are reported as part of other revenues. However, deposits received from the sale of interest sensitive products, namely universal life insurance products, deferred annuities, and annuities and supplementary contracts without life contingencies are not reported as premium revenues, but are instead reported as additions to the policyholders' account balances and are reflected as deposits in the Consolidated Statements of Cash Flows. Accordingly, revenues on these products are recognized over time in the form of contract charges assessed against policyholder account balances, charges assessed on the early surrender of policyholder account balances and other charges deducted from policyholders' balances.

The Company's profitability depends on many factors, which include but are not limited to:

- The sale of life, annuity, and accident and health products;
- The rate of mortality, lapse and surrenders of future policy benefits and policyholder account balances;
- The rate of morbidity, disability and incurrence of other policyholder benefits;
- Persistency of existing insurance policies;
- Interest rates credited to policyholders;

Table of Contents

- The effectiveness of reinsurance programs;
- The amount of investment assets under management;
- Investment spreads earned on policyholder account balances;
- The ability to maximize investment returns and minimize risks such as interest rate risk, credit risk and equity risk;
- Timely and cost-effective access to liquidity; and
- Management of distribution costs and operating expenses.

Strong sales competition, highly competitive products and a difficult economic environment present significant challenges to the Company from a new sales perspective. The Company's primary emphasis is on expanding sales of individual life insurance products. The Company's continued focus is on delivering competitive products for a reasonable cost, prompt customer service, excellent financial strength and effective sales and marketing support to the field force.

The Company generates cash largely through premiums collected through the sale of insurance products, and deposits through the sale of universal life-type and deposit-type products and through investment activity. The principal uses of cash are for the insurance operations, including the purchase of investments, payment of insurance benefits and other withdrawals from policyholder accounts, operating expenses, premium taxes, and costs related to acquiring new business. In addition, cash is used to pay income taxes and stockholder dividends, as well as to fund potential acquisition opportunities.

Starting in 2007 and continuing into 2009, extreme fluctuations in market conditions significantly impacted the financial markets and the Company's investments and revenues. The interest rate and credit environments have presented a significant challenge to the markets as a whole and specifically to companies invested in fixed maturity and equity securities. These conditions may persist into the future as the credit and equity markets continue to be challenged, particularly in the financial services sector. The Company is broadly diversified and has high quality investments, as 94% of all fixed maturity securities were investment grade at December 31, 2009. However, as a result of the consolidations occurring in the financial services sector, diversification in this sector will be a challenge until greater market stabilization occurs. In addition, the entrance of the U.S. Government into private company arrangements and specific guarantees may add further complications to a variety of issues, which are yet to be fully determined.

Business Changes

In January of 2007, the Company completed the sale of its bank subsidiary, Generations Bank, for $10.1 million in cash after receiving regulatory approval. The gain on the sale was $1.9 million and was included in realized investment gains. The bank subsidiary and the results of operations were not material to the financial statements of the Company and are not disclosed separately.

Cautionary Statement on Forward-Looking Information

This report reviews the Company's financial condition and results of operations, and historical information is presented and discussed. Where appropriate, factors that may affect future financial performance are also identified and discussed. Certain statements made in this report include "forward-looking statements" that fall within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include any statement that may predict, forecast, indicate or imply future results, performance or achievements rather than historical facts and may contain words like "believe," "expect," "estimate," "project," "forecast," "anticipate," "plan," "will," "shall," and other words expressions with similar meaning.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those contemplated by the forward-looking statements. Factors that could cause the Company's future results to differ materially from expected results include, but are not limited to:

- Changes in general economic conditions, including the performance of financial markets and interest rates;
- Increasing competition and changes in consumer behavior, which may affect the Company's ability to sell its products and retain business;
- Customer and agent response to new products, distribution channels and marketing initiatives;
- Fluctuations in experience regarding current mortality, morbidity, persistency and interest rates relative to expected amounts used in pricing the Company's products;
- Changes in assumptions related to deferred acquisition costs and the value of business acquired;
- Regulatory, accounting or tax changes that may affect the cost of, or the demand for, the Company's products or services; and
- Unanticipated changes in industry trends and ratings assigned by nationally recognized rating organizations.

Table of Contents

The Company cannot give assurances that such statements will prove to be correct. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

Critical Accounting Policies and Estimates

The accounting policies below have been identified as critical to the understanding of the results of operations and financial position. The application of these critical accounting policies in preparing the financial statements requires management to use a variety of assumptions and estimates, in particular expectations of current and future mortality, morbidity, persistency, expenses, interest rates and equity market performance. Actual results may differ from these estimates under different assumptions or conditions. The profitability of life insurance and annuity products is dependent on actual experience, and differences between actual experience and pricing assumptions may result in variability of net income (loss) in amounts which may be material. On an ongoing basis, the Company evaluates the estimates, assumptions and judgments based on historical experience and other information that the Company believes to be reasonable under the circumstances. A detailed discussion of significant accounting policies is provided in Note 1 – Nature of Operations and Significant Accounting Policies in the Notes to Consolidated Financial Statements.

Valuation of Investments
The Company's principal investments are in fixed maturity securities, mortgage loans and real estate; all of which are exposed to three primary sources of investment risk: credit, interest rate and liquidity. Credit risk is the risk that the value of the investment may decline due to deterioration in the financial strength of the issuer and that the timely or ultimate payment of principal or interest might not occur. A default by an issuer usually involves some loss of principal to the investor. Losses can be mitigated by timely sales of affected securities or by active involvement in a restructuring process. However, there can be no assurance that the efforts of an investor will lead to favorable outcomes in a bankruptcy or restructuring. Interest rate risk arises from the price sensitivity of investments to changes in interest rates. Coupon and dividend income represent the greatest portion of an investment's total return for most fixed income instruments in stable interest rate environments. The changes in the fair market price of such investments are inversely related to changes in market interest rates. As interest rates fall, the coupon and dividend streams of existing fixed-rate investments become more valuable and market values rise. As interest rates rise, the opposite effect occurs. In addition, the Company is exposed to liquidity risk. Liquidity risk refers to the risk that investments cannot be converted into cash when needed or that the terms for conversion have a negative effect on the Company. This risk increased in the recent economic downturn.

Fixed maturity securities, which are classified as available for sale, are carried at their fair value in the Company's balance sheet, with unrealized gains or losses recorded in accumulated other comprehensive loss. The unrealized gains or losses are recorded net of the adjustment to policyholder account balances to reflect what would have been earned had those gains or losses been realized and the proceeds reinvested. The Company's fair value of fixed maturity and equity securities are derived from external pricing services, brokers, and internal matrices and calculations. At December 31, 2009, approximately 92% of the carrying value of these investments was from external pricing services and 8% was derived from brokers and internal matrices or calculations. The investment portfolio is monitored regularly to ensure that investments which may be other-than-temporarily impaired are identified in a timely fashion and properly valued. Other-than-temporary impairments that are determined to be due to credit are charged against earnings as realized investment losses. The valuation of the investment portfolio involves a variety of assumptions and estimates.

The Company monitors the various markets in which its investments are traded. The Company utilizes a primary independent third-party pricing service to determine the majority of its fair values. At December 31, 2009 the Company used a second independent third-party pricing service to validate the fair market values provided by the primary pricing service. The Company also used the second pricing service to determine the fair value of certain securities for which the primary pricing service was unable to provide. At December 31, 2009, 91% of the value of the Company's fixed maturity and equity securities were from the primary third-party pricing service and 1% was from the second independent pricing service. The Company reviews values received from independent pricing sources for validity. In addition, the Company tests a limited number of securities from each independent pricing service each reporting period to further validate reliance on the fair values provided. When fair values are not available from external service providers, where possible, the Company utilizes quotes from brokers. When the Company cannot obtain reliable broker pricing, a fair value is determined based upon an assessment of several factors appropriate for the specific issue, including but not limited to: the issuer's industry; liquidity; cash flows; marketability, ratings and the ability of the issuer to satisfy the obligation; government intervention or regulations; fair value of comparable securities in actively traded or quoted markets; or other factors. The Company creates a matrix of factors from which to calculate an estimable value. However, all factors may not be known or publicly available from which to determine a value and, as such, the fair value used by the Company may not be truly indicative of the actual value available in an active market or an actual exit price if the Company were to sell the security in the current market.

Table of Contents

The Company has a policy and process in place to identify securities that could potentially have an impairment that is other-than-temporary. This process involves monitoring market events that could impact issuers' credit ratings, business climate, management changes, litigation and government actions, and other similar factors. This process also involves monitoring late payments, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts, asset quality and cash flow projections as indicators of credit issues.

At the end of each quarter, all securities are reviewed to determine whether impairments exist and whether other-than-temporary impairments should be recorded. This quarterly process includes an assessment of the credit quality of each investment in the entire securities portfolio. Additional reporting and review procedures are conducted for those securities where fair value is less than 90% of amortized cost. The Company prepares a formal review document no less often than quarterly of all investments with greater than 20% declines in fair value for six months or more, investments that have previously been written down and that remain in an unrealized loss position greater than 20% of their value, and selected investments that have changed significantly from a previous period and that have a decline in fair value greater than 10% of amortized cost.

The Company considers relevant facts and circumstances in evaluating whether the impairment of a security is other-than-temporary. Relevant facts and circumstances considered include but are not limited to:

- The current fair value of the security as compared to amortized cost;
- The credit rating of the security;
- The extent and the length of time the fair value has been below amortized cost;
- The financial position of the issuer, including the current and future impact of any specific events, material declines in the issuer's revenues, margins, cash positions, liquidity issues, asset quality, debt levels and income results;
- Significant management or organizational changes;
- Significant uncertainty regarding the issuer's industry;
- Violation of financial covenants;
- Consideration of information or evidence that supports timely recovery;
- The Company's intent and ability to hold an equity security until it recovers in value;
- Whether the Company intends to sell a debt security and whether it is not more likely than not that the Company will be required to sell a debt security before recovery of the amortized cost basis; and
- Other business factors related to the issuer's industry.

To the extent the Company determines that a fixed maturity security is deemed to be other-than-temporarily impaired, the portion of the impairment that is deemed to be due to credit is charged to the income statement and the amortized cost basis of the underlying investment is reduced. The portion of the impairment that is deemed to be non-credit is charged to other comprehensive income (loss). Equity securities that are determined to be other-than-temporarily impaired are written down to fair value and the impairment is charged to the income statement.

There are a number of significant risks and uncertainties inherent in the process of monitoring impairments, determining if an impairment is other-than-temporary and determining the portion of an other-than-temporary impairment that is due to credit. These risks and uncertainties include but are not limited to:

- The risk that the Company's assessment of an issuer's ability to meet all of its contractual obligations will change based on changes in the credit characteristics of that issuer;
- The risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated;
- The risk that the performance of the underlying collateral for securities could deteriorate in the future and the Company's credit enhancement levels and recovery values do not provide sufficient protection to the Company's

contractual principal and interest;
- The risk that fraudulent, inaccurate or misleading information could be provided to the Company's credit, investment and accounting professionals who determine the fair value estimates and accounting treatment for securities;
- The risk that new information obtained by the Company or changes in other facts and circumstances may lead the Company to change its intent to sell the security before it recovers in value;
- The risk that facts and circumstances change such that it becomes more likely than not that the Company will be required to sell the investment before recovery of the amortized cost basis; and
- The risk that the methodology or assumptions used to develop estimates of the portion of impairments due to credit prove, over time, to be inaccurate or insufficient.

Table of Contents

Any of these situations could result in a charge to income in a future period.

The Company may selectively determine, as part of its individual investment assessment process in relation to specific investments that it intends to sell a fixed maturity security prior to its maturity. If the Company makes this determination and the fair value is less than the cost basis, an analysis of the fair value of the investment is performed and the amortized cost of the investment is written down to the fair value and an other-than-temporary impairment is recorded on this particular position. Subsequently, the Company seeks to obtain the best possible outcome available for this specific issue and records an investment gain or loss at the disposal date.

The evaluation of loan-backed and similar asset-backed securities, particularly including residential mortgage-backed securities, with significant indications of potential other-than-temporary impairment requires significant use of estimates and judgment. Specifically, the Company performs discounted future cash flow calculations to assure the value of the investment is expected to be fully realized. Projections of expected future cash flows are based upon considerations of the performance of the actual underlying assets, including historical delinquencies, defaults, severity of losses incurred, and prepayments, along with the Company's estimates of future results for these factors. The Company's estimates of future results are based upon actual historical performance of the underlying assets relative to historical, current and expected general economic conditions, specific conditions related to the underlying assets, industry data, and other factors that are believed to be relevant.

Deferred Acquisition Costs and Value of Business Acquired

Deferred acquisition costs (DAC), principally agent commissions and other selling, selection and issue costs, which vary with and are directly related to the production of new business, are capitalized as incurred. These deferred costs are then amortized in proportion to future premium revenues or the expected future profits of the business, depending upon the type of product.

When a new block of business is acquired or when an insurance company is purchased, a portion of the purchase price is allocated to a separately identifiable intangible asset, called the value of business acquired (VOBA). VOBA is established as the actuarially determined present value of future gross profits of the business acquired and is amortized in proportion to future premium revenues or the expected future profits, depending on the type of business acquired.

The Company considers the following assumptions to be of significance when evaluating the amortization of DAC and VOBA: expected mortality, interest spreads, surrender rates and expense margins. Mortality relates to the occurrence of death. Interest spreads are the difference between the investment returns earned and the crediting rates of interest applied to policyholder account balances. Surrender rates relate to the relative volume of policy terminations. Expense margins involve the expenses incurred for maintaining and servicing in-force policies.

At least annually, a review is performed of the models and the assumptions used to develop expected future profits, based upon management's current view of future events. DAC is reviewed on an ongoing basis to determine that the unamortized portion does not exceed the expected recoverable amounts. Management's view primarily reflects Company experience but can also reflect emerging trends within the industry. Short-term deviations in experience affect the amortization of DAC and VOBA in the period, but do not necessarily indicate that a change to the long-term assumptions of future experience is warranted. If it is determined that it is appropriate to change the long-term assumptions of future experience, then an unlocking adjustment is recognized for the block of business being evaluated. Certain assumptions, such as interest spreads and surrender rates, may be interrelated. As such, unlocking adjustments often reflect revisions to multiple assumptions. The balances of DAC and VOBA are immediately impacted by any assumption changes, with the change reflected through the income statement as an unlocking adjustment in the amount of DAC or VOBA amortized. These adjustments can be positive or negative. The impact of unlocking adjustments from the changes in estimates for the periods reported are included in the Consolidated Results of Operations and Operating Results by Segment sections of the Management's Discussion and Analysis of Financial

Condition and Results of Operations contained within this document.

The following table reflects the estimated pre-tax impact to DAC and VOBA on universal life, variable universal life, and fixed and variable deferred annuity products that could occur in a twelve-month period for an unlocking adjustment due to reasonably likely changes in significant assumptions. Changes in assumptions of the same magnitude in the opposite direction would have an impact of a similar magnitude but opposite direction of the examples provided.

Table of Contents

Critical Accounting Estimate	Determination Methodology	Potential One-Time Effect on DAC, VOBA and Related Items
Mortality Experience	Based on Company mortality experience. Industry experience and trends are also considered.	A 2.5% increase in expected mortality experience for all future years would result in a reduction in DAC and VOBA, and an increase in current period amortization expense of $4.4 million.
Surrender Rates	Based on Company surrender experience. Industry experience and trends are also considered.	A 10% increase in expected surrender rates for all future years would result in a reduction in DAC and VOBA, and an increase in current period amortization expense of $2.1 million.
Interest Spreads	Based on expected future investment returns and expected future crediting rates applied to policyholder account balances; future crediting rates include constraints imposed by policy guarantees.	A 10 basis point reduction in future interest rate spreads would result in a reduction in DAC and VOBA, and an increase in current period amortization expense of $3.4 million.
Maintenance Expenses	Based on Company experience using an internal expense allocation methodology.	A 10% increase in future maintenance expenses would result in a reduction in DAC and VOBA, and an increase in current period amortization expense of $2.2 million.

Reinsurance

A variety of reinsurance vehicles are currently in use, including individual and bulk arrangements on both coinsurance and mortality/morbidity-only basis. Reinsurance supports a multitude of corporate objectives, including managing statutory capital, reducing volatility and surplus strain and is an actively managed tool for the Company. At the customer level, reinsurance increases the Company's capacity, provides access to additional underwriting expertise, and generally makes it possible for the Company to offer products at competitive levels that could not otherwise be made available.

The Company remains contingently liable if the reinsurer should be unable to meet obligations assumed under the reinsurance contract. The Company monitors the relative financial strength and viability of its reinsurance partners.

Reinsurance receivables include amounts related to paid benefits and estimated amounts related to unpaid policy and contract claims, future policy benefits and policyholder account balances.

Future Policy Benefits

The Company establishes liabilities for amounts payable under insurance policies, including traditional life insurance, annuities and accident and health insurance. Generally, amounts are payable over an extended period of time. Liabilities for future policy benefits of traditional life insurance have been computed by a net level premium method based upon estimates at the time of issue for investment yields, mortality and withdrawals. These estimates include provisions for experience less favorable than initially expected. Mortality assumptions are based on Company experience expressed as a percentage of standard mortality tables. The 2001 VBT and the 1975-1980 Select and Ultimate Basic Table serve as the basis for most mortality assumptions.

Liabilities for future policy benefits of immediate annuities and supplementary contracts with life contingencies are computed by calculating an actuarial present value of future policy benefits, based upon estimates for investment yields and mortality at the time of issue.

Liabilities for future policy benefits of immediate annuities and supplementary contracts with life contingencies are also computed by a net level premium method, based upon estimates at the time of issue for investment yields and mortality.

Liabilities for future policy benefits of accident and health insurance represent estimates of payments to be made on reported insurance claims, as well as claims incurred but not yet reported. These liabilities are estimated using actuarial analyses and case basis evaluations that are based upon past claims experience, claim trends and industry experience.

Table of Contents

Policyholder Account Balances

Policyholder account balances include universal life insurance, fixed deferred annuity contracts and investment-type contracts. Liabilities for these policyholder account balances are included without reduction for potential surrender charges and deferred front-end contract charges. The account balances for universal life contracts are equal to cumulative premiums, less contract charges and withdrawals, plus interest credited. The account balances for fixed deferred annuities and investment-type contracts are equal to the cumulative deposits, less any applicable contract charges and withdrawals, plus interest credited. Front-end contract charges are deferred and amortized over the term of the policies. Policyholder benefits incurred in excess of related policyholder account balances are charged to policyholder benefits expense. Interest on policyholder account balances is credited as earned.

On an ongoing basis, the Company performs testing and analysis on its blocks of business to ensure that both the assumptions made when the Company purchases a block of business or when the Company sells new policies remain viable. The Company also periodically performs sensitivity testing on these blocks of business to ensure it maintains the capacity to meet an increase in demand in policyholder benefits, namely increased surrenders, policy loans or other policyholder elective withdrawals, especially when financial markets become volatile.

Pensions and Other Postretirement Benefits

The measurement of pension and other postretirement benefit obligations and costs depends on a variety of assumptions. Assumptions are made regarding the discount rate, expected long-term rate of return on plan assets, employee turnover, expected compensation increases, health care claim costs, heath care cost trends, retirement rates and mortality. The discount rate and the expected return on plan assets have the most significant impact on the level of cost. See Note 8 – Pensions and Other Postretirement Benefits in the Notes to Consolidated Financial Statements for further details.

In addition, the Company recognizes the funded status of its defined benefit pension and postretirement plans, measured as the difference between plan assets at fair value and the benefit obligation, on the balance sheet. Changes in the funded status that arise during the period but are not recognized as components of net periodic benefit cost are recognized within other comprehensive income (loss) net of income taxes.

Recognition of Revenues

Premiums for traditional life insurance products are reported as revenue when due. Premiums on accident and health, disability and dental insurance are reported as earned ratably over the contract period in proportion to the amount of insurance protection provided. A reserve is provided for the portion of premiums written which relate to unexpired terms of coverage.

Deposits related to universal life, fixed deferred annuity contracts and investment-type products are credited to policyholder account balances. Revenues from such contracts consist of amounts assessed against policyholder account balances for mortality, policy administration and surrender charges, and are recognized in the period in which the benefits and services are provided. The cash flows from deposits are credited to policyholder account balances. Deposits are not recorded as revenue. Deposits are shown as a Financing Activity in the Consolidated Statements of Cash Flows.

The Company measures its sales or new business production with two components: new premiums recorded and new deposits received. Premiums and deposits are subdivided into two categories: new and renewal. New premiums and deposits are measures of sales or new business production. Renewal premiums and deposits occur as continuing business from existing customers.

Income Taxes

Deferred income taxes are recorded on the differences between the tax bases of assets and liabilities and the amounts at which they are reported in the consolidated financial statements. Recorded amounts are adjusted to reflect changes in income tax rates and other tax law provisions as they become enacted. Deferred income tax assets are subject to ongoing evaluation of whether such assets will be realized. The ultimate realization of deferred income tax assets generally depends on the reversal of deferred tax liabilities and the generation of future taxable income and realized gains during the periods in which temporary differences become deductible. Deferred income taxes include future deductible differences relating to unrealized losses on investment securities. The Company evaluates the character and timing of unrealized gains and losses to determine whether sufficient future taxable amounts are sufficient to offset future deductible amounts. A valuation allowance against deferred income tax assets may be required if future taxable income of the correct character is not expected.

Table of Contents

Consolidated Results of Operations

Summary of Results

The Company earned net income of $10.7 million in 2009 compared to a net loss of $17.1 million in 2008 and net income of $35.7 million in 2007. Net income per share was $0.93 in 2009 versus a net loss of $1.47 per share in 2008 and net income of $3.01 per share in 2007. The increase in 2009 net income was largely attributed to a reduction in realized investment losses and higher insurance revenues, which were partially offset by an increase in operating expenses. The decline in net income in 2008 largely resulted from increased realized investment losses, reduced net investment income, and increases in policyholder benefits and operating expenses. These were partially offset by an increase in insurance revenues and a decrease in interest credited to policyholder account balances.

Sales

The Company measures sales in terms of new premiums and deposits. Premiums are included in insurance revenues in the Consolidated Statements of Income, while deposits are shown as a Financing Activity in the Consolidated Statements of Cash Flows.

The Company's marketing plan is to focus its primary growth strategies on individual life insurance business in both the Individual Insurance and Old American segments. This growth strategy includes new premiums for individual life products and new deposits for universal life and variable universal life products. The Company's growth strategy encourages a product mix that includes both life and annuity products. The marketing plan includes strategies to grow the business through the Company's existing sales force and with the addition of new general agents and agents. The Company believes that increasing both the number and productivity of general agents and agents is essential to this strategy. Accordingly, the Company has been successful in recruiting new general agents and agents nationwide and has placed an emphasis on training and direct support within the field. The Company also utilizes third-party marketing arrangements to enhance its sales objectives. In addition, the Company's marketing and product strategy allows the Company the flexibility to identify niches in the existing market environment and to react quickly to be able to take advantage of short-term opportunities when they occur.

The following table reconciles premiums included in insurance revenues and provides detail by new and renewal business over the three years ended December 31. New premiums are also detailed by product.

	2009	% Change	2008	% Change	2007
New premiums:					
Individual life insurance	$ 14,182	10	$ 12,926	5	$ 12,356
Immediate annuities	22,113	75	12,612	55	8,142
Group life insurance	1,599	(23)	2,084	37	1,516
Group accident and health insurance	10,648	(2)	10,889	9	9,997
Total new premiums	48,542	26	38,511	20	32,011
Renewal premiums	142,257	-	142,271	(1)	143,449
Total premiums	$ 190,799	6	$ 180,782	3	$ 175,460

Consolidated total premiums increased $10.0 million or 6% in 2009 compared to 2008, as total new premiums increased $10.0 million or 26% and total renewal premiums were flat. The increase in new premiums was driven by a $9.5 million or 75% increase in immediate annuity premiums. This improvement reflects a continuing demand for guaranteed benefit and retirement income products by consumers and an increase in sales from a third-party arrangement. In addition, new individual life insurance premiums increased $1.3 million or 10%. This increase largely resulted from a 20% increase in new premiums in the Old American segment. The increase in new premiums from the Old American segment reflects a combination of expanded distribution and improved agency productivity. New group life insurance premiums decreased $0.5 million or 23% and new group accident and health premiums decreased $0.2 million or 2%. While total renewal premiums were flat compared to 2008, a $1.4 million increase in renewal dental premiums was offset by a $1.2 million decrease in renewal individual life premiums and a $0.3 million decrease in renewal individual accident and health premiums.

Consolidated total premiums increased $5.3 million or 3% in 2008 versus 2007, as total new premiums increased $6.5 million or 20% and total renewal premiums decreased $1.2 million or 1%. The largest contributor to the increase in new premiums was a $4.5 million or 55% increase in immediate annuity premiums. This increase largely reflects changes in consumer preferences. New group life insurance premiums increased $0.6 million or 37% and new group accident and health premiums increased $0.9 million or 9%, reflecting an increase in dental premiums. The improvements in both new group life and new group accident and health premiums reflect an increase in the number of sales representatives and the realignment of sales territories. In addition, enhanced product features within the dental product line contributed to the increase in new group accident and health premiums. The Company exited the stop loss market during 2006 but continued to process

Table of Contents

existing business until the stop loss contracts expired in 2007. Excluding this product line from 2007, the result would be a 4% increase in total premiums, a 26% increase in total new premiums and a 27% increase in new group accident and health premiums in 2008. New individual life premiums increased $0.6 million or 5%, which includes an 11% increase in new premiums in the Old American segment. The increase in new premiums at the Old American segment reflects a combination of enhancements to products, compensation and distribution expansion. The slight decline in total renewal premiums was largely the result of a 1% decline in total individual life renewal premiums.

The following table reconciles deposits with the Consolidated Statements of Cash Flows and provides detail by new and renewal deposits over the three years ended December 31. New deposits are also detailed by product.

	2009	% Change	2008	% Change	2007
New deposits:					
Universal life insurance	$ 9,873	(10)	$ 10,913	-	$ 10,869
Variable universal life insurance	1,031	(47)	1,942	(22)	2,480
Fixed deferred annuities	76,612	152	30,413	15	26,348
Variable annuities	16,078	(37)	25,496	(13)	29,426
Total new deposits	103,594	51	68,764	(1)	69,123
Renewal deposits	136,048	3	131,701	(4)	136,644
Total deposits	$ 239,642	20	$ 200,465	(3)	$ 205,767

Total new deposits increased $34.8 million or 51%, following a $0.4 million or 1% decrease in 2008. The increase in 2009 was due to a $46.2 million or 152% increase in new fixed deferred annuity deposits. This increase can be attributed to consumer preferences for fixed-rate products resulting from the volatility of the equity markets. This volatility, along with the general effects of the recessionary environment, is also reflected in the reduction in sales of new universal life deposits, new variable universal life deposits and new variable annuities, which declined 10%, 47% and 37%, respectively. The slight decline in 2008 was largely due to a $3.9 million or 13% decline in new variable annuity deposits and a $0.5 million or 22% decline in new variable universal life deposits. These declines reflect the difficult economic environment, increased competition, and the continued impact of alternative products in the marketplace. Mostly offsetting these declines, new fixed deferred annuity deposits increased $4.1 million or 15%. This increase was largely due to an increase in sales that can be partially attributed to changes in consumer preferences resulting from the volatility in the equity markets.

Renewal deposits increased $4.3 million or 3% in 2009 versus a $4.9 million or 4% decline in 2008. The increase in 2009 resulted from higher fixed deferred annuity deposits, which increased $9.3 million or 54% compared to one year ago. This increase was partially offset by declines in the following products: $2.9 million or 3% in universal life deposits, $1.2 million or 8% in variable universal life deposits and $0.8 million or 8% in variable annuity deposits. The decline in 2008 was largely due to a $4.5 million or 30% decline in variable annuity deposits and a $2.1 million or 2% decline in universal life deposits. These declines were partially offset by a $2.3 million or 16% increase in fixed deferred annuity deposits.

Insurance Revenues

Insurance revenues consist of premiums and contract charges less reinsurance ceded. Insurance revenues increased $5.5 million or 2% to $241.7 million in 2009, compared to a $4.3 million or 2% increase in 2008. The improvement in 2009 resulted from a $10.0 million or 6% increase in premiums. Total annuity premiums increased $9.5 million or 75% and total accident and health premiums increased $1.0 million or 2%. The improvement in premiums was partially offset by a $3.3 million or 3% decrease in contract charges and a $1.2 million or 2% increase in reinsurance ceded. The increase in insurance revenues in 2008 was largely due to a $5.3 million or 3% increase in premiums and a $1.4 million or 2% decrease in reinsurance ceded. These were partially offset by a $2.4 million or 2% decrease in contract charges. Total annuity premiums increased $4.5 million or 55% and accident and health premiums increased

$0.8 million or 2% in 2008 compared to a year earlier.

Insurance revenues are affected by the level of new sales, the type of products sold, the persistency of policies, general economic conditions, and competitive forces. The Company strives to provide a portfolio of products with safety and competitive return objectives. The Company offers a broad range of products, including variable insurance products, which allow policyholders to participate in both the equity and fixed income markets. Interest sensitive and traditional insurance products combine safety of principal with competitive interest returns.

Contract charges consist of cost of insurance, expense loads, amortization of unearned revenues and surrender charges. Certain contract charges for universal life insurance are not recognized in income immediately but are deferred as unearned revenues and are amortized into income in a manner similar to the amortization of DAC. These contract charges, which are recorded as unearned revenues, are recognized into income in proportion to the expected future gross profits of the business.

Table of Contents

In the same manner as DAC, profit expectations are based upon assumptions of future interest spreads, mortality margins, expense margins and policy and premium persistency experience. At least annually, a review is performed of the assumptions related to profit expectations. If it is determined the assumptions should be revised, the impact is recorded as a change in the revenue reported in the current period as an unlocking adjustment.

Contract charges declined 3% in 2009 and 2% in 2008. The decline in 2009 can largely be attributed to three factors: lower account balances on variable contracts, lower surrender charges due to a decline in policy surrenders on certain products, and the runoff of closed blocks. The Company has purchased blocks of policies and companies with the intent of servicing these blocks to achieve profit streams but without the expectation to generate new business within these blocks of policies. Total contract charges on these closed blocks equaled 37% of total consolidated contract charges during 2009, compared to 38% in 2008. Total contract charges on closed blocks declined 4% in 2009 compared to 2008, and total contract charges on open blocks of business declined 2% in 2009 compared to 2008. In 2008, policy charges declined due to lower policyholder account balances and increased sales of certain products where the contract charges are not recognized into income immediately. Instead, such charges are deferred as unearned revenues and amortized into income similar to the amortization of deferred acquisition costs (DAC). Another contributing factor in the decrease in 2008 was the unlocking of DAC assumptions in the second quarter of 2008, which further reduced current period recognition of these revenues. The resulting increase in unearned revenues will be recognized into income in proportion to the expected future gross profits of the business. Partially offsetting these, surrender charges increased, largely due to higher surrenders on variable products.

The Company uses reinsurance as a means to mitigate its risks and to reduce the earnings volatility from claims. Reinsurance ceded premiums increased $1.2 million to $54.9 million in 2009 from $53.6 million in 2008. In 2007, reinsurance ceded was $55.0 million. The increase in 2009 was largely in the Group Insurance segment, reflecting an increase in sales from a third-party arrangement that is 100% reinsured.

Investment Revenues
Net investment income was flat in 2009, following a 7% decline in 2008. Net investment income was $177.4 million in both 2009 and 2008, compared with $190.4 million in 2007. Net investment income results in 2009 were impacted by a decline in the Company's invested asset base and a slight improvement in yields from the portfolio. Net investment income results in 2008 were impacted by declines in both the invested asset base and yields earned on the portfolio. In addition, expenses associated with investment income declined in both 2009 and 2008, favorably impacting results.

Gross investment income is largely composed of interest, dividends and other earnings on fixed maturity securities, equity securities, short-term investments, mortgage loans, real estate and policy loans. Gross investment income was flat compared with 2008, as a decline in investment assets was mostly offset by an increase in investment yields. The decline in investment assets largely reflects declines in book value due to sales, maturities and calls. The increase in investment yields was largely due to a higher return on an alternative investment fund compared to last year. In 2009, this investment added gross investment income of $2.2 million. However, as a result of the significant decline in the economic environment experienced in 2008, this investment resulted in a decline in gross investment income of $4.0 million in the prior year. Gross investment income declined $13.7 million or 7% in 2008 compared with 2007. This decrease primarily resulted from a $7.2 million decline in gross investment income on reduced investment assets and a $6.5 million decline from lower investment yields. The decline in investment assets includes declines in book value due to sales, maturities and calls along with a decline in fair values. The decline from lower yields was largely due to a reduction in income from the alternative investment fund mentioned above. In 2007, this investment added gross investment income of $2.7 million.

Investments in mortgage loans totaled $457.6 million at December 31, 2009, an increase of $12.2 million from December 31, 2008. Mortgage loans are stated at cost, adjusted for amortization of premium and accrual of discount, less a reserve for probable losses. A loan is considered impaired if it is probable that contractual amounts due will not be collected. Loans in foreclosure and loans considered to be impaired are placed on a non-accrual status. The mortgage loan reserve was $3.4 million at December 31, 2009, unchanged from December 31, 2008. The reserve for mortgage loans is maintained at a level believed by management to be adequate to absorb estimated credit losses. Management's periodic evaluation and assessment of the adequacy of the reserve is based on known and inherent risks in the portfolio, historical and industry data, current economic conditions and other relevant factors. No mortgage loans were restructured or delinquent for more than 90 days or foreclosed upon and transferred to real estate investments during the last three years. The Company does not hold mortgage loans of any borrower that exceed 5% of stockholders' equity. Mortgage loans comprised 14% of the investment portfolio at December 31, 2009, down slightly from 15% at the end of 2008. Almost all of the mortgages were commercial loans on industrial warehouses and office properties at both December 31, 2009 and 2008. Investment income from mortgage loans decreased $0.4 million or 1% in 2009 and $1.6 million or 5% in 2008 compared to the same periods one year earlier. The decline in 2009 was largely due to lower prepayment penalties and assumption fees, as well as lower rates earned on new loans. The decline in 2008 was due to reduced mortgage loan balances, as a result of fewer new mortgage loans, lower rates earned on new loans and lower fee income earned.

Table of Contents

Real estate investments were $114.1 million at December 31, 2009 and $99.6 million at December 31, 2008. Real estate investments consist principally of industrial warehouses, office buildings and investments in multi-family and single-family residential properties, including affordable housing properties. The primary monetary benefit received from investments in affordable housing properties is in the form of tax credits, which primarily serve to reduce current and future tax expense rather than increase investment revenues. The Company also invests in unimproved land for future development. Properties have been acquired through individual purchases, build-to-suit and speculative development. The Company generally maintains its ownership interest in these properties on a direct and joint venture basis with the long-term intention of earning positive cash flow and income by leasing the properties, along with the expectation of realizing capital appreciation upon sale. The Company periodically sells certain real estate assets when management believes that the market and timing are perceived to be advantageous. Real estate investments comprised 3% of the investment portfolio at both December 31, 2009 and 2008. Investment income on real estate increased 9% in 2009, following a 4% decrease in 2008. The increase in 2009 primarily resulted from an increase in occupancy in certain real estate properties. While higher rental income resulted in 2008 from an increase in occupancy in certain real estate properties, investment income on real estate joint ventures declined.

Short-term investments totaled $138.7 million at December 31, 2009, up $103.6 million from December 31, 2008. Short-term invested assets consist primarily of money-market funds. The large increase in short-term investments in 2009 reflects sales and maturities of long-term investments which had not been reinvested at year-end. Income from short-term investments declined $0.7 million or 73% in 2009 and declined $2.7 million or 72% in 2008. The decline experienced in 2009 was primarily the result of a decline in yields. The decline in 2008 was largely due to lower short-term invested assets and a decline in short-term yields.

The Company offers policy loans as a benefit to its policyholders. These loans are secured by the cash value of the policy. Policy loans totaled $85.6 million at December 31, 2009, down $2.7 million from December 31, 2008. Investment income from policy loans declined 5% in 2009 and was flat in 2008. The decline in 2009 was largely due to the reduced balances of policy loans outstanding. In 2008, the decline in the balance of policy loans was offset by an increase in yields.

Net investment income is stated net of investment expenses, and investment expenses decreased $0.4 million or 3% versus one year earlier. Interest expense on short-term notes payable decreased in 2009 compared to last year. The Company has an investment in the Federal Home Loan Bank from which it is able to borrow money at favorable interest rates. The Company periodically borrows and subsequently reinvests these proceeds. The Company had increased its borrowings during the first quarter of 2008 and subsequently reduced these borrowings. The Company had no notes payable outstanding at December 31, 2009.