EMPIRE PETROLEUM CORP
Form 5
December 30, 2014

FORM 5

OMB APPROVAL

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Form 3 Holdings Reported
Form 4 Transactions Reported

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

ANNUAL STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

1. Name and Address of Reporting Person *
WHITEHEAD ALBERT E

(Last) (First) (Middle)

6506 S. LEWIS AVE,Â SUITE 112

(Street)

TULSA,Â OKÂ 74136-1020

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
EMPIRE PETROLEUM CORP [EMPR]

3. Statement for Issuer's Fiscal Year Ended (Month/Day/Year)
12/31/2013

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director __X__ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
PRESIDENT

6. Individual or Joint/Group Reporting

(check applicable line)

_X_ Form Filed by One Reporting Person
___ Form Filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)	4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned at end of Issuer's Fiscal Year (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
				Amount	(A) or (D)	Price			
COMMON STOCK	12/30/2014	Â	S	1,997,388	D	$ 0.0001	0	D	Â

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 2270 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)	5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. of D Se Be O Er Is Fi (I
					(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
WHITEHEAD ALBERT E 6506 S. LEWIS AVE SUITE 112 TULSA,Â OKÂ 74136-1020	Â X	Â X	Â PRESIDENT	Â

Signatures

ALBERT E. WHITEHEAD	12/30/2014
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, see Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Note: File three copies of this Form, one of which must be manually signed. If space provided is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. nits (RSUs) provide solely for cash settlement based upon the market price of the Company's Class A commons shares, often referred to as "phantom stock-based awards". Unlike share-settled awards, which have a fixed grant-date fair value, the fair value of unsettled or unvested liability awards is remeasured at the end of each reporting period based on the change in fair value of a share. The liability and corresponding expense are adjusted accordingly until the award is settled. Other awards may involve performance share units (PSUs) which are units granted at a specified dollar amount per unit, typically linked to the Company's Class A common share price, that are subsequently multiplied by an attained performance factor to derive the number of PSUs to be paid as cash compensation at the vesting date.

On February 17, 2016, the Company granted 5,727 PSUs and 3,661 RSUs to officers of National Western based upon the closing market price per Class A common share of $216.48. Both the PSUs and RSUs vest three years from the date of grant. The RSUs are payable in cash at the vesting date equal to the closing price of the Company's Class A common share at that time. For PSUs, the performance period begins the first day of the calendar year, in this case January 1, 2016, and runs three years. At that time, the three-year performance outcome will be measured against the pre-defined target amounts to determine the number of PSUs earned as compensation.

On April 14, 2016, the Company granted 2,563 RSUs to directors of NWLGI, based upon the closing market price per Class A common share of $226.84. The RSUs vest one year from the date of grant, and are payable in cash at the vesting date equal to the closing price of the Company's Class A common share at that time.

The Company uses the current fair value method to measure compensation cost. As of September 30, 2016 and 2015, the liability balance was $6.4 million and $6.2 million, respectively. A summary of shares available for grant and activity is detailed below.

		Options Outstanding	
	Shares Available For Grant	Shares	Weighted-Average Exercise Price
Stock Options:			
Balance at January 1, 2016	291,000	27,768	$ 243.26
Exercised	—	—	$ —
Forfeited	—	(500)	$ 255.13
Expired	—	—	$ —
Stock options granted	—	—	$ —
Balance at September 30, 2016	291,000	27,268	$ 243.04

	Liability Awards		
	SAR	RSU	PSU
Balance at January 1, 2016	86,261	—	—
Exercised	(1,275)	—	—
Forfeited	(2,826)	(106)	—
Granted	14,643	6,224	5,727
Balance at September 30, 2016	96,803	6,118	5,727

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

The total intrinsic value of SARs exercised was $0.1 million and $0.4 million for the nine months ended September 30, 2016 and 2015, respectively. The total share-based liabilities paid for the exercised SARs were $0.1 million and $0.4 million for the nine months ended September 30, 2016 and 2015, respectively. The total fair value of stock options and SARs vested during the nine months ended September 30, 2016 and 2015 was $0.3 million and $0.6 million, respectively. For the nine months ended September 30, 2016 and 2015, the total cash received from the exercise of stock options under the Plans was $0.0 million and $0.0 million, respectively.

The following table summarizes information about stock options and SARs outstanding at September 30, 2016.

	Options/SARs Outstanding		
	Number Outstanding	Weighted-Average Remaining Contractual Life	Number Exercisable
Exercise prices:			
255.13 (options)	20,268	1.5 years	20,268
208.05 (options)	7,000	1.7 years	7,000
114.64 (SARs)	22,768	2.4 years	22,768
132.56 (SARs)	26,818	5.2 years	13,008
210.22 (SARs)	33,000	7.2 years	3,600
216.48 (SARs)	14,217	9.4 years	—
Totals	124,071		66,644
Aggregate intrinsic value (in thousands)	$4,018		$ 3,013

The aggregate intrinsic value in the table above is based on the closing stock price of $205.37 per share on September 30, 2016.

In estimating the fair value of the share based awards outstanding at September 30, 2016 and December 31, 2015, the Company employed the Black-Scholes option pricing model with assumptions detailed below.

	September 30, 2016	December 31, 2015
Expected term of options	1.5 to 9.4 years	2.3 to 8.0 years

Expected volatility:				
Range	22.53% to 28.81%		21.11% to 37.77%	
Weighted-average	23.83	%	23.89	%
Expected dividend yield	0.18	%	0.14	%
Risk-free rate:				
Range	0.54% to 1.52%		0.22% to 1.67%	
Weighted-average	1.03	%	0.63	%

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

The pre-tax compensation cost (benefit) recognized in the financial statements related to the two plans defined above was \$1.7 million and \$(1.1) million for the three and nine months ended September 30, 2016, and \$(1.0) million and \$(2.6) million for the three and nine months ended September 30, 2015, respectively. The related tax (expense)/benefit recognized was \$(0.6) million and \$0.4 million for the three and nine months ended September 30, 2016 and to \$0.4 million and \$0.9 million for the three and nine months ended September 30, 2015, respectively.

As of September 30, 2016, the total compensation cost related to nonvested share based awards not yet recognized was \$3.1 million. This amount is expected to be recognized over a weighted-average period of 1.5 years. The Company recognizes compensation cost over the graded vesting periods.

(8) COMMITMENTS AND CONTINGENCIES

(A) Legal Proceedings

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

On October 26, 2011 the Brazilian Superintendence of Private Insurance ("SUSEP") attempted to serve National Western with a subpoena regarding an administrative proceeding initiated by SUSEP in which it alleged that National Western was operating as an insurance company in Brazil without due authorization. National Western had been informed that SUSEP was attempting to impose a penal fine, based on currency exchange rates at that time, of approximately \$6.0 billion on the company. SUSEP unsuccessfully attempted to serve National Western with notice regarding this matter. National Western does not transact business in Brazil and has no officers, employees, property, or assets in Brazil. National Western believes that SUSEP has no jurisdiction over the company, that SUSEP's attempts at service of process were invalid, and that any penal fine would be unenforceable. In addition, due to a new law recently enacted in Brazil the penal fine has been limited to 3 million reais (approximately \$960,000 based on current exchange rates). For the reasons described above, the Company does not believe that this matter meets the definition of a material pending legal proceeding as such term is defined in Item 103 of Regulation S-K. However, the Company had included the foregoing description solely due to the amount of the fine initially sought by SUSEP. National Western will continue its discussions with SUSEP in an effort to resolve this matter. No conclusion can be drawn at this time as to the outcome of these discussions, or whether they will continue, or how any such outcome may impact the Company's business, results of operations, or financial condition. However, in light of the pendency of discussions with Brazilian authorities, National Western has ceased accepting new applications from residents in Brazil.

National Western was the named defendant in the case of Damaris Maldonado Vinas, et al. vs. National Western Life Insurance, in which the plaintiffs, after National Western had paid the death benefits to the beneficiary (Francisco Iglesias-Alvarez) upon the annuitant's (Carlos Iglesias-Alvarez) death, sought to annul two annuity policies issued by National Western at the behest of Carlos Iglesias-Alvarez and which named Francisco Iglesias-Alvarez as their beneficiary. On March 31, 2016, the United States District Court for the District of Puerto Rico (the "Court") issued its Opinion and Order on the pending Motions for Summary Judgment submitted by the parties, and therein denied National Western's motion and granted plaintiffs' motion voiding the two annuities and requesting a refund of the premiums paid ($2.9 million). National Western vigorously defended the case and believes that the Court's Opinion and Order is contrary to applicable law. As such, National Western filed a Motion for Reconsideration of Opinion and Order and Corresponding Judgment with the Court on April 27, 2016, which the Court denied on May 5, 2016. National Western filed its Appeal Brief on September 12, 2016.

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

Separately, the Brazilian authorities have commenced an investigation into possible violations of Brazilian criminal law in connection with the issuance of National Western insurance policies to Brazilian residents, and in assistance of such investigation a Commissioner appointed by the U.S. District Court for the Western District of Texas has issued a subpoena upon the company to provide information relating to such possible violations. No conclusion can be drawn at this time as to its outcome or how such outcome may impact the Company’s business, results of operations, or financial condition. National Western is cooperating with the relevant governmental authorities in regard to this matter.

(B) Financial Instruments

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

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

The Company had $32.0 million commitments to fund new loans and $0.6 million commitments on existing loans to extend credit relating to loans at September 30, 2016. The Company evaluates each customer's creditworthiness on a case-by-case basis.

(9) INVESTMENTS

(A) Investment Gains and Losses

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Available for sale debt securities:				
Realized gains on disposal	$1,773	125	2,455	3,323

Realized losses on disposal	(23)	—	(29)	(74)
Held to maturity debt securities:				
Realized gains on disposal	3,278	666	4,764	2,794
Realized losses on disposal	(3)	—	(109)	—
Equity securities realized gains (losses)	401	22	607	113
Real estate gains (losses)	—	—	2,901	—
Totals	$5,426	813	10,589	6,156

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

The Company uses the specific identification method in computing realized gains and losses. For the three and nine months ended September 30, 2016 the percentage of gains on bonds due to the call of securities was 95% and 87%, respectively. For the three and nine months ended September 30, 2015 the percentage of gains on bonds due to the call of securities was 84% and 90%, respectively. This includes calls out of the Company's available for sale portfolio of debt securities.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Total other-than-temporary impairment gains (losses) on debt securities	$27	284	80	549
Portion of loss (gain) recognized in comprehensive income	(27)	(284)	(80)	(549)
Net impairment losses on debt securities recognized in earnings	—	—	—	—
Equity securities impairments	—	—	—	(107)
Totals	$—	—	—	(107)

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

	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2016	For the Year Ended December 31, 2015
	(In thousands)		
Beginning balance, cumulative credit losses related to other-than-temporary impairments	$1,649	2,278	2,298
Reductions for securities sold during current period	(209)	(838)	(20)
Additions for credit losses not previously recognized in other-than-temporary impairments	—	—	—

Ending balance, cumulative credit losses related to other-than-temporary impairments	$1,440	1,440	2,278

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(B) Debt and Equity Securities

The table below presents amortized costs and fair values of securities held to maturity at September 30, 2016.

	Securities Held to Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
U.S. agencies	$—	—	—	—
U.S. Treasury	1,932	300	—	2,232
States and political subdivisions	440,027	39,460	(3)	479,484
Public utilities	1,061,021	71,581	—	1,132,602
Corporate	4,189,831	246,973	(3,327)	4,433,477
Residential mortgage-backed	1,402,475	79,474	(174)	1,481,775
Home equity	9,383	1,526	—	10,909
Manufactured housing	1,704	152	—	1,856
Totals	$7,106,373	439,466	(3,504)	7,542,335

The table below presents amortized costs and fair values of securities available for sale at September 30, 2016.

	Securities Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
States and political subdivisions	$581	20	—	601
Foreign governments	9,953	757	—	10,710
Public utilities	127,201	7,834	—	135,035
Corporate	2,743,232	161,263	(5,609)	2,898,886
Residential mortgage-backed	29,265	2,829	(43)	32,051
Home equity	9,682	162	—	9,844
Manufactured housing	674	11	—	685
	2,920,588	172,876	(5,652)	3,087,812
Equity securities	14,021	5,052	(91)	18,982
Totals	$2,934,609	177,928	(5,743)	3,106,794

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The table below presents amortized costs and fair values of securities held to maturity at December 31, 2015.

	Securities Held to Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
U.S. agencies	$15,019	275	—	15,294
U.S. Treasury	1,927	317	—	2,244
States and political subdivisions	435,941	29,129	(662)	464,408
Public utilities	1,044,063	42,271	(6,621)	1,079,713
Corporate	4,160,628	114,920	(72,913)	4,202,635
Residential mortgage-backed	1,503,021	59,013	(6,227)	1,555,807
Home equity	11,047	1,701	—	12,748
Manufactured housing	2,321	266	—	2,587
Totals	$7,173,967	247,892	(86,423)	7,335,436

The table below presents amortized costs and fair values of securities available for sale at December 31, 2015.

	Securities Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Debt securities:				
States and political subdivisions	$586	—	(34)	552
Foreign governments	9,947	408	—	10,355
Public utilities	129,980	5,354	(775)	134,559
Corporate	2,635,536	73,132	(54,503)	2,654,165
Residential mortgage-backed	36,463	3,103	—	39,566
Home equity	20,123	825	(12)	20,936
Manufactured housing	1,063	26	—	1,089
	2,833,698	82,848	(55,324)	2,861,222
Equity securities	13,716	4,797	(152)	18,361
Totals	$2,847,414	87,645	(55,476)	2,879,583

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The following table shows the gross unrealized losses and fair values of the Company's held to maturity investments by investment category and length of time the individual securities have been in a continuous unrealized loss position at September 30, 2016.

	Securities Held to Maturity					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	$3,032	(3)	—	—	3,032	(3)
Corporate	32,317	(364)	181,928	(2,963)	214,245	(3,327)
Residential mortgage-backed	16,997	(63)	9,308	(111)	26,305	(174)
Total temporarily impaired securities	$52,346	(430)	191,236	(3,074)	243,582	(3,504)

The following table shows the gross unrealized losses and fair values of the Company's available for sale investments by investment category and length of time the individual securities have been in a continuous unrealized loss position at September 30, 2016.

	Securities Available for Sale					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	$—	—	—	—	—	—
Corporate	3,027	(21)	113,560	(5,588)	116,587	(5,609)
Residential mortgage-backed	1,381	(43)	—	—	1,381	(43)
	4,408	(64)	113,560	(5,588)	117,968	(5,652)
Equity securities	462	(45)	336	(46)	798	(91)
Total temporarily impaired securities	$4,870	(109)	113,896	(5,634)	118,766	(5,743)

The Company does not consider securities to be other-than-temporarily impaired when the market decline is attributable to factors such as interest rate movements, market volatility, liquidity, spread widening and credit quality and when recovery of all amounts due under the contractual terms of the security is anticipated. Based on the review and the Company's ability and intent not to sell these securities until maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2016. The Company will monitor the investment portfolio for future changes in issuer facts and circumstances that could result in future impairments beyond those currently identified.

Unrealized losses for securities held to maturity and securities available for sale decreased during the first nine months of 2016 primarily due to the downward movement in market interest rates during this period (which increases the market price of debt securities).

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The following table shows the gross unrealized losses and fair values of the Company's held to maturity investments by investment category and length of time the individual securities have been in a continuous unrealized loss position at December 31, 2015.

	Securities Held to Maturity					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	$16,763	(387)	8,723	(275)	25,486	(662)
Public utilities	298,962	(5,953)	17,840	(668)	316,802	(6,621)
Corporate	1,522,544	(54,295)	323,567	(18,618)	1,846,111	(72,913)
Residential mortgage-backed	148,712	(2,726)	95,443	(3,501)	244,155	(6,227)
Total temporarily impaired securities	$1,986,981	(63,361)	445,573	(23,062)	2,432,554	(86,423)

The following table shows the gross unrealized losses and fair values of the Company's available for sale investments by investment category and length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2015.

	Securities Available for Sale					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities:						
States and political subdivisions	$—	—	552	(34)	552	(34)
Public utilities	42,093	(775)	—	—	42,093	(775)
Corporate	843,679	(32,500)	151,319	(22,003)	994,998	(54,503)
Home equity	—	—	4,823	(12)	4,823	(12)
	885,772	(33,275)	156,694	(22,049)	1,042,466	(55,324)
Equity securities	649	(124)	102	(28)	751	(152)
Total temporarily impaired securities	$886,421	(33,399)	156,796	(22,077)	1,043,217	(55,476)

During the three and nine months ended 2016, the Company recorded no other-than-temporary impairment on debt and equity securities.

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Debt securities. The gross unrealized losses for debt securities are made up of 51 individual issues, or 3.8% of the total debt securities held by the Company at September 30, 2016. The market value of these bonds as a percent of amortized cost averages 97.5%. Of the 51 securities, 40, or 78.4%, fall in the 12 months or greater aging category; and 43 were rated investment grade at September 30, 2016.

Equity securities. The gross unrealized losses for equity securities are made up of 20 individual issues at September 30, 2016. These holdings are reviewed quarterly for impairment.

The amortized cost and fair value of investments in debt securities at September 30, 2016, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Debt Securities Available for Sale		Debt Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Due in 1 year or less	$141,741	144,968	198,352	202,724
Due after 1 year through 5 years	953,561	1,032,456	1,791,119	1,942,670
Due after 5 years through 10 years	1,704,850	1,783,821	3,404,124	3,580,986
Due after 10 years	80,815	83,987	299,216	321,415
	2,880,967	3,045,232	5,692,811	6,047,795
Mortgage and asset-backed securities	39,621	42,580	1,413,562	1,494,540
Total	$2,920,588	3,087,812	7,106,373	7,542,335

(C) Transfer of Securities

During the three and nine months ended September 30, 2016 the Company made no transfers from the held to maturity category to securities available for sale.

(D) Mortgage Loans and Real Estate

A financing receivable is a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in a company's statement of financial position. Mortgage, equity, participation and mezzanine loans on real estate are considered financing receivables reported by the Company.

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

Loans in foreclosure, loans considered impaired or loans past due 90 days or more are placed on a non-accrual status. If a mortgage loan is determined to be on non-accrual status, the mortgage loan does not accrue any revenue into the Condensed Consolidated Statements of Earnings. The loan is independently monitored and evaluated as to potential impairment or foreclosure. If delinquent payments are made and the loan is brought current, then the Company returns the loan to active status and accrues income accordingly. The Company had no mortgage loans past due 90 days or more at September 30, 2016 or 2015 and as a result all interest income was recognized at September 30, 2016 and 2015.

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

	September 30, 2016		December 31, 2015	
	Amount (In thousands)	%	Amount (In thousands)	%
Mortgage Loans by Loan-to-Value Ratio (1):				
Less than 50%	$49,418	33.5	$64,986	59.7
50% to 60%	8,669	5.9	9,714	8.9
60% to 70%	56,191	38.1	10,134	9.3
70% to 80%	9,543	6.4	4,843	4.4
80% to 90%	23,742	16.1	19,284	17.7
Greater than 90%	—	—	—	—
Gross balance	147,563	100.0	108,961	100.0
Allowance for possible losses	(650)	(0.4)	(650)	(0.6)
Totals	$146,913	99.6	$108,311	99.4

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

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

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

The following table represents the mortgage loan allowance.

	September 30, 2016	December 31, 2015
	(In thousands)	
Balance, beginning of period	$ 650	650

Provision	—	—
Releases	—	—
Balance, end of period	$ 650	650

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The Company's direct investments in real estate are not a significant portion of its total investment portfolio and totaled approximately $32.0 million and $16.3 million at September 30, 2016 and December 31, 2015, respectively. During the first nine months of 2016 the Company purchased two properties, one located in Cypress, Texas and the other in Tupelo, Mississippi for a total of $16.8 million. The Company recognized operating income on real estate properties of approximately $2.0 million for the first nine months of 2016. In addition, the Company recorded a net realized investment gain on disposed properties located in Brazoria County (Texas), Ruidoso, New Mexico, and Austin, Texas, totaling $2.9 million during the first nine months of 2016.

(10) FAIR VALUES OF FINANCIAL INSTRUMENTS

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

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

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

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

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

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

	September 30, 2016			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale	$3,087,812	—	3,087,812	—
Equity securities, available for sale	18,982	18,889	93	—
Derivatives, index options	90,097	—	—	90,097
Total assets	$3,196,891	18,889	3,087,905	90,097
Policyholder account balances (a)	$96,095	—	—	96,095
Other liabilities (b)	6,434	—	—	6,434
Total liabilities	$102,529	—	—	102,529

During the three and nine months ended September 30, 2016, the Company had no transfers into or out of Levels 1, 2 or 3.

	December 31, 2015			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale	$2,861,222	—	2,861,222	—
Equity securities, available for sale	18,361	17,980	381	—
Derivatives, index options	38,409	—	—	38,409
Total assets	$2,917,992	17,980	2,861,603	38,409
Policyholder account balances (a)	$58,359	—	—	58,359
Other liabilities (b)	7,669	—	—	7,669
Total liabilities	$66,028	—	—	66,028

(a) Represents the fair value of certain product-related embedded derivatives that were recorded at fair value.
(b) Represents the liability for share-based compensation.

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

	September 30, 2016			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale:				
Priced by third-party vendors	$3,087,812	—	3,087,812	—
Priced internally	—	—	—	—
Subtotal	3,087,812	—	3,087,812	—
Equity securities, available for sale:				
Priced by third-party vendors	18,982	18,889	93	—
Priced internally	—	—	—	—
Subtotal	18,982	18,889	93	—
Derivatives, index options:				
Priced by third-party vendors	90,097	—	—	90,097
Priced internally	—	—	—	—
Subtotal	90,097	—	—	90,097
Total	$3,196,891	18,889	3,087,905	90,097
Percent of total	100.0 %	0.6 %	96.6 %	2.8 %

	December 31, 2015			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Debt securities, available for sale:				
Priced by third-party vendors	$2,861,222	—	2,861,222	—
Priced internally	—	—	—	—
Subtotal	2,861,222	—	2,861,222	—
Equity securities, available for sale:				
Priced by third-party vendors	18,361	17,980	381	—
Priced internally	—	—	—	—
Subtotal	18,361	17,980	381	—
Derivatives, index options:				
Priced by third-party vendors	38,409	—	—	38,409
Priced internally	—	—	—	—
Subtotal	38,409	—	—	38,409

Total	$2,917,992	17,980	2,861,603	38,409
Percent of total	100.0 %	0.6 %	98.1 %	1.3 %

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

	For the Three Months Ended September 30, 2016				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Balance at July 1, 2016	$—	—	63,319	63,319	81,056
Total realized and unrealized gains (losses):					
Included in net income	—	—	19,113	19,113	13,492
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	18,848	18,848	18,848
Sales	—	—	—	—	—
Issuances	—	—	—	—	388
Settlements	—	—	(11,183)	(11,183)	(11,255)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	90,097	90,097	102,529
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	23,851	23,851	—
Benefits and expenses	—	—	—	—	25,150
Total	$—	—	23,851	23,851	25,150

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	For the Three Months ended September 30, 2015				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Balance at July 1, 2015	$—	—	72,527	72,527	95,368
Total realized and unrealized gains (losses):					
Included in net income	—	—	(52,816)	(52,816)	(42,887)
Included in other comprehensive income	—	—	—	—	—
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	24,891	24,891	24,891
Sales	—	—	—	—	—
Issuances	—	—	—	—	—
Settlements	—	—	(19,376)	(19,376)	(19,377)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	25,226	25,226	57,995
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	(51,707)	(51,707)	—
Benefits and expenses	—	—	—	—	(1,048)
Total	$—	—	(51,707)	(51,707)	(1,048)

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	Nine Months Ended September 30, 2016				
	Debt Securities, Available for Sale	Equity Securities Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Beginning balance, January 1, 2016	$—	—	38,409	38,409	66,028
Total realized and unrealized gains (losses):					
Included in net income	—	—	8,307	8,307	(7,691)
Included in other comprehensive income	—	—	—	—	—
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	56,387	56,387	56,387
Sales	—	—	—	—	
Issuances	—	—	—	—	921
Settlements	—	—	(13,006)	(13,006)	(13,116)
Transfers into (out of) Level 3	—	—	—	—	—
Balance at end of period	$—	—	90,097	90,097	102,529
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	15,628	15,628	—
Other operating expenses	—	—	—	—	13,582
Total	$—	—	15,628	15,628	13,582

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	Nine Months Ended September 30, 2015				
	Debt Securities, Available for Sale	Equity Securities, Available for Sale	Derivatives, Index Options	Total Assets	Other Liabilities
	(In thousands)				
Beginning balance, January 1, 2015	$—	—	114,287	114,287	142,492
Total realized and unrealized gains (losses):					
Included in net income	—	—	(69,884)	(69,884)	(64,923)
Included in other comprehensive income	—	—	—	—	—
Purchases, sales, issuances and settlements, net:					
Purchases	—	—	64,820	64,820	64,820
Sales	—	—	—	—	—
Issuances	—	—	—	—	—
Settlements	—	—	(83,997)	(83,997)	(84,394)
Transfers into (out of) Level 3	—	—	—	—	
Balance at end of period	$—	—	25,226	25,226	57,995
Change in unrealized gains or losses for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period:					
Net investment income	$—	—	(67,392)	(67,392)	—
Other operating expenses	—	—	—	—	(2,648)
Total	$—	—	(67,392)	(67,392)	(2,648)

The following tables show the quantitative information about the Company's level 3 assets and liabilities.

	September 30, 2016		
	Fair Value (In thousands)	Valuation Technique	Unobservable Input
Derivatives, index options	$90,097	Broker prices	Implied volatility Inputs from broker proprietary models
Total assets	$90,097		
Policyholder account balances	$96,095	Deterministic cash flow model	Projected option cost
Other liabilities	6,434	Black-Scholes model	Expected term Forfeiture assumptions

Total liabilities	$102,529

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	December 31, 2015		
	Fair Value (In thousands)	Valuation Technique	Unobservable Input
Derivatives, index options	$38,409	Broker prices	Implied volatility
			Inputs from broker proprietary models
Total assets	$38,409		
Policyholder account balances	$58,359	Deterministic cash flow model	Projected option cost
Other liabilities	7,669	Black-Scholes model	Expected term
			Forfeiture assumptions
Total liabilities	$66,028		

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

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

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

	September 30, 2016				
			Fair Value Hierarchy Level		
	Carrying Values	Fair Values	Level 1	Level 2	Level 3
	(In thousands)				
ASSETS					
Investments in debt and equity securities:					
Securities held to maturity	$7,106,373	7,542,335	—	7,542,335	—
Securities available for sale	3,106,794	3,106,794	18,889	3,087,905	—
Cash and cash equivalents	177,288	177,288	177,288	—	—
Mortgage loans	146,913	150,125	—	—	150,125
Policy loans	59,218	113,290	—	—	113,290
Other loans	12,349	11,878	—	—	11,878
Derivatives, index options	90,097	90,097	—	—	90,097
Short-term investments	14,972	14,972	—	14,972	—
Life interest in Trust	7,379	12,775	—	—	12,775
LIABILITIES					
Deferred annuity contracts	$7,693,495	7,314,565	—	—	7,314,565
Immediate annuity and supplemental contracts	443,162	485,702	—	—	485,702

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	December 31, 2015				
			Fair Value Hierarchy Level		
	Carrying Values	Fair Values	Level 1	Level 2	Level 3
	(In thousands)				
ASSETS					
Investments in debt and equity securities:					
Securities held to maturity	$7,173,967	7,335,436	—	7,335,436	—
Securities available for sale	2,879,583	2,879,583	17,980	2,861,603	—
Cash and cash equivalents	106,007	106,007	106,007	—	—
Mortgage loans	108,311	111,162	—	—	111,162
Policy loans	61,957	108,550	—	—	108,550
Other loans	2,779	2,957	—	—	2,957
Derivatives, index options	38,409	38,409	—	—	38,409
Life interest in Trust	7,379	12,775	—	—	12,775
LIABILITIES					
Deferred annuity contracts	$7,640,951	7,288,108	—		7,288,108
Immediate annuity and supplemental contracts	434,468	461,457	—	—	461,457

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

(11) DERIVATIVE INVESTMENTS

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

The Company purchases over-the-counter index options, which are derivative financial instruments, to hedge the equity return component of its fixed-index annuity and life products. The index options act as hedges to match closely the returns on the underlying index or indices. The amounts which may be credited to policyholders are linked, in part, to the returns of the underlying index or indices. As a result, changes to policyholders' liabilities are substantially offset by changes in the value of the options. Cash is exchanged upon purchase of the index options and no principal or interest payments are made by either party during the option periods. Upon maturity or expiration of the options, cash may be paid to the Company depending on the performance of the underlying index or indices and terms of the contract.

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

Although there is credit risk in the event of nonperformance by counterparties to the index options, the Company does not expect any of its counterparties to fail to meet their obligations, given their high credit ratings. In addition, credit support agreements are in place with all counterparties which further reduces the Company's credit exposure.

The tables below present the fair value of derivative instruments as of September 30, 2016 and December 31, 2015, respectively.

	September 30, 2016 Asset Derivatives Balance Sheet Location	Fair Value (In thousands)	Liability Derivatives Balance Sheet Location	Fair Value (In thousands)
Derivatives not designated as hedging instruments				
Equity index options	Derivatives, Index Options	$ 90,097		
Fixed-index products			Universal Life and Annuity Contracts	$ 96,095
Total		$ 90,097		$ 96,095

	December 31, 2015 Asset Derivatives Balance Sheet Location	Fair Value (In thousands)	Liability Derivatives Balance Sheet Location	Fair Value (In thousands)
Derivatives not designated as hedging instruments				

Equity index options	Derivatives, Index Options	$ 38,409		
Fixed-index products			Universal Life and Annuity Contracts	$ 58,359
Total		$ 38,409		$ 58,359

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The table below presents the effect of derivative instruments in the Condensed Consolidated Statements of Earnings for the three months ended September 30, 2016 and 2015.

Derivatives Not Designated As Hedging Instruments	Location of Gain or (Loss) Recognized In Income on Derivatives	September 30, 2016	September 30, 2015
		Amount of Gain or (Loss) Recognized in Income on Derivatives (In thousands)	
Equity index options	Net investment income	$19,114	(52,816)
Fixed-index products	Universal life and annuity contract interest	(12,194)	41,839
		$6,920	(10,977)

The table below presents the effect of derivative instruments in the Condensed Consolidated Statements of Earnings for the nine months ended September 30, 2016 and 2015.

Derivatives Not Designated As Hedging Instruments	Location of Gain or (Loss) Recognized In Income on Derivatives	September 30, 2016	September 30, 2015
		Amount of Gain or (Loss) Recognized in Income on Derivatives (In thousands)	
Equity index options	Net investment income	$8,307	(69,884)
Fixed-index products	Universal life and annuity contract interest	5,645	62,275
		$13,952	(7,609)

(12) SUBSEQUENT EVENTS

Subsequent events have been evaluated and no reportable items were identified.

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

FORWARD-LOOKING STATEMENTS

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

Management's discussion and analysis of the financial condition and results of operations (“MD&A”) of National Western Life Group, Inc. (formerly National Western Life Insurance Company and subsidiaries) for the three and nine months ended September 30, 2016 follows. Where appropriate, discussion specific to the insurance operations of National Western Life Insurance Company is denoted by "National Western" or "company". This discussion should be read in conjunction with the Company's condensed consolidated financial statements and related notes beginning on page 3 of this report and with the 2015 Annual Report filed on Form 10-K with the SEC.

Overview

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

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

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

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

The Company monitors these factors continually as key business indicators. The discussion that follows in this Item 2 includes these indicators and presents information useful to an overall understanding of the Company's business performance for the nine months ended September 30, 2016, incorporating required disclosures in accordance with the rules and regulations of the Securities and Exchange Commission.

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Insurance Operations - Domestic

National Western is currently licensed to do business in all states and the District of Columbia except for New York. Products marketed are annuities, universal life insurance, fixed-index universal life, and traditional life insurance, which include both term and whole life products. The company's domestic sales have historically been more heavily weighted toward annuity products, which include single and flexible premium deferred annuities, single premium immediate annuities, and fixed-index annuities. Most of these annuities can be sold either as tax qualified or nonqualified products. At September 30, 2016, the Company maintained approximately 136,100 annuity contracts in force and 52,900 domestic life insurance policies in force representing $3.0 billion in face amount of coverage.

National Western markets and distributes its domestic products primarily through independent national marketing organizations ("NMOs"). These NMOs assist the company in recruiting, contracting, and managing independent agents. The company's agents are independent contractors who are compensated on a commission basis. The company currently has approximately 24,000 domestic independent agents contracted.

Insurance Operations - International

The company's international clientèle consists mainly of foreign nationals in upper socioeconomic classes. Insurance products are issued currently to residents of countries in South America, the Caribbean, Eastern Europe, and Asia based upon applications received in the Company's home office in Austin, Texas. Issuing policies to residents of countries in these different regions provides diversification that helps to minimize large fluctuations that could arise due to various economic, political, and competitive pressures that may occur from one country to another. Products issued to international residents are almost entirely universal life and traditional life insurance products. However, certain annuity and investment contracts are also available. At September 30, 2016, the company had approximately 65,200 international life insurance policies in force representing approximately $18.0 billion in face amount of coverage.

International applications are submitted by independent contractor consultants and broker-agents. The company has approximately 2,200 independent international consultants and brokers currently contracted.

There are some inherent risks of accepting international applications, which are not present within the domestic market, that are reduced substantially by the company in several ways. As previously described, National Western accepts applications from foreign nationals in upper socioeconomic classes who have substantial financial resources. This targeted customer base coupled with the company's conservative underwriting practices have historically resulted in claims experience, due to natural causes, similar to that in the United States. The company minimizes exposure to foreign currency risks by requiring payment of premiums, claims and other benefits entirely in United States dollars (except for a small block of business in Haiti whose policies are denominated in Haitian gourdes). National Western's fifty plus years of experience with the international products and its longstanding independent consultant and broker-agent relationships further serve to minimize risks.

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SALES

Life Insurance

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
International:				
Universal life	$590	793	1,785	2,220
Traditional life	416	796	1,396	2,289
Equity-index life	2,143	3,483	6,744	10,724
	3,149	5,072	9,925	15,233
Domestic:				
Universal life	22	15	32	49
Traditional life	32	14	89	105
Equity-index life	4,309	4,387	12,287	13,281
	4,363	4,416	12,408	13,435
Totals	$7,512	9,488	22,333	28,668

Life insurance sales, as measured by annualized first year premiums, decreased 21% in the third quarter of 2016 as compared to the third quarter of 2015. By market segment, the domestic life insurance line of business declined 1% while the international life insurance line of business posted a 38% decrease over the comparable results during the third quarter of 2015. For the nine months ended September 30, 2016 total life sales decreased 22% from 2015 levels as domestic life insurance sales declined 8% during this period and international life insurance sales decreased 35%.

The company's domestic operations life insurance product portfolio includes single premium universal life ("SPUL") and equity-index universal life ("EIUL") products as well as hybrids of the EIUL and SPUL products, combining features of these core products. Equity-index universal life products continue to be the predominant product sold in the domestic life market. Most of these sales are single premium mode products (one year, five year, or ten year) designed for transferring accumulated wealth tax efficiently into life insurance policies with limited underwriting due to lesser net insurance amounts at risk (face amount of the insurance policy less cash premium contributed). These products were designed and implemented several years ago targeting the accumulated savings of the Baby Boomer segment of the population entering their retirement years. The wealth transfer life products have been valuable offerings for the Company's distributors as evidenced by comprising 99% of total domestic life sales in the first nine months of 2016. The company also began offering in its domestic line of business graded death benefit whole life and term insurance (traditional) products in 2015.

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

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Applications submitted from residents of Latin America have historically comprised the majority of the company's international life insurance sales. As noted previously, the company's international sales by geographic market tend to fluctuate with the socio and economic climates in these regions. The company's mix of international sales by geographic region is as follows.

	Nine Months Ended September 30, 2016	2015
Percentage of International Sales:		
Latin America	95.9 %	84.6 %
Pacific Rim	—	12.4
Eastern Europe/Asia	4.1	3.0
Totals	100.0%	100.0%

Year-to-date, the company has accepted new business from residents outside of the United States in over thirty different countries with Venezuela (30%), Peru (16%), Chile (12%), and Argentina (10%) comprising the regions with contributions of 10% or more of total international sales.

As previously disclosed in prior SEC filings, the Brazilian Superintendence of Private Insurance ("SUSEP") attempted to serve National Western in 2011 with a subpoena regarding an administrative proceeding initiated by SUSEP in which it alleged the company was operating as an insurance company in Brazil without due authorization. While the company believes that SUSEP has no jurisdiction over the company, the company has been in discussions with SUSEP in an effort to resolve this matter. In light of the pendency of discussions with Brazilian authorities, the company ceased accepting new applications from residents in Brazil in the fourth quarter of 2015. Additionally, after careful consideration of various factors, including segment performance and the volume of application submissions, the company ceased accepting applications from residents in certain other countries, primarily in Central America and the Pacific Rim. Sales of new policies issued to residents in these countries, including Brazil, represented approximately 24% of total international life insurance new business placed during 2015. The actions taken with regard to ceasing the acceptance of applications in the areas mentioned above occurred in the fourth quarter of 2015. Consequently, the international life insurance declines in sales for the quarter and nine months ended September 30, 2016 in comparison to like periods in 2015 reflect the discontinuance of business.

The average new policy face amounts since 2010 are as shown in the following table.

	Average New Policy Face Amount Domestic	International
Year ended December 31, 2010	164,800	338,600
Year ended December 31, 2011	178,500	363,600
Year ended December 31, 2012	254,900	380,200
Year ended December 31, 2013	286,000	384,000
Year ended December 31, 2014	286,600	382,600
Year ended December 31, 2015	274,500	342,500
Nine months ended September 30, 2016	311,300	328,600

The company's efforts are directed toward maintaining its competitive advantages in accepting applications from upper socio-economic residents of international countries and to its wealth transfer strategies for domestic life sales. In both of these strategies the company's portfolio of fixed-index (equity indexed) life insurance products plays an important role. Fixed-index life products accounted for 85% of total life sales in the first nine months of 2016, as compared to 84% for the same period in 2015.

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

	Insurance In Force as of September 30,	
	2016	2015
	($ in thousands)	
Universal life:		
Number of policies	44,940	48,600
Face amounts	$5,064,620	6,042,850
Traditional life:		
Number of policies	34,330	36,140
Face amounts	$3,490,930	3,620,430
Fixed-index life:		
Number of policies	38,850	39,530
Face amounts	$9,462,720	9,856,540
Rider face amounts	$3,046,760	3,102,820
Total life insurance:		
Number of policies	118,120	124,270
Face amounts	$21,065,030	22,622,640

At September 30, 2016, the company’s face amount of life insurance in force was comprised of $18.0 billion from the international line of business and $3.0 billion from the domestic line of business. At September 30, 2015, these amounts were $19.5 billion and $3.1 billion for the international and domestic lines of business, respectively.

Annuities

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Fixed-index annuities	$156,297	174,294	498,186	511,796
Other deferred annuities	4,671	9,787	27,075	39,700
Immediate annuities	807	1,757	3,198	3,774
Totals	$161,775	185,838	528,459	555,270

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Explanation of Responses:

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Annuity sales in the third quarter of 2016 were 13% below those of the comparable period in 2015. For the nine months ended September 30th, annuity sales were 5% below the amount recorded in the first nine months of 2015. The company's mix of annuity sales has historically shifted with interest rate levels and the relative performance of the equity market. Over the past several years, sales of fixed-index products have accounted for 90% or more of all annuity sales. During the first nine months of 2016, this percentage exceeded 94% reflecting the ongoing bull market run in equities since bottoming out in 2009 and the persisting low level of fixed interest rates. For all fixed-index products, the company purchases over the counter call options to hedge the equity return feature. The options are purchased relative to the issuance of the annuity contracts in such a manner to minimize timing risk. Generally, the index return during the indexing period (if the underlying index increases) becomes a component in a formula (set forth in the annuity), the result of which is credited as interest to contract holders electing the index formula crediting method at the beginning of the indexing period. The formula result can never be less than zero with these products. The company does not deliberately mismatch or under hedge for the equity feature of the products. Fixed-index products also provide the contract holder the alternative to elect a fixed interest rate crediting option.

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

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

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

	Annuities In Force as of September 30,	
	2016	2015
	($ in thousands)	
Fixed-index annuities		
Number of policies	73,930	71,520
GAAP annuity reserves	$5,666,087	5,425,463
Other deferred annuities		
Number of policies	47,780	51,370
GAAP annuity reserves	$1,958,672	2,132,500
Immediate annuities		
Number of policies	14,400	15,120
GAAP annuity reserves	$368,724	363,173

Total annuities		
Number of policies	136,110	138,010
GAAP annuity reserves	$7,993,483	7,921,136

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Impact of Recent Business Environment

The Company's business is generally aided by an economic environment undergoing expansion, whether moderate or vibrant, characterized by metrics which indicate improving employment data and increases in personal income. Approximately 450,000 U.S. jobs were added during the third quarter indicative of moderate economic activity and provided a steady foundation for future growth prospects. The continued recovery in the housing market, low gas prices, and fuel provided by incremental consumer spending all portend economic growth. The ongoing level of low or negative interest rates in many economies across the globe is helping to provide a climate for growth to occur as well. Conversely, uncertainty persists due to the European and U.S. political landscapes, the U.K's exit from the European Union, and the path of interest rates to be set by the Federal Reserve and other major central banks.

Industry analysts and observers generally agree that a sudden jump in interest rate levels, while currently not thought to be a likely scenario, would be harmful to life insurers with interest-sensitive products as it could provide an impetus for abnormal levels of product surrenders and withdrawals at the same time fixed debt securities held by insurers declined in market value. Currently, the solid jobs market and improving economic activity suggest that less monetary stimulus is needed to sustain the recovery of the U.S. economy. The consensus at this time by market prognosticators is for another rate hike of 25 basis points by the Federal Reserve at its December meeting. Future movements beyond this are data-dependent according to central bank policy makers. It is uncertain what direction and at what pace interest rate movements may occur in the future and what impact, if any, such movements would have on the Company's business, results of operations, cash flows or financial condition.

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

RESULTS OF OPERATIONS

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

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Consolidated Operations

Revenues. The following details Company revenues.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Universal life and annuity contract charges	$40,333	39,175	123,791	114,833
Traditional life premiums	4,631	4,840	13,721	14,349
Net investment income (excluding derivatives)	107,867	109,025	327,425	328,275
Other revenues	4,476	5,067	14,050	15,590
Operating revenues	157,307	158,107	478,987	473,047
Derivative gain (loss)	19,114	(52,816)	8,307	(69,884)
Net realized investment gains (losses)	5,426	813	10,589	6,049
Total revenues	$181,847	106,104	497,883	409,212

Universal life and annuity contract charges - Revenues for universal life and annuity contracts were higher for the first nine months in 2016 compared to 2015 primarily due to an increase in surrender charge revenue. Revenues for universal life and annuity products consist of policy charges for the cost of insurance, administration charges, and surrender charges assessed against policyholder account balances, less reinsurance premiums, as shown in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Contract Revenues:				
Cost of insurance and administrative charges	$33,335	33,754	99,624	99,997
Surrender charges	11,348	10,173	34,955	28,898
Other charges	(187)	(735)	1,131	(2,537)
Gross contract revenues	44,496	43,192	135,710	126,358
Reinsurance premiums	(4,163)	(4,017)	(11,919)	(11,525)
Net contract revenues	$40,333	39,175	123,791	114,833

Cost of insurance charges typically trend with the size of the life insurance block in force and the amount of new business issued during the period. Life insurance in force during the nine months ended September 30, 2016 averaged approximately $21.5 billion while for the same period of 2015 averaged $22.9 billion. Countering the decline in insurance in force, the Company implemented higher cost of insurance charges on international life insurance products during the second quarter of 2016. Accordingly, for the three months ended September 30, 2016, cost of insurance charges remained level to the $26.5 million reported in the comparable quarter of 2015. For the nine months ended September 30, 2016, cost of insurance charges increased slightly to $79.2 million from $78.8 million at September 30, 2015. In addition to the increase in international cost of insurance charges, the increase reflects larger domestic face amounts of insurance being added to the in force block of business, which produce higher contract charges per policy, replacing smaller face amounts terminated through death, surrender or lapsation. Administrative charges pertaining to new business issued declined marginally to $20.5 million for the nine months ended September 30, 2016 versus $21.2 million for the nine months ended September 30, 2015 due to a lower amount of life insurance policies issued.

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Surrender charges assessed against policyholder account balances upon withdrawal increased 21% in the first nine months of 2016 versus the comparable prior year period. While the Company earns surrender charge income that is assessed upon policy terminations, the Company's overall profitability is enhanced when policies remain in force and additional contract revenues are realized and the Company continues to make an interest rate spread equivalent to the difference it earns on its investment and the amount that it credits to policyholders. In the first nine months of 2016, lapse rates on domestic life insurance and annuity policies were generally consistent with the prior year. The increase in surrender charge income recognized in the current quarter reflects an increase in the international life insurance lapse rate, most noticeably in the countries from which the Company ceased accepting applications from residents in the fourth quarter of 2015. Surrender charge income recognized is also dependent upon the duration of policies at the time of surrender (i.e. later duration policy surrenders having a lower surrender charge assessed and earlier duration surrenders having a higher surrender charge).

Traditional life premiums - Traditional life premiums were down slightly in the three and nine months ended September 30, 2016 compared to the same periods in 2015. Most of the decline was incurred in renewal life insurance premiums reflecting the increase in international policy lapses noted above. Traditional life insurance premiums for products such as whole life and term life are recognized as revenues over the premium-paying period. The Company's life insurance sales focus has historically been primarily centered around universal life products, although additional term products have been added to the Company's portfolio recently. Universal life products, especially the Company's equity indexed universal life products which offer the opportunity for consumers to acquire life insurance protection and receive credited interest linked in part to an outside market index, have been more popular product offerings in the Company's markets representing in excess of 85% of new life insurance sales for 2016 the periods shown.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Gross investment income:				
Debt and equities	$103,650	104,524	312,833	311,911
Mortgage loans	2,070	2,967	5,576	7,823
Policy loans	868	995	2,732	2,945
Short-term investments	252	28	507	183
Other invested assets	1,318	785	6,594	6,241
Total investment income	108,158	109,299	328,242	329,103
Less: investment expenses	291	274	817	828
Net investment income (excluding derivatives)	107,867	109,025	327,425	328,275
Derivative gain (loss)	19,114	(52,816)	8,307	(69,884)
Net investment income	$126,981	56,209	335,732	258,391

For the nine months ended September 30, 2016, debt and equity securities generated approximately 96% of total investment income, excluding derivative gain (loss). The Company's strategy is to invest substantially all of its cash flows in fixed debt securities consistent with its guidelines for credit quality, duration, and diversification. The relatively stable level of investment income from debt and equity securities through the third quarter of 2016 versus 2015, despite higher portfolio balances in the current period, reflects higher yielding debt securities maturing or being called by borrowers and being replaced with lower yielding securities in the current interest rate environment. Investment yields on new bond purchases during the first nine months of 2016 remained below the portfolio's weighted average yield approximating 4.16%.

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Mortgage loan investment income for the nine months ended September 30, 2016 decreased over the comparable period in 2015 reflecting a gradual decline in the portfolio balance over a period of years with the most recent year-end balances dropping from $149.5 million at December 31, 2014 to $108.3 million at December 31, 2015. The Company identified this as an area of investment focus going forward and has increased the mortgage loan portfolio balance to $146.9 million at September 30, 2016. During the nine months ended September 30, 2016 the Company originated new mortgage loans in the amount of $55.8 million compared to $5.0 million in the comparable period of 2015.

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

	Nine Months Ended September 30,	
	2016	2015
	(In thousands)	
Excluding derivatives:		
Net investment income	$327,425	328,275
Average invested assets, at amortized cost	$10,407,898	10,084,537
Annual yield on average invested assets	4.19 %	4.34 %
Including derivatives:		
Net investment income	$335,732	258,391
Average invested assets, at amortized cost	$10,472,151	10,154,294
Annual yield on average invested assets	4.27 %	3.39 %

The lower yield on average invested assets, excluding derivatives, through the third quarter of 2016 compared to 2015 is due to ongoing lower yields obtained on new fixed maturity debt securities investments. During 2015, the average yield on bond purchases to fund insurance operations was 3.45% representing a 1.31% spread over treasury rates. Insurance operation bond purchases through the third quarter of 2016 had a comparable average yield of 3.43% as spreads increased to 1.68% over treasury rates during this period while treasury rates declined. However, insurance operation bond purchases for the three months ended September 30, 2016 averaged 3.18%.

The bond yield rates during both 2015 and 2016 are below the weighted average bond portfolio rate which was slightly above 4.16% at September 30, 2016. The weighted average quality of new purchases during the first nine months of the current year was "BBB+", which was slightly lower than the "A-" overall quality rating of purchases during 2015. The composite duration of purchases during the first nine months of 2016 was approximately the same as that for 2015 purchases. The Company's general investment strategy is to purchase securities with maturity dates approximating ten years in the future. Accordingly, an appropriate measure for benchmarking the direction of interest rate levels for the Company's debt security purchases is the ten year treasury bond rate. After ending 2015 at a rate of 2.27%, the daily closing yield of the ten year treasury bond ranged from a low of approximately 1.35% to a high of 2.25% during the first nine months of 2016, and ended the third calendar quarter at 1.59%.

The pattern in average invested asset yield, including derivatives, incorporates increases and decreases in the fair value of index options purchased by the Company to support its fixed-index products. Fair values of the purchased call options increased during the 2016 period and decreased in the 2015 period corresponding to the movement in equity market indices in these time frames. Refer to the derivatives discussion below for a more detailed explanation of these instruments.

Other revenues - Other revenues primarily pertain to the Company's two nursing home operations in Reno, Nevada and San Marcos, Texas. Revenues associated with these operations were $13.5 million and $15.5 million for the nine months ended September 30, 2016 and 2015, respectively. Lower nursing home revenues reflect lower census figures at the facilities thus far in 2016 given local competition for residents and a change in mix of payor sources toward lower reimbursement patient types.

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

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Gains and losses from index options are substantially due to changes in equity market conditions. Index options are intended to act as hedges to match the returns on the product's underlying reference index and the rise or decline in the index relative to the index level at the time of the option purchase which causes option values to likewise rise or decline. As income from index options fluctuates with the underlying index, the contract interest expense to policyholder accounts for the Company's fixed-index products also fluctuates in a similar manner and direction. For the three and nine months ended September 30, 2016, the reference indices increased and the Company recorded an overall gain from index options as shown below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Derivatives:				
Unrealized gain (loss)	$32,821	(52,391)	60,121	(100,509)
Realized gain (loss)	(13,707)	(425)	(51,814)	30,625
Total gain (loss) included in net investment income	$19,114	(52,816)	8,307	(69,884)
Total contract interest	$67,776	16,259	179,592	114,729

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

Net realized investment gains (losses) - Realized gains on investments in 2016 primarily resulted from bond calls and sales. The net gains reported for the nine months ended September 30, 2016 consisted of gross gains of $10.0 million offset by gross losses of $0.1 million. No other-than-temporary credit impairment losses were recorded during the nine months ended September 30, 2016 while $0.1 million was recorded during the same period for 2015.

The Company records impairment write-downs when a decline in value is considered to be other-than-temporary and full recovery of the investment is not expected. Impairments due to credit factors are recorded in the Company's Condensed Consolidated Statements of Earnings while non-credit (liquidity) impairment losses are included in Condensed Consolidated Statement of Comprehensive Income (Loss). Impairment and valuation write-downs reflected in the Company's Condensed Consolidated Statements of Earnings are summarized in the following table.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			

Impairment or valuation write-downs:		
Bonds	$ ——	——
Equities	— —	—107
Total	$ ——	—107

As shown in the table above, the Company recognized minimal impairments during the first nine months of 2016 and 2015. While the Company frequently impairs equity securities in reporting periods, the level of potential impairments in 2016 thus far did not approach the threshold of materiality. Equity securities (common stocks) represent 0.1% of invested assets and individual common stock holdings have an average cost basis of approximately $40,000.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Life and other policy benefits	$17,430	14,181	48,571	49,567
Amortization of deferred policy acquisition costs	24,395	32,058	88,581	87,780
Universal life and annuity contract interest	67,776	16,259	179,592	114,729
Other operating expenses	23,595	18,482	66,306	57,794
Totals	$133,196	80,980	383,050	309,870

Life and other policy benefits - Death claim benefits, the largest component of policy benefits, decreased to $25.9 million in the first nine months of 2016 compared to $28.3 million for the first nine months of 2015. Death claim amounts are generally subject to variation from period to period. For the three months ended September 30, 2016 and 2015, death claim benefits were $8.0 million and $6.8 million, respectively. The Company's overall mortality experience has generally been consistent with or better than its product pricing assumptions.

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

The following table identifies the effects of unlocking and true-up adjustments on DPAC balances recorded through amortization expense three and nine months ended September 30, 2016 and 2015.

Increase (Decrease) in DPAC Balance	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Unlocking	$8,170	—	11,790	1,810
True-up	(2,350)	490	(3,370)	6,010
Totals	$5,820	490	8,420	7,820

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True-up adjustments were recorded in 2016 and 2015 relative to partial surrender rates, mortality rates, credited interest rates and earned rates for the current years' experience. In the third quarter, true-up adjustments resulted in a $2.4 million increase in amortization expense for 2016 and a $0.5 million decrease for 2015. These adjustments further produced a $3.4 million increase in amortization expense for the nine months ended September 30, 2016, and a $6.0 million decrease for the nine months ended September 30, 2015. The true-up adjustments for the life insurance lines of business were positive (decrease to amortization expense) by $12.7 million in the first nine months of 2016 whereas the true-up adjustments for the annuity line of business during the same period were negative by $16.0 million incrementally adding to amortization expense. For the nine months ended September 30, 2015, true-up adjustments for the life insurance lines of business were positive (decrease to amortization expense) by $14.5 million while true-up adjustments for the annuity line of business during the same period were negative by $8.5 million incrementally adding to amortization expenses. The annuity true-up adjustments in the 2016 period relative to 2015 were a larger negative amount due to increased spread compression on the block of business.

In the quarter ended September 30, 2016, the Company unlocked the DPAC balance associated with its Domestic Life insurance segment for favorable mortality. The effect the prospective unlocking was to increase DPAC balances by $8.2 million (and decrease amortization expense). During the second quarter of 2016, the Company unlocked the DPAC balance associated with its International Life insurance segment for favorable mortality, increased cost of insurance charges that had been implemented, and higher lapse assumptions for policies associated with residents in "disengaged countries" (countries which the Company ceased accepting applications from residents during 2015). The effect of the prospective unlocking was to increase DPAC balances by $7.3 million (and decrease amortization expense). Concurrent with this unlocking, the Company also unlocked the DPAC balance for its Annuity segment for surrender and annuitization rates on its indexed, single tier, and two tier annuities. The effect of this prospective unlocking was to decrease DPAC balances by $3.7 million (and increase amortization expense).

In the nine months ended September 30, 2015, the Company unlocked the DPAC balance associated with its International Life insurance segment for favorable mortality experience on one of its universal life products. The effect of the prospective unlocking was to increase DPAC balances by $7.1 million (and decrease amortization expense). In addition, the Company unlocked the DPAC balance associated with its annuity segment for future assumptions pertaining to product development override costs (trailer commissions) which it is obligated to pay to certain contracted National Marketing Organizations. The effect of the prospective unlocking was to decrease DPAC balances by $5.3 million (and increase amortization expense).

The Company is required to evaluate its emergence of profits continually and management believes that the current amortization patterns of deferred policy acquisition costs, incorporating these unlocking adjustments, are reflective of actual experience.

As the DPAC balance is an asset on the Company's Condensed Consolidated Balance Sheet, generally accepted accounting principles (GAAP) provide for an earned interest return on the unamortized balance each period. The earned interest serves to increase the DPAC balance and reduce amortization expense. The rate at which the DPAC balance earns interest is the average credited interest rate on the Company's universal life and annuity policies in force, including credited interest on equity-index policies. Since the Company's crediting rates have declined, both due to lower fixed interest rates as well as lower equity-index credits, the amount of earned interest on DPAC balances has declined resulting in higher amortization expense.

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

The Company's approximated average credited rates through the first nine months, excluding and including fixed-index (derivative) products, were as follows:

	September 30,		September 30,	
	2016	2015	2016	2015
	(Excluding fixed-index products)		(Including fixed-index products)	
Annuity	2.32%	2.45%	1.94%	1.50%
Interest sensitive life	3.62%	3.72%	3.90%	2.27%

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Contract interest including fixed-index products also encompasses the performance of the index options associated with the Company's fixed-index products. As previously noted, the market performance of these derivative features resulted in net realized and unrealized gains/(losses) of $19.1 million and $(52.8) million for the quarters ended September 30, 2016 and 2015, respectively. Generally, the impact of the market value change of index options on asset values aligns closely with the movement of the embedded derivative liability held for the Company's fixed-index products such that the net effect upon pretax earnings is negligible (i.e. net realized and unrealized gains/(losses) included in net investment income approximate the change in contract interest associated with the corresponding embedded derivative liability change). However, during periods of equity market movements (gains or losses), in tandem with Company changes in asset management fees assessed on these products (increases or decreases), deviations can occur between index option asset values and the embedded derivative liability. In the three month periods ending September 30, 2016 and 2015, contract interest was decreased $5.9 million and increased $11.2 million, respectively, for this occurrence.

Similar to deferred policy acquisition costs, the Company defers sales inducements in the form of first year credited interest bonuses on annuity products that are directly related to the production of new business. These bonus interest charges are deferred and amortized using the same methodology and assumptions used to amortize other capitalized acquisition costs and the amortization is included in contract interest. In addition, deferred sales inducement balances are also reviewed periodically to ascertain whether actual experience has deviated significantly from that assumed (unlock) and are adjusted to reflect current policy lapse or termination rates, expense levels and credited rates on policies compared to anticipated experience (true-up). These adjustments, plus or minus, are included in contract interest expense. For the nine months ended September 30, 2016 and 2015, the Company recorded true-up adjustments of its deferred sales inducement balances resulting in decreased balance sheet amounts of $4.8 million and $2.4 million, respectively, which thereby increased contract interest expense by a like amount. For the quarter ended September 30, 2016 and 2015, the true-up adjustments recorded decreased balance sheet amounts by $1.4 million and $1.3 million, respectively.

The Company unlocked its deferred sales inducement balance during the nine months ended September 30, 2016 associated with its annuity segment for surrender and annuitization rate changes as noted in the discussion on deferred policy acquisition costs. The effect of the prospective unlocking was to decrease the deferred sales inducement balance by $1.7 million. In addition, as part of this unlocking, benefit reserves for international universal life and deferred annuities (two tier) were increased by a net amount of $6.0 million. This reserve change increased the contract interest charge for the period.

The Company also unlocked its deferred sales inducement balance in the first nine months of 2015 associated with its annuity segment for future expense assumptions pertaining to product development override costs as previously discussed. The effect of the prospective unlocking was to decrease the deferred sales inducement balance by $1.8 million which increased contract interest expense by the same amount.

Other operating expenses - Other operating expenses consist of general administrative expenses, licenses and fees, commissions not subject to deferral, nursing home expenses and compensation costs. These expenses for the nine months ended September 30, 2016 and 2015 are summarized in the table that follows.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
General insurance expenses	$7,661	5,037	25,447	16,948

Nursing home expenses	4,531	4,902	13,650	14,311
Compensation expenses	6,909	3,929	14,063	13,114
Commission expenses	3,043	3,137	8,480	8,841
Taxes, licenses and fees	1,451	1,477	4,666	4,580
Totals	$23,595	18,482	66,306	57,794

General insurance expenses include expenditures for software and amortization of previously capitalized information technology expenditures. In 2016, the Company began processing new policy applications for certain lines of business on a proprietary policy administration system that had been under development for a number of years. Amortization of the costs capitalized in development of this system therefore commenced in 2016 and increased information technology expense to $6.3 million for the first nine months of 2016 compared to $2.6 million during the comparable period in 2015. This amortization will continue for the next seven years. Given the Company's strategic commitment to upgrading its information technology, consulting expenditures have similarly increased approximating $2.2 million during 2016 year-to-date from $1.6 million in the prior year.

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General insurance expenses include provisions for litigation and other settlement payments made in lieu of litigation. As discussed in the Legal Proceedings section of the footnotes to the condensed consolidated financial statements, the Company charged $2.9 million against earnings in the first quarter of 2016 related to litigation involving an annuity contract matter in Puerto Rico.

Nursing home expenses reflect the operations of the two facilities owned by the Company. Expenses during the first nine months of 2016 were slightly below the previous period reflecting cost containment measures coinciding with lower census figures.

Compensation expenses include share-based compensation costs related to outstanding vested and nonvested stock options and SARs. As further discussed in Note 7 to the condensed consolidated financial statements, the Company awarded 14,643 new SARs to officers of National Western during the first quarter of 2016. No stock options or SARs were awarded in the first nine months of 2015. The related share-based compensation costs move in tandem not only with the number of stock options and SARs outstanding but also with the movement in the market price of the Company's Class A common stock as a result of marking the stock options and SARs to fair value under the liability method of accounting. Consequently, the related expense amount varies positive or negative in any given period. During the third quarter of 2016, the Company's closing stock price increased from $197.27 at June 30, 2016 to $205.37 at September 30, 2016. For the three months ended September 30, 2016 share based compensation expense was $1.7 million while for the comparable period in 2015 share based compensation expense was $(1.0) million. For the nine months ended September 30, 2016 share-based compensation expense was $(1.1) million versus $(2.6) million in the same period for 2015.

Taxes, licenses and fees include premium taxes and licensing fees paid to state insurance departments, guaranty fund assessments, the company portion of social security and Medicare taxes, and other state and municipal taxes. For the nine months ended September 30, 2016, these amounts remained level to the comparable period in 2015.

Federal Income Taxes. Federal income taxes on earnings from operations reflect an effective tax rate of 32.7% for the nine months ended September 30, 2016 compared to 33.2% for the nine months ended September 30, 2015. The Company's effective tax rate is typically lower than the Federal rate of 35% due to tax-exempt investment income related to municipal securities and dividends-received deductions on income from stocks.

Segment Operations

Summary of Segment Earnings

A summary of segment earnings for the three and nine months ended September 30, 2016 and 2015 is provided below. The segment earnings exclude realized gains and losses on investments, net of taxes.

	Domestic Life Insurance	International Life Insurance	Annuities	All Others	Totals
	(In thousands)				
Segment earnings (losses):					
Three months ended:					
September 30, 2016	$3,492	9,936	13,661	3,120	30,209
September 30, 2015	$1,896	9,952	1,071	2,773	15,692
Nine months ended:					
September 30, 2016	$3,811	41,548	14,160	10,878	70,397

September 30, 2015	$664	34,136	16,842	10,831	62,473

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Domestic Life Insurance Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Premiums and contract revenues:				
Premiums and contract charges	$8,507	8,259	24,814	22,683
Net investment income	12,294	2,095	28,011	17,265
Other revenues	7	3	37	23
Total revenues	20,808	10,357	52,862	39,971
Benefits and expenses:				
Life and other policy benefits	5,338	3,545	13,629	12,540
Amortization of deferred policy acquisition costs	(4,331)	1,594	989	6,473
Universal life insurance contract interest	9,795	14	20,855	10,413
Other operating expenses	4,847	2,397	11,745	9,554
Total benefits and expenses	15,649	7,550	47,218	38,980
Segment earnings (loss) before Federal income taxes	5,159	2,807	5,644	991
Provision (benefit) for Federal income taxes	1,667	911	1,833	327
Segment earnings (loss)	$3,492	1,896	3,811	664

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Universal life insurance revenues	$9,384	9,875	26,909	24,279
Traditional life insurance premiums	1,161	201	3,825	3,648
Reinsurance premiums	(2,038)	(1,817)	(5,920)	(5,244)
Totals	$8,507	8,259	24,814	22,683

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The Company's domestic life insurance in force in terms of policy count has been declining for several years. The pace of new policies issued has lagged the number of policies terminated from death or surrender by roughly a two-to-one rate over the past couple of years causing a declining level of insurance in force from which contract charge revenue is received. Consequently, the number of domestic life insurance policies in force has declined from 55,700 at December 31, 2014 to 54,300 at December 31, 2015, and to 52,900 at September 30, 2016. Universal life insurance revenues are also generated with the issuance of new business based upon amounts per application and percentages of the face amount (volume) of insurance issued. Revenues associated with issuing new business are typically greater than that realized in a renewal period for in force policies. The number of domestic life policies issued in the first nine months of 2016 was 20% lower than in the comparable period for 2015 and the volume of insurance issued was 6% less than that in 2015. Universal life insurance revenues also include surrender charge income realized on terminating policies and, in the case of Domestic universal life, amortization into income of the premium load on single premium policies which the Company began deferring in 2013

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

	Three Months Ended September 30, 2016	2015	Nine Months Ended September 30, 2016	2015
	(In thousands)			
Universal life insurance:				
First year and single premiums	$30,373	30,534	85,915	91,263
Renewal premiums	5,135	5,423	15,481	15,910
Totals	$35,508	35,957	101,396	107,173

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

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

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

	Three Months Ended September 30, 2016	2015	Nine Months Ended September 30, 2016	2015
	(In thousands)			

Net investment income (excluding derivatives)	$8,329	8,368	25,093	23,635
Derivative gain (loss)	3,965	(6,273)	2,918	(6,370)
Net investment income	$12,294	2,095	28,011	17,265

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Life and policy benefits for a smaller block of business are subject to variation from quarter to quarter. Claim activity during the first nine months of 2016 was in line with historical trends and was slightly higher compared to the same period for 2015. The number of incurred claims during the first nine months of 2016 increased 1% compared to the first nine months of 2015 while the average net claim amount increased from $21,000 to $24,000, respectively. The low face amount per claim reflects the older block of domestic life insurance policies sold which were final expense type products (i.e. purchased to cover funeral costs). The increase in the average net claim amount reflects claims from more recent policy sales (single premium wealth transfer products) which have much higher face amounts of insurance coverage per policy. The Company's overall mortality experience for this segment has been better than pricing assumptions.

As noted previously in the discussion of Results of Operations, the Company records true-up adjustments to DPAC balances each period to reflect current policy lapse or termination rates, expense levels and credited rates on policies as compared to anticipated experience with the adjustment reflected in current period amortization expense. To the extent required, the Company may also record unlocking adjustments to DPAC balances. The following table identifies the effects of unlocking and true-up adjustments on domestic life insurance DPAC balances recorded through amortization expense three and nine months ended September 30, 2016 and 2015.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Increase (Decrease) in DPAC Balance				
Unlocking	$8,170	—	8,170	—
True-up	460	2,520	3,260	5,710
Totals	$8,630	2,520	11,430	5,710

As noted in the table above, the true-up adjustments recorded increased the DPAC balance on the Condensed Consolidated Balance Sheets which conversely reduced amortization expense in current earnings by a like amount for the periods shown. As noted in the Consolidated Operations discussion, the Company unlocked the DPAC balance for this segment during the third quarter of 2016 for favorable mortality. The effect of the prospective unlocking was to increase DPAC balances by $8.2 million (and decrease amortization expense).

International Life Insurance Operations

The Company's international life operations have been a significant factor in the Company's overall earnings performance and represents a niche where the Company believes it has had a competitive advantage historically. A stable population of distribution relationships has been developed over decades of operations providing the Company with a consistent foundation for development of the block of business.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Premiums and other revenues:				
Premiums and contract revenues	$31,066	29,773	95,291	89,470
Net investment income	12,763	448	30,203	17,847
Other revenues	10	5	50	66
Total revenues	43,839	30,226	125,544	107,383
Benefits and expenses:				
Life and other policy benefits	5,038	5,002	14,789	16,794
Amortization of deferred policy acquisition costs	7,296	6,834	11,720	11,347
Universal life insurance and annuity contract interest	11,287	(854)	19,643	13,203
Other operating expenses	6,691	3,929	17,867	15,063
Total benefits and expenses	30,312	14,911	64,019	56,407
Segment earnings (losses) before Federal income taxes	13,527	15,315	61,525	50,976
Provision (benefit) for Federal income taxes	3,591	5,363	19,977	16,840
Segment earnings (loss)	$9,936	9,952	41,548	34,136

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Universal life insurance revenues	$29,687	26,332	91,359	85,056
Traditional life insurance premiums	3,470	5,639	9,896	10,701
Reinsurance premiums	(2,091)	(2,198)	(5,964)	(6,287)
Totals	$31,066	29,773	95,291	89,470

In general, universal life revenues and operating earnings are anticipated to emerge with growth in the amount of international life insurance in force. The volume of insurance in force contracted from $20.0 billion at December 31, 2014 to $19.0 billion at December 31, 2015 and further decreased to $18.0 billion at September 30, 2016. Universal life insurance revenues are also generated with the issuance of new business based upon amounts per application and percentages of the face amount (volume) of insurance issued. The number of international life policies issued in the first nine months of 2016 was 28% lower than in the first nine months of 2015 while the volume of insurance issued was 33% less than that issued in 2015 during the same period as a result of ceasing the acceptance of applications from residents from certain countries in the fourth quarter of 2015.

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A third component of international universal life revenues include surrender charges assessed upon surrender of contracts by policyholders. At the height of the financial crisis in 2008 through 2010 the Company's international policyholders exhibited concern regarding the developments in U.S. financial markets. This evidenced itself in the Company's termination activity in its international life policies in force. The Company incurred higher termination experience than is typical which resulted in recognition of increased surrender charge fee income. This level of termination activity subsequently subsided in 2011 with the termination activity over the following years remaining relatively stable. In 2015, termination activity revisited the levels last seen during the 2008 through 2010 period resulting in additional surrender charge fee revenues, and this activity has continued into 2016. The following table illustrates the Company's recent international life termination experience.

	Amount in $'s (millions)	Annualized Termination Rate	
Volume In Force Terminations			
Year ended December 31, 2011	$ 1,465.1	7.3	%
Year ended December 31, 2012	1,828.4	8.7	%
Year ended December 31, 2013	1,838.5	8.6	%
Year ended December 31, 2014	1,825.5	8.4	%
Year ended December 31, 2015	2,659.1	12.3	%
Nine months ended September 30, 2016	1,819.2	12.0	%

The higher incidence of terminations primarily is occurring with policies to residents of the countries from which the Company discontinued accepting applications in late 2015. As a result of the higher termination incidence, the Company unlocked its DPAC balances for this segment of the business in the second quarter of 2016 to incorporate a greater lapse assumption, among other things.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Universal life insurance:				
First year and single premiums	$ 5,578	7,706	14,679	20,162
Renewal premiums	23,393	24,835	69,903	76,831
Totals	$ 28,971	32,541	84,582	96,993

The Company's most popular international products have been its fixed-index universal life products in which the policyholder can elect to have the interest rate credited to their policy account values linked in part to the performance of an outside equity index. Included in the totals in the above table are collected premiums for fixed-index universal life products of approximately $50.2 million and $63.1 million for the first nine months of 2016 and 2015, respectively. The decline in renewal premiums during 2016 compared to 2015 corresponds with the increased termination activity discussed above.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Net investment income (excluding derivatives)	$9,221	9,233	27,738	28,637
Derivative gain (loss)	3,542	(8,786)	2,465	(10,790)
Net investment income	$12,763	447	30,203	17,847

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

Life and policy benefits primarily consist of death claims on policies. The Company's clientèle for international products are generally wealthy individuals with access to U.S. dollars and quality medical care. Consequently, the amounts of coverage purchased tend to be larger amounts than those for domestic life insurance. In the year ended December 31, 2015, the average face amount of insurance purchased was $343,000, and in the first nine months of 2016, the average was slightly lower at $329,000. While life and policy benefit expense for the international life segment reflects the larger policies purchased, mortality due to natural causes is comparable to that in the United States. The Company's maximum risk exposure per insured life is capped at $500,000 through reinsurance. The average international life net claim amount in the first nine months of 2016 decreased from that in the first nine months of 2015 to $140,000 from $176,000. The number of claims incurred during the first nine months of 2016 increased 1% from the prior year level.

The Company records true-up adjustments to DPAC balances each period to reflect current policy lapse or termination rates, expense levels and credited rates on policies as compared to anticipated experience as well as unlocking adjustments as necessary. The following table identifies the effects of unlocking and true-up adjustments on international life insurance DPAC balances recorded through amortization expense three and nine months ended September 30, 2016 and 2015.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Increase (Decrease) in DPAC Balance				
Unlocking	$—	—	7,270	7,120
True-up	2,260	2,220	9,400	8,760

Totals	$2,260	2,220	16,670	15,880

As noted in the Consolidated Operations discussion, the Company unlocked the DPAC balance for this segment during the first nine months of 2016 for favorable mortality, higher cost of insurance charges which had been implemented and increased lapse rates for disengaged countries. The effect of the prospective unlocking was to increase DPAC balances by $7.3 million (and decrease amortization expense). Similarly, in the nine months ended September 30, 2015, the Company unlocked the DPAC balance associated with its International Life segment for favorable mortality experience on one of its universal life products. The effect of the prospective unlocking at that time was to increase DPAC balances by $7.1 million (and decrease amortization expense).

True-up adjustments in the first nine months of 2016 and 2015 were favorable and increased the DPAC balance on the Condensed Consolidated Balance Sheet and decreased amortization expense in current earnings by a like amount.

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As indicated in the discussion concerning net investment income, contract interest expense includes fluctuations that are the result of the effect upon the embedded derivative for the performance of underlying equity indices associated with fixed-index universal life products. The amounts realized on purchased call options approximate the amounts the Company credits to policyholders. In addition, as part of the unlocking in the first nine months of 2016 mentioned above, the Company's benefit reserves for the International Life segment were decreased by $6.2 million. The effect of this decrease was to correspondingly decrease contract interest during the period by a like amount.

Annuity Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Premiums and other revenues:				
Premiums and contract revenues	$5,391	5,983	17,407	17,029
Net investment income	97,384	49,518	261,579	208,263
Other revenues	139	12	145	31
Total revenues	102,914	55,513	279,131	225,323
Benefits and expenses:				
Life and other policy benefits	7,054	5,634	20,153	20,233
Amortization of deferred policy acquisition costs	21,430	23,630	75,872	69,960
Annuity contract interest	46,694	17,099	139,094	91,113
Other operating expenses	7,526	7,254	23,044	18,866
Total benefits and expenses	82,704	53,617	258,163	200,172
Segment earnings (loss) before Federal income taxes	20,210	1,896	20,968	25,151
Provision (benefit) for Federal income taxes	6,549	825	6,808	8,309
Segment earnings (loss)	$13,661	1,071	14,160	16,842

Premiums and contract charges primarily consist of surrender charge income recognized on terminated policies. The amount of the surrender charge income recognized is determined by the volume of surrendered contracts as well as the duration of each contract at the time of surrender given the pattern of declining surrender charge rates over time that is common to most annuity contracts. The Company's lapse rate for annuity contracts in the first nine months of 2016 was 6.7% compared to 6.4% during the same period in 2015.

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Deposits collected on annuity contracts are not reflected as revenues in the Company's Condensed Consolidated Statements of Earnings, in accordance with GAAP. Actual annuity deposits collected three and nine months ended September 30, 2016 and 2015 are detailed below.

	Three Months Ended September 30, 2016	2015	Nine Months Ended September 30, 2016	2015
	(In thousands)			
Fixed-index annuities	$156,417	179,911	502,386	534,848
Other deferred annuities	7,555	9,296	31,767	32,134
Immediate annuities	1,865	3,053	5,575	7,978
Totals	$165,837	192,260	539,728	574,960

Fixed-index products are more attractive for consumers when interest rate levels remain low and equity markets produce positive returns. Since the Company does not offer variable products or mutual funds, fixed-index products provide an important alternative to the Company's existing fixed interest rate annuity products. Fixed-index annuity deposits as a percentage of total annuity deposits were 93% for each of the nine months ended September 30, 2016 and 2015, respectively. The percentage of fixed-index products of total annuity sales reflects the low interest rate environment and the ongoing bull market in equities.

As a selling inducement, some of the deferred products, including fixed-index annuity products, contain a first year interest bonus ranging from 1% to 7% depending upon the product, in addition to the base first year interest rate. Other products include a premium bonus ranging from 2% to 10% which is credited to the account balance when premiums are applied. These bonus rates are deferred in conjunction with other capitalized policy acquisition costs. The amounts deferred to be amortized over future periods amounted to approximately $13.6 million and $12.6 million during the first nine months of 2016 and 2015, respectively. Amortization of deferred sales inducements is included as a component of annuity contract interest as described later in this discussion of Annuity Operations.

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

	Three Months Ended September 30, 2016	2015	Nine Months Ended September 30, 2016	2015
	(In thousands)			
Net investment income (excluding derivatives)	$85,777	87,275	258,655	260,987
Derivative gain (loss)	11,607	(37,757)	2,924	(52,724)
Net investment income	$97,384	49,518	261,579	208,263

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

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Consistent with the domestic and international life segments, the Company records true-up adjustments to DPAC balances each period to reflect current policy lapse or termination rates, expense levels and credited rates on policies as compared to anticipated experience as well as unlocking adjustments as necessary. The following table identifies the effects of unlocking and true-up adjustments on annuity DPAC balances recorded through amortization expense for the three and nine months ended September 30, 2016 and 2015.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Increase (Decrease) in DPAC Balance				
Unlocking	$—	—	(3,650)	(5,310)
True-up	(5,070)	(4,250)	(16,030)	(8,460)
Totals	$(5,070)	(4,250)	(19,680)	(13,770)

The Company unlocked the DPAC balance associated with its annuity segment in the second quarter of 2016 for surrender and annuitization rates. The effect of the prospective unlocking was to decrease DPAC balances by $3.7 million (and increase amortization expense). The Company also unlocked in the first quarter of 2015 for future expense assumptions pertaining to product development override costs (trailer commissions) which it is obligated to pay to certain contracted National Marketing Organizations. The effect of the prospective unlocking was to decrease DPAC balances by $5.3 million (and increase amortization expense).

As the true-up adjustments decreased the DPAC balances on the Condensed Consolidated Balance Sheet for the nine months ended September 30, 2016 and 2015, a corresponding increase in DPAC amortization expense was recorded in the Company's Condensed Consolidated Statements of Earnings in each respective period. The increase in the negative true-up adjustment for the Annuity line of business year-to-date compared to the prior year period is due to the impact of spread compression on the Company's interest rate margin. The effect of spread compression is to reduce the estimated gross profits for the product line and result in higher amortization of DPAC balances than expected.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Fixed-index annuities	$26,780	(4,936)	68,373	16,722
All other annuities	18,140	17,769	63,590	63,250
Gross contract interest	44,920	12,833	131,963	79,972
Bonus interest deferred and capitalized	(4,243)	(4,413)	(13,587)	(12,560)
Bonus interest amortization	6,017	8,679	20,718	23,701

Total contract interest	$46,694	17,099	139,094	91,113

The fluctuation in reported contract interest amounts for fixed-index annuities is driven by sales levels, the level of the business in force and the effect of positive or negative market returns of option values on projected interest credits. As noted in the discussion on Consolidated Operations, a deviation between index option asset values and the embedded derivative liability occurred during the three month periods ended September 30, 2016 and 2015 such that contract interest was decreased $5.9 million and increased $11.2 million, respectively.

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Annuity contract interest includes true-up adjustments for the deferred sales inducement balance. True-up adjustments for the deferred sales inducement balance are made each period similar to that done with respect to DPAC balances. For the nine months ended September 30, 2016 and 2015, deferred sales inducement balances on the Condensed Consolidated Balance Sheet were reduced by $4.8 million and $2.4 million, respectively, for true-up adjustments. These adjustments are included in the above table as an addition to bonus interest amortization. The Company also unlocked its deferred sales inducement balance in the second quarter of 2016 for surrender and annuitization rates. The effect of the prospective unlocking was to decrease the deferred sales inducement balance by $1.7 million which increased contract interest expense by a like amount. This same unlocking, in addition to impacting the DPAC and deferred sales inducement balances, also increased the Company's benefit reserves by $12.2 million for the two-tier deferred annuity block of business. This reserve increase added $12.2 million to contract interest expense in the nine months ended September 30, 2016.

The Company also unlocked deferred sales inducement balances in the first quarter of 2015 associated with the annuity segment for future expense assumptions pertaining to product development override costs as previously discussed. The effect of the prospective unlocking was to decrease the deferred sales inducement balance by $1.8 million which increased contract interest expense by the same amount.

The majority of litigation and legal matters the Company is involved with emanate from annuity products. The $2.9 million litigation provision discussed in the Consolidated Operations section of this report was allocated to the Annuity Operations segment and is included in other operating expenses in 2016.

Other Operations

The Company's primary business encompasses its domestic and international life insurance operations and its annuity operations of National Western. However, NWLGI and National Western also have small real estate, nursing home, and other investment operations through their wholly owned subsidiaries. Nursing home operations generated $(0.1) million and $1.2 million of operating earnings in the first nine months of 2016 and 2015, respectively. The remaining pre-tax earnings of $16.2 million and $15.0 million in Other Operations during the nine month periods represent investment income from real estate, municipal bonds, and common and preferred equities held in subsidiary company portfolios principally for tax advantage purposes. Included in these amounts are semi-annual distributions from a life interest in the Libby Shearn Moody Trust which is an asset held in NWLSM, Inc. Pretax distributions from this trust were $2.9 million and $3.5 million in the nine month periods ended September 30, 2016 and 2015, respectively.

INVESTMENTS

General

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

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

	September 30, 2016		December 31, 2015	
	Carrying Value (In thousands)	%	Carrying Value (In thousands)	%
Debt securities	$10,194,185	96.3	$10,035,189	97.4
Mortgage loans	146,913	1.4	108,311	1.1
Policy loans	59,218	0.6	61,957	0.6
Derivatives, index options	90,097	0.9	38,409	0.4
Real estate	31,951	0.3	16,333	0.2
Equity securities	18,982	0.2	18,361	0.2
Other	35,001	0.3	10,454	0.1
Totals	$10,576,347	100.0	$10,289,014	100.0

Debt and Equity Securities

The Company maintains a diversified portfolio which consists mostly of corporate, mortgage-backed, and public utility fixed income securities. Investments in mortgage-backed securities primarily include U.S. Government agency pass-through securities and collateralized mortgage obligations ("CMO"). The Company's investment guidelines prescribe limitations by type of security as a percent of the total investment portfolio and all holdings were within these threshold limits. As of September 30, 2016 and December 31, 2015, the Company's debt securities portfolio consisted of the following classes of securities:

	September 30, 2016		December 31, 2015	
	Carrying Value (In thousands)	%	Carrying Value (In thousands)	%
Corporate	$7,088,717	69.6	$6,814,793	68.0
Residential mortgage-backed securities	1,434,526	14.1	1,542,587	15.4
Public utilities	1,196,056	11.7	1,178,622	11.7
State and political subdivisions	440,628	4.3	436,493	4.3
U.S. agencies	—	—	15,019	0.1
Asset-backed securities	21,616	0.2	35,393	0.4
Foreign governments	10,710	0.1	10,355	0.1
U.S. Treasury	1,932	—	1,927	—
Totals	$10,194,185	100.0	$10,035,189	100.0

Explanation of Responses:

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

	Nine Months Ended September 30, 2016		Year Ended December 31, 2015	
	($ In thousands)			
Cost of acquisitions	$453,985		$1,309,930	
Average credit quality	BBB+		A-	
Effective annual yield	3.43	%	3.51	%
Spread to treasuries	1.68	%	1.36	%
Effective duration	8.3 years		8.5 years	

Rating agencies generally view mortgage-backed securities as having additional risk for insurers holding interest sensitive liabilities given the potential for asset/liability disintermediation. Consequently, the Company holds predominantly agency mortgage-backed securities. Because mortgage-backed securities are subject to prepayment and extension risk, the Company has substantially reduced these risks by investing in collateralized mortgage obligations ("CMO"), which have more predictable cash flow patterns than pass-through securities. These securities, known as planned amortization class I ("PAC I"), very accurately defined maturity ("VADM") and sequential tranches are designed to amortize in a more predictable manner than other CMO classes or pass-throughs. The Company does not purchase tranches, such as PAC II and support tranches, that subject the portfolio to greater than average prepayment risk. Using this strategy, the Company can more effectively manage and reduce prepayment and extension risks, thereby helping to maintain the appropriate matching of the Company's assets and liabilities.

In addition to diversification, an important aspect of the Company's investment approach is managing the credit quality of its investment in debt securities. Thorough credit analysis is performed on potential corporate investments including examination of a company's credit and industry outlook, financial ratios and trends, and event risks. This emphasis is reflected in the high average credit rating of the Company's debt securities portfolio with 98.3%, as of September 30, 2016, held in investment grade securities. In the table below, investments in debt securities are classified according to credit ratings by nationally recognized statistical rating organizations.

	September 30, 2016		December 31, 2015	
	Carrying Value (In thousands)	%	Carrying Value (In thousands)	%
AAA	$91,828	0.9	$97,068	1.0
AA	2,225,589	21.8	2,361,417	23.5
A	3,303,077	32.4	3,399,230	33.9

BBB	4,402,172	43.2	4,016,665	40.0
BB and other below investment grade	171,519	1.7	160,809	1.6
Totals	$10,194,185	100.0	$10,035,189	100.0

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

	Below Investment Grade Debt Securities			
	Amortized Cost	Carrying Value	Fair Value	% of Invested Assets
	(In thousands, except percentages)			
September 30, 2016	$173,700	171,519	175,811	1.6 %
December 31, 2015	$166,508	160,809	160,867	1.6 %

The Company's percentage of below investment grade securities as of September 30, 2016 compared with the percentage at December 31, 2015 increased marginally due to downgrade of several securities, principally energy-related entities. The Company's holdings of below investment grade securities are relatively small and as a percentage of total invested assets low compared to industry averages.

Holdings in below investment grade securities by category as of September 30, 2016 are summarized below, including their comparable fair value as of December 31, 2015. The Company continually monitors developments in these industries for issues that may affect security valuation.

	Below Investment Grade Debt Securities			
Industry Category	Amortized Cost September 30, 2016	Carrying Value September 30, 2016	Fair Value September 30, 2016	Fair Value December 31, 2015
	(In thousands)			
Asset-backed securities	$9,009	9,031	10,522	6,059
Residential mortgage-backed	1,423	1,381	1,381	1,426
Oil & Gas	35,083	31,488	31,488	15,570
Manufacturing	39,011	39,619	41,661	39,548
Banking/finance	15,000	15,000	14,700	13,800
Other	74,174	75,000	76,059	50,829
Totals	$173,700	171,519	175,811	127,232

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

In the energy sector, oil prices incurred a precipitous drop in prices over the past two years. While it appears that prices have bottomed and come off of their lows, this downturn affected the credit quality of individual companies. At September 30, 2016 and December 31, 2015, the Company's aggregate holdings in this sector approximated $943 million and $939 million, respectively. These holdings represented debt securities issued by approximately forty companies in the oil and gas industry. The Company's oil and gas debt securities were 96.7% investment grade as of the balance sheet date. Further mitigating the risk of the Company's holdings in this sector are ample diversification by subsector (integrated, independent, pipeline, servicer, and equipment).

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Certain European countries have experienced varying degrees of financial stress over the past five to ten years. Risks, while not as highly publicized recently, could continue to disrupt financial markets and have a detrimental impact on global conditions as well as on sovereign and non-sovereign obligations. The Company has no exposure to the sovereign debt of Portugal, Ireland, Italy, Greece or Spain. These countries in particular had been experiencing the more significant economic, fiscal and political strains that increase the likelihood of default for sovereign countries. Additionally, the Company has no exposure to the debt of financial institutions domiciled in these countries.

However, the Company does have exposure to the debt of non-financial companies in certain of these countries. The following tables show bond holdings at September 30, 2016 of non-financial companies that are domiciled in Portugal, Ireland, Italy, or Spain held in the available for sale and held to maturity debt security portfolios.

Securities Available for Sale Company	S&P Rating	Amortized Cost September 30, 2016	Fair Value September 30, 2016	Country Domiciled
	(In thousands)			
Allergan	BBB	$ 22,695	23,813	Ireland
CRH	BBB+	25,748	27,934	Ireland
Medtronic	A	34,113	36,918	Ireland
Shire	BBB-	23,997	24,129	Ireland
Telefonica	BBB	9,026	9,316	Spain
Totals		$ 115,579	122,110	

Securities Held to Maturity Company	S&P Rating	Amortized Cost September 30, 2016	Fair Value September 30, 2016	Country Domiciled
	(In thousands)			
EDP	BB+	$ 17,288	18,202	Portugal
Enel	BBB	19,962	21,147	Italy
Finmeccanica	BB+	15,012	16,350	Italy
Iberdrola Finance	BBB+	2,951	3,280	Spain
Kerry Group	BBB+	24,929	24,996	Ireland
Medtronic	A	19,967	20,888	Ireland
Telefonica	BBB	8,065	8,884	Spain
Perrigo	BBB-	25,817	26,564	Ireland
Totals		$ 133,991	140,311	

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

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During the nine months ended September 30, 2016 the Company recorded no other-than-temporary impairment credit related write-downs on debt or equity securities. See Note 9, Investments, of the accompanying Condensed Consolidated Financial Statements for further discussion. Since the Company's adoption of the GAAP guidance on the recognition and accounting for other-than-temporary impairments due to credit loss versus non-credit loss, the Company has recognized a total of $2.1 million of other-than-temporary impairments of which $1.4 million was deemed credit related and recognized as realized investment losses in earnings, and $0.7 million, net of amortization, was deemed a non-credit related impairment and recognized in other comprehensive income.

The Company is required to classify its investments in debt and equity securities into one of three categories: (a) trading securities; (b) securities available for sale; or (c) securities held to maturity. The Company purchases securities with the intent to hold to maturity and accordingly does not maintain a portfolio of trading securities. Of the remaining two categories, available for sale and held to maturity, the Company makes a determination on categorization based on various factors including the type and quality of the particular security and how it will be incorporated into the Company's overall asset/liability management strategy. As shown in the table below, at September 30, 2016, 29.2% of the Company's total debt and equity securities, based on fair values, were classified as securities available for sale. The holdings in available for sale provide flexibility to the Company to react to market opportunities and conditions and to practice active management within the portfolio to provide adequate liquidity to meet policyholder obligations and other cash needs.

	September 30, 2016		
	Fair Value	Amortized Cost	Unrealized Gains (Losses)
	(In thousands)		
Securities held to maturity:			
Debt securities	$7,542,335	7,106,373	435,962
Securities available for sale:			
Debt securities	3,087,812	2,920,588	167,224
Equity securities	18,982	14,021	4,961
Totals	$10,649,129	10,040,982	608,147

Asset-Backed Securities

The Company holds approximately $21.6 million in asset-backed securities as of September 30, 2016. This portfolio includes $2.4 million of manufactured housing bonds and $19.2 million of home equity loans (also referred to as subprime securities). These holdings are down from the levels held at December 31, 2015 of $3.4 million and $32.0 million, respectively. The Company does not have any holdings in collateralized bond obligations (“CBO”s), collateralized debt obligations (“CDO”s), or collateralized loan obligations (“CLO”s). Principal risks in holding asset-backed securities are structural, credit, and capital market risks. Structural risks include the securities' priority in the issuer's capital structure, the adequacy of and ability to realize proceeds from collateral and the potential for prepayments. Credit risks include corporate credit risks or consumer credit risks for financing such as subprime mortgages. Capital market risks include the general level of interest rates and the liquidity for these securities in the marketplace.

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The Company's exposure to the subprime sectors has been limited to investments in the senior tranches of subprime residential mortgage loans. The subprime sector is generally categorized under the asset-backed sector. This sector lends to borrowers who do not qualify for prime interest rates due to poor or insufficient credit history. The slowing housing market, rising interest rates, and relaxed underwriting standards for loans originated after 2005 resulted in higher delinquency rates and losses beginning in 2007. These events caused illiquidity in the market and volatility in the market prices of subprime securities. The housing market subsequently stabilized and an improvement in the prices of subprime securities occurred as the bond market regained more liquidity. All of the loans classified as subprime in the Company's portfolio as of September 30, 2016 were underwritten prior to 2005 as noted in the table below.

Investment Origination Year	September 30, 2016 Carrying Value	September 30, 2016 Fair Value	December 31, 2015 Carrying Value	December 31, 2015 Fair Value
	(In thousands)			
Subprime:				
1998	$2,322	2,402	2,836	2,933
2003	3,128	4,554	3,474	5,012
2004	13,777	13,797	25,675	25,739
Total	$19,227	20,753	31,985	33,684

During the first nine months of 2016, the Company reduced its exposure to the subprime sector through sales of securities held. As of September 30, 2016, the Company held nine subprime issues of which 1 was rated AAA, 2 were rated AA, 1 was rated BBB, 2 were rated CCC, 1 was rated CC and 2 were not rated.

Mortgage Loans and Real Estate

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

The Company requires a minimum specified yield on mortgage loan investments determined by reference to currently available debt security instrument yields plus a desired amount of incremental basis points. During the past several years, the low interest rate environment has resulted in fewer loan opportunities being available that meet the Company's required rate of return. Mortgage loans originated by the Company totaled $38.5 million for the year ended December 31, 2015 and $55.8 million for the nine months ended September 30, 2016. The increase in new originations during 2016 reflects a concerted effort by the Company to grow this part of its investment portfolio. Principal repayments on mortgage loans for the nine months ended September 30, 2016 were $17.3 million.

Loans in foreclosure, loans considered impaired or loans past due 90 days or more are placed on a non-accrual status. If a mortgage loan is determined to be on non-accrual status, the mortgage loan does not accrue any revenue into the Condensed Consolidated Statements of Earnings. The loan is independently monitored and evaluated as to potential impairment or foreclosure. If delinquent payments are made and the loan is brought current, then the Company returns the loan to active status and accrues income accordingly. The Company has no loans past due 90 days which are accruing interest.

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The Company held net investments in mortgage loans totaling $146.9 million and $108.3 million at September 30, 2016 and December 31, 2015, respectively. The diversification of the portfolio by geographic region and by property type was as follows:

	September 30, 2016		December 31, 2015	
	Amount (In thousands)	%	Amount (In thousands)	%
Mortgage Loans by Geographic Region:				
West South Central	$83,832	56.8	$58,002	53.2
East North Central	24,914	16.9	18,477	17.0
New England	11,576	7.9	11,830	10.9
Pacific	9,931	6.7	10,101	9.3
East South Central	5,815	3.9	5,818	5.3
South Atlantic	9,839	6.7	3,047	2.8
Mountain	1,656	1.1	1,686	1.5
Gross balance	147,563	100.0	108,961	100.0
Allowance for possible losses	(650)	(0.4)	(650)	(0.6)
Totals	$146,913	99.6	$108,311	99.4

	September 30, 2016		December 31, 2015	
	Amount (In thousands)	%	Amount (In thousands)	%
Mortgage Loans by Property Type:				
Retail	$76,252	51.7	$66,237	60.8
Office	47,515	32.2	22,941	21.0
Land/Lots	4,819	3.3	4,445	4.1
Hotel/Motel	5,397	3.6	1,513	1.4
All other	13,580	9.2	13,825	12.7
Gross balance	147,563	100.0	108,961	100.0
Allowance for possible losses	(650)	(0.4)	(650)	(0.6)
Totals	$146,913	99.6	$108,311	99.4

The Company's direct investments in real estate are not a significant portion of its total investment portfolio. The Company also participates in several real estate joint ventures, limited partnerships, and other loans that invest primarily in income-producing retail properties. These investments have enhanced the Company's overall investment portfolio returns. The Company's real estate investments totaled approximately $32.0 million and $16.3 million at September 30, 2016 and December 31, 2015, respectively. The Company purchased two properties, one located in Cypress, Texas and the other in Tupelo, Mississippi for a total of $16.8 million during the first nine months of 2016.

The Company recognized operating income of approximately $2.0 million on real estate properties in the first nine months of 2016. The Company monitors the conditions and market values of these properties on a regular basis and makes repairs and capital improvements to keep the properties in good condition. The Company recorded net realized investment gains on disposed properties located in Brazoria County (Texas), Ruidoso, New Mexico, and Austin, Texas, totaling $2.9 million during the first nine months of 2016.

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Market Risk

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

Interest Rate Risk

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

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

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

	September 30, 2016	June 30, 2016	December 31, 2015
	(In thousands except percentages)		
Debt securities - fair value	$10,630,147	10,645,963	10,196,658
Debt securities - amortized cost	$10,026,961	10,026,030	10,007,665
Fair value as a percentage of amortized cost	106.02 %	106.18 %	101.89 %
Net unrealized gain balance	$603,186	619,933	188,993
Ten-year U.S. Treasury bond – (decrease) increase in yield for the period	0.12 %	(0.30)%	0.10 %

	Net Unrealized Gain Balance				
	At September 30, 2016	At June 30, 2016	At December 31, 2015	Quarter Change in Unrealized Balance	Year-to-date Change in Unrealized Balance
Debt securities held to maturity	$435,962	457,826	161,469	(21,864)	274,493
Debt securities available for sale	167,224	162,107	27,524	5,117	139,700

Totals	$603,186	619,933	188,993	(16,747)	414,193

Changes in interest rates typically have a sizable effect on the fair values of the Company's debt securities. The market interest rate of the ten-year U.S. Treasury bond decreased approximately 68 basis points from 2.27% at year-end 2015 to 1.59% by the end of the first nine months of 2016 and the Company's unrealized gain position increased $414.2 million on a portfolio with an amortized cost basis of approximately $10.0 billion. Given that the majority of the Company's debt securities are classified as held to maturity, which are recorded at amortized cost, changes in fair values have a relatively small effect on the Company's Condensed Consolidated Balance Sheet.

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

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

The Company performed detailed sensitivity analysis as of December 31, 2015, for its interest rate-sensitive assets and liabilities. The changes in market values of the Company's debt securities in the first nine months of 2016 were reasonable given the expected range of results of this analysis.

Credit Risk

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

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

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

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Explanation of Responses:

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LIQUIDITY AND CAPITAL RESOURCES

Liquidity

Liquidity requirements are met primarily by funds provided from operations. Premium deposits and annuity considerations, investment income, and investment maturities and prepayments are the primary sources of funds while investment purchases, policy benefits in the form of claims, and payments to policyholders and contract holders in connection with surrenders and withdrawals as well as operating expenses are the primary uses of funds. To ensure the Company will be able to pay future commitments, the funds received as premium payments and deposits are invested in high quality investments, primarily fixed income securities. Funds are invested with the intent that the income from investments, plus proceeds from maturities, will meet the ongoing cash flow needs of the Company. The approach of matching asset and liability durations and yields requires an appropriate mix of investments. Although the Company historically has not been put in the position of having to liquidate invested assets to provide cash flow, its investments consist primarily of marketable debt securities that could be readily converted to cash for liquidity needs. The Company (National Western) may also borrow up to $40 million on its bank line of credit for short-term cash needs. There were no borrowings outstanding under the line of credit at September 30, 2016.

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

The actual amounts paid by product line in connection with surrenders and withdrawals for the three-month periods ended September 30, for each respective year, are noted in the table below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Product Line:				
Traditional Life	$ 1,636	1,501	4,616	4,178
Universal Life	27,831	23,533	82,781	59,719
Annuities	126,275	119,921	388,102	360,051
Total	$ 155,742	144,955	475,499	423,948

The above contractual withdrawals, as well as the level of surrenders experienced, were generally consistent with the Company's assumptions in asset/liability management, and the associated cash outflows did not have an adverse impact on overall liquidity. Individual life insurance policies are less susceptible to withdrawal than annuity reserves and deposit liabilities because policyholders may incur surrender charges and undergo a new underwriting process in order to obtain a new insurance policy. The increase in Universal Life payments reflects the increased termination activity associated with policyholder residents of international countries from which the Company ceased accepting new applications from in the fourth quarter of 2015. Cash flow projections and tests under various market interest rate scenarios are also performed to assist in evaluating liquidity needs and adequacy. The Company currently expects available liquidity sources and future cash flows to be more than adequate to meet the demand for funds.

Cash flows from the Company's insurance operations have historically been sufficient to meet current needs. Cash flows from operating activities were $246.2 million and $247.3 million for the nine months ended September 30, 2016 and 2015, respectively. The Company also has significant cash flows from both scheduled and unscheduled investment security maturities, redemptions, and prepayments. These cash flows totaled $438.4 million and $563.2 million for the nine months ended September 30, 2016 and 2015, respectively. Operating and investing activity cash flow items could be reduced if interest rates rise at an accelerated rate in the future. Net cash inflows/(outflows) from the Company's universal life and investment annuity deposit product operations totaled $(49.3) million and $11.1 million during the nine months ended September 30, 2016 and 2015, respectively.

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Capital Resources

The Company relies on stockholders' equity for its capital resources as there is no long-term debt outstanding and the Company does not anticipate the need for any long-term debt in the near future. As of September 30, 2016, the Company had no commitments beyond its normal operating and investment activities.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

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

Insurance reserves are the means by which life insurance companies determine the liabilities that must be established to assure that future policy benefits are provided for and can be paid. These reserves are required by law and based upon standard actuarial methodologies to ensure fulfillment of commitments guaranteed to policyholders and their beneficiaries, even though the obligations may not be due for many years. Refer to Note 1 in the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 for a discussion of reserving methods.

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

	Payment Due by Period				
	Total	Less Than 1 Year	1 - 3 Years	3 - 5 Years	More Than 5 Years
	(In thousands)				
Loan commitments	$32,596	32,596	—	—	—
Operating lease obligations	1,133	72	578	386	97
Life claims payable (1)	70,176	70,176	—	—	—
Other long-term reserve liabilities reflected on the balance sheet (2)	11,493,319	941,329	1,746,494	1,754,085	7,051,411
Total	$11,597,224	1,044,173	1,747,072	1,754,471	7,051,508

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

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

CHANGES IN ACCOUNTING PRINCIPLES AND CRITICAL ACCOUNTING POLICIES

Changes in Accounting Principles

There were no changes in accounting principles during the periods reported in this Form 10-Q.

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REGULATORY AND OTHER ISSUES

Statutory Accounting Practices

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

Risk-Based Capital Requirements

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

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

During the quarter ended March 31, 2016, the Company implemented an internally developed policy administration system with respect to the processing of its annuity and traditional life new business policy applications and paying commissions on such business. This constitutes a change in the Company's internal controls over financial reporting as defined in Rules 13a-15(f) and 15d-15(e) under the Exchange Act. Prior to implementation, the Company performed model office testing encompassing the new processes and procedures to be employed using the new system and defined its internal controls with respect to such processing in this environment. During the course of the quarter ended September 30, 2016, management continued to perform post-implementation testing and analysis of the processing and internal controls implemented and determined that the change did not materially affect the Company's internal controls over financial reporting such that the information required to reported and disclosed in its reports under the Exchange Act was adversely impacted. Internal controls over financial reporting change as the Company modifies or enhances its systems and processes to meet business needs. Any significant changes in controls are evaluated prior to implementation to help ensure continued effectiveness of internal controls and the control environment.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 8(A) "Legal Proceedings" of the accompanying condensed consolidated financial statements included in this Form 10-Q.

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ITEM 1A. RISK FACTORS

There have been no substantial changes relative to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

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

Effective August 22, 2008, National Western adopted and implemented a limited stock buy-back program associated with the company's 2008 Incentive Plan which provides Option Holders the additional alternative of selling shares acquired through the exercise of options directly back to the company. This program succeeded a similar buy-back program implemented March 10, 2006 associated with the company's 1995 Stock Option and Incentive Plan. Option Holders may elect to sell such acquired shares back to the company at any time within ninety (90) days after the exercise of options at the prevailing market price as of the date of notice of election. These plans and programs were assumed by National Western Life Group, Inc. from National Western pursuant to the terms of the Reorganization on October 1, 2015.

The following table sets forth the Company's repurchase of its Class A common shares from Option Holders for the quarter ended September 30, 2016. There were no shares repurchased during the period.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May yet Be Purchased Under the Plans or Programs
July 1, 2016 through July 31, 2016	—	—	N/A	N/A
August 1, 2016 through August 31, 2016	—	—	N/A	N/A
September 1, 2016 through September 30, 2016	—	—	N/A	N/A
Total	—	—	N/A	N/A

Purchased shares are reported in the Company's condensed consolidated financial statements as authorized and unissued.

ITEM 4. Removed and Reserved.

ITEM 6. EXHIBITS

(a) Exhibits

Exhibit 31(a)	-	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31(b)	-	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 32(a)	-	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

NATIONAL WESTERN LIFE GROUP, INC.
(Registrant)

Date: November 4, 2016	/S/ Ross R. Moody Ross R. Moody Chairman of the Board, President, Chief Executive Officer and Director (Authorized Officer)
Date: November 4, 2016	/S/ Brian M. Pribyl Brian M. Pribyl Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer) (Principal Accounting Officer)