KANSAS CITY LIFE INSURANCE CO
Form 10-Q
July 26, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2013 or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 1-33348
KANSAS CITY LIFE INSURANCE COMPANY
(Exact name of registrant as specified in its charter)

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

816-753-7000
Registrant's telephone number, including area code
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock: $1.25 par	11,022,766 shares
Class	Outstanding June 30, 2013

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Part I. Financial Information
Item 1. Financial Statements
Amounts in thousands, except share data, or as otherwise noted
Kansas City Life Insurance Company
Consolidated Balance Sheets

	June 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Investments:		
Fixed maturity securities available for sale, at fair value	$2,646,651	$2,788,141
Equity securities available for sale, at fair value	35,550	20,061
Mortgage loans	652,828	674,034
Real estate	138,964	124,742
Policy loans	83,746	77,133
Short-term investments	18,151	24,902
Other investments	1,831	2,572
Total investments	3,577,721	3,711,585
Cash	6,912	7,026
Accrued investment income	34,121	34,747
Deferred acquisition costs	248,562	176,275
Reinsurance recoverables	194,154	190,613
Property and equipment	17,856	18,343
Other assets	69,837	47,063
Separate account assets	359,559	340,093
Total assets	$4,508,722	$4,525,745
LIABILITIES		
Future policy benefits	$899,337	$889,107
Policyholder account balances	2,114,841	2,128,002
Policy and contract claims	36,145	29,813
Other policyholder funds	156,574	155,749
Other liabilities	213,776	232,580
Separate account liabilities	359,559	340,093
Total liabilities	3,780,232	3,775,344
STOCKHOLDERS' EQUITY		
Common stock, par value $1.25 per share		
Authorized 36,000,000 shares, issued 18,496,680 shares	23,121	23,121
Additional paid in capital	40,977	40,969
Retained earnings	815,818	805,730
Accumulated other comprehensive income	22,475	54,094
Treasury stock, at cost (2013 - 7,473,914 shares; 2012 - 7,463,823 shares)	(173,901)	(173,513)
Total stockholders’ equity	728,490	750,401
Total liabilities and stockholders’ equity	$4,508,722	$4,525,745

See accompanying Notes to Consolidated Financial Statements

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Kansas City Life Insurance Company
Consolidated Statements of Comprehensive Income

	Quarter Ended June 30 2013 (Unaudited)	2012	Six Months Ended June 30 2013 (Unaudited)	2012
REVENUES				
Insurance revenues:				
Net premiums	$34,995	$34,205	$73,695	$66,909
Contract charges	30,611	25,590	54,959	50,723
Total insurance revenues	65,606	59,795	128,654	117,632
Investment revenues:				
Net investment income	42,878	43,435	85,288	87,644
Net realized investment gains, excluding other-than-temporary impairment losses	1,732	1,361	2,178	17,198
Net impairment losses recognized in earnings:				
Total other-than-temporary impairment losses	(272)	(188)	(459)	(456)
Portion of impairment losses recognized in other comprehensive income (loss)	41	42	99	150
Net other-than-temporary impairment losses recognized in earnings	(231)	(146)	(360)	(306)
Total investment revenues	44,379	44,650	87,106	104,536
Other revenues	2,558	2,312	4,791	4,497
Total revenues	112,543	106,757	220,551	226,665
BENEFITS AND EXPENSES				
Policyholder benefits	39,230	41,276	84,662	79,746
Interest credited to policyholder account balances	19,865	20,377	39,528	40,935
Amortization of deferred acquisition costs	10,904	5,121	19,769	13,022
Operating expenses	26,504	27,078	53,008	51,040
Total benefits and expenses	96,503	93,852	196,967	184,743
Income before income tax expense	16,040	12,905	23,584	41,922
Income tax expense	5,189	4,508	7,545	14,084
NET INCOME	$10,851	$8,397	$16,039	$27,838
COMPREHENSIVE INCOME (LOSS), NET OF TAXES				
Change in net unrealized gains on securities available for sale	$(53,348)	$15,925	$(43,875)	$18,017
Change in future policy benefits	6,637	(3,502)	6,924	(4,969)
Change in policyholder account balances	310	(143)	322	(218)
Change in benefit plan obligations	5,010	—	5,010	—
Other comprehensive income (loss)	(41,391)	12,280	(31,619)	12,830
COMPREHENSIVE INCOME (LOSS)	$(30,540)	$20,677	$(15,580)	$40,668

Basic and diluted earnings per share:				
Net income	$0.98	$0.78	$1.45	$2.50

See accompanying Notes to Consolidated Financial Statements

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Kansas City Life Insurance Company
Consolidated Statement of Stockholders' Equity

	Six Months Ended June 30, 2013 (Unaudited)	
COMMON STOCK, beginning and end of year	$23,121	
ADDITIONAL PAID IN CAPITAL		
Beginning of period	40,969	
Excess of proceeds over cost of treasury stock sold	8	
End of period	40,977	
RETAINED EARNINGS		
Beginning of period	805,730	
Net income	16,039	
Stockholder dividends of $0.27 per share	(5,951	)
End of period	815,818	
ACCUMULATED OTHER COMPREHENSIVE INCOME, net of taxes		
Beginning of period	54,094	
Other comprehensive loss	(31,619	)
End of period	22,475	
TREASURY STOCK, at cost		
Beginning of period	(173,513	)
Cost of 10,454 shares acquired	(393	)
Cost of 363 shares sold	5	
End of period	(173,901	)
TOTAL STOCKHOLDERS' EQUITY	$728,490	

See accompanying Notes to Consolidated Financial Statements

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Kansas City Life Insurance Company
Consolidated Statements of Cash Flows

	Six Months Ended June 30	
	2013	2012
	(Unaudited)	
OPERATING ACTIVITIES		
Net income	$16,039	$27,838
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premium and discount	2,042	1,977
Depreciation	2,094	1,643
Acquisition costs capitalized	(18,661)	(18,991)
Amortization of deferred acquisition costs	19,769	13,022
Realized investment gains	(1,818)	(16,892)
Changes in assets and liabilities:		
Reinsurance recoverables	(3,541)	(4,143)
Future policy benefits	20,303	(583)
Policyholder account balances	(15,993)	(4,739)
Income taxes payable and deferred	545	2,639
Other, net	1,092	(3,754)
Net cash provided (used)	21,871	(1,983)
INVESTING ACTIVITIES		
Purchases:		
Fixed maturity securities	(106,941)	(192,935)
Equity securities	(13,212)	(728)
Mortgage loans	(30,291)	(30,691)
Real estate	(17,549)	(28,845)
Policy loans	(5,670)	(7,419)
Sales or maturities, calls, and principal paydowns:		
Fixed maturity securities	138,414	96,448
Equity securities	1,459	179
Mortgage loans	51,104	52,510
Real estate	368	49,164
Policy loans	8,005	8,347
Net sales of short-term investments	6,751	31,868
Net acquisition of property and equipment	(351)	(142)
Reinsurance assumption transaction	(34,279)	—
Net cash used	(2,192)	(22,244)

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Kansas City Life Insurance Company

Consolidated Statements of Cash Flows (Continued)

	Six Months Ended June 30	
	2013	2012
	(Unaudited)	
FINANCING ACTIVITIES		
Deposits on policyholder account balances	$116,485	$116,859
Withdrawals from policyholder account balances	(133,369)	(86,715)
Net transfers from (to) separate accounts	(1,734)	2,099
Change in other deposits	5,156	(4,728)
Cash dividends to stockholders	(5,951)	(6,104)
Net change in treasury stock	(380)	(2,047)
Net cash provided (used)	(19,793)	19,364
Decrease in cash	(114)	(4,863)
Cash at beginning of year	7,026	10,436
Cash at end of period	$6,912	$5,573
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$7,000	$10,500

See accompanying Notes to Consolidated Financial Statements

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Kansas City Life Insurance Company
Notes to Consolidated Financial Statements (Unaudited)

1. Nature of Operations and Significant Accounting Policies
Basis of Presentation
The unaudited interim consolidated financial statements and the accompanying notes include the accounts of the consolidated entity (the Company), which primarily consists of three life insurance companies. Kansas City Life Insurance Company (Kansas City Life) is the parent company. Sunset Life Insurance Company of America (Sunset Life) and Old American Insurance Company (Old American) are wholly-owned subsidiaries.
The unaudited interim consolidated financial statements have been prepared on the basis of U.S. generally accepted accounting principles (GAAP) for interim financial reporting with the instructions to Form 10-Q and Regulations S-K, S-X, and other applicable regulations. Accordingly, they do not include all of the disclosures required by GAAP for complete financial statements. As such, these unaudited interim consolidated financial statements should be read in conjunction with the Company's 2012 Form 10-K, as filed with the Securities and Exchange Commission. Management believes that the disclosures are adequate to make the information presented not misleading, and all normal and recurring adjustments necessary to present fairly the financial position at June 30, 2013 and the results of operations for all periods presented have been made. The results of operations for any interim period are not necessarily indicative of the Company's operating results for a full year. Significant intercompany transactions have been eliminated in consolidation and certain immaterial reclassifications have been made to prior period results to conform with the current period's presentation.
The preparation of the unaudited interim consolidated financial statements requires management of the Company to make estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the unaudited interim consolidated financial statements, and the reported amounts of revenue and expenses during the period. These estimates are inherently subject to change and actual results could differ from these estimates.

Reinsurance Assumption Transaction
In April 2013, the Company assumed a closed block of variable life insurance policies and variable annuity contracts from American Family Life Insurance Company (American Family). Under the reinsurance agreement, the Company assumed 100% of the separate account liabilities on a modified coinsurance basis and 100% of the general account liabilities on a coinsurance basis. The transaction also involves ongoing servicing arrangements with American Family during the period that such policies and contracts are transitioned to administration by the Company. This block will be included as a component of the Individual Insurance segment.

The purchase price of the transaction was $34.3 million and added $58.5 million in assets on the acquisition date, including deferred acquisition costs of $49.2 million. These deferred acquisition costs will amortize with the expected future gross profits of the block of business. Liabilities included in the purchase totaled $24.2 million.

The modified coinsurance portion of the transaction represented approximately $291.6 million in separate account fund balances. The Company will receive fees based upon both specific transactions and the fund value of the block of policies, as provided under modified coinsurance transactions. These separate account fund balances were not recorded as separate accounts on the Company's financial statements. The coinsurance portion of the transaction represented approximately $23.6 million in fund value and $0.6 million in future policy benefits at acquisition. The Company recorded these fixed fund accounts as a separate block under its general accounts, and the Company will also receive certain ongoing fees associated with specific transactions. This reinsurance assumption transaction did not have a significant effect on the Company's results of operations or financial condition. For additional information, please refer to the Company's 8-K filed with the SEC on April 2, 2013.

Significant Accounting Policies

For a full discussion of the Company's significant accounting policies, please refer to the Company's 2012 Form 10-K. No significant updates or changes to these policies occurred during the six months ended June 30, 2013.

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Kansas City Life Insurance Company
Notes to Consolidated Financial Statements–(Continued) (Unaudited)

2. New Accounting Pronouncements
For a full discussion of new accounting pronouncements and other regulatory activity and their impact on the Company, please refer to the Company's 2012 Form 10-K.
Accounting Pronouncements Adopted During 2013
In February 2013, the FASB issued guidance regarding the reporting of reclassifications out of accumulated other comprehensive income (AOCI). The guidance requires entities to provide information about the amounts reclassified out of AOCI by component. Significant amounts reclassified out of AOCI that are required under U.S. GAAP to be reclassified to net income in their entirety in the same reporting period must be presented either on the face of the statement, where net income is presented, or in the footnotes. For amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, entities are required to cross-reference to other disclosures that are required by U.S. GAAP that provide additional detail about those amounts. The Company adopted this new guidance as of January 1, 2013 with no material impact to the consolidated financial statements.
All other new accounting standards and updates of existing standards issued through the date of this filing were considered by management and did not relate to accounting policies and procedures pertinent to the Company at this time.

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

3. Investments
Fixed Maturity and Equity Securities Available for Sale
Securities by Asset Class
The following table provides amortized cost and fair value of securities by asset class at June 30, 2013.

	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government	$118,079	$9,098	$573	$126,604
Federal agencies [1]	20,065	2,990	—	23,055
Federal agency issued residential mortgage-backed securities [1]	67,236	6,236	1	73,471
Subtotal	205,380	18,324	574	223,130
Corporate obligations:				
Industrial	501,341	31,032	5,872	526,501
Energy	198,556	17,120	2,962	212,714
Communications and technology	205,960	14,699	1,172	219,487
Financial	276,246	20,606	1,687	295,165
Consumer	477,789	31,008	4,125	504,672
Public utilities	241,291	29,686	646	270,331
Subtotal	1,901,183	144,151	16,464	2,028,870
Corporate private-labeled residential mortgage-backed securities	130,043	5,031	720	134,354
Municipal securities	138,219	15,333	17	153,535
Other	99,277	4,193	5,716	97,754
Redeemable preferred stocks	10,174	—	1,166	9,008
Fixed maturity securities	2,484,276	187,032	24,657	2,646,651
Equity securities	34,539	1,667	656	35,550
Total	$2,518,815	$188,699	$25,313	$2,682,201

[1] Federal agency securities are not backed by the full faith and credit of the U.S. Government.

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Kansas City Life Insurance Company
Notes to Consolidated Financial Statements–(Continued) (Unaudited)

The following table provides amortized cost and fair value of securities by asset class at December 31, 2012.

	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government	$121,774	$14,302	$25	$136,051
Federal agencies [1]	22,070	3,999	—	26,069
Federal agency issued residential mortgage-backed securities [1]	83,608	8,381	4	91,985
Subtotal	227,452	26,682	29	254,105
Corporate obligations:				
Industrial	494,615	51,645	377	545,883
Energy	188,790	22,473	14	211,249
Communications and technology	198,332	23,283	15	221,600
Financial	287,854	27,487	1,467	313,874
Consumer	476,913	49,395	70	526,238
Public utilities	246,389	39,840	102	286,127
Subtotal	1,892,893	214,123	2,045	2,104,971
Corporate private-labeled residential mortgage-backed securities	144,852	4,033	754	148,131
Municipal securities	140,843	27,141	—	167,984
Other	106,442	6,494	8,192	104,744
Redeemable preferred stocks	7,984	266	44	8,206
Fixed maturity securities	2,520,466	278,739	11,064	2,788,141
Equity securities	18,195	1,956	90	20,061
Total	$2,538,661	$280,695	$11,154	$2,808,202

[1] Federal agency securities are not backed by the full faith and credit of the U.S. Government.

Contractual Maturities

The following table provides the distribution of maturities for fixed maturity securities available for sale at June 30, 2013. Expected maturities may differ from these contractual maturities since borrowers may have the right to call or prepay obligations.

	June 30, 2013	
	Amortized Cost	Fair Value
Due in one year or less	$120,983	$123,663
Due after one year through five years	686,129	747,826
Due after five years through ten years	961,114	1,005,146
Due after ten years	435,886	473,456
Securities with variable principal payments	269,990	287,552
Redeemable preferred stocks	10,174	9,008
Total	$2,484,276	$2,646,651

No material derivative financial instruments were held during the first six months of 2013 or during 2012.

Unrealized Losses on Investments

At the end of each quarter, all securities are reviewed to determine whether impairments exist and whether other-than-temporary impairments should be recorded. This quarterly process includes an assessment of the credit quality of each investment in the entire securities portfolio. Additional reporting and review procedures are conducted for those securities where fair value is less than 90% of amortized cost. The Company prepares a formal review document no less often than quarterly of all investments

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

where fair value is less than 80% of amortized cost for six months or more and selected investments that have changed significantly from a previous period and that have a decline in fair value greater than 10% of amortized cost. For additional information on the Company's process and considerations, as well as related accounting when other-than-temporary impairments are identified, please refer to Note 4 - Investments of the Company's 2012 Form 10-K.

The following table provides information regarding fixed maturity and equity security investments available for sale with unrealized losses by length of time at June 30, 2013.

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government	$14,617	$569	$539	$4	$15,156	$573
Federal agency issued residential mortgage-backed securities [1]	—	—	290	1	290	1
Subtotal	14,617	569	829	5	15,446	574
Corporate obligations:						
Industrial	128,943	5,872	—	—	128,943	5,872
Energy	59,859	2,962	—	—	59,859	2,962
Communications and technology	30,603	1,172	—	—	30,603	1,172
Financial	26,637	750	4,918	937	31,555	1,687
Consumer	108,363	4,125	—	—	108,363	4,125
Public utilities	11,083	646	—	—	11,083	646
Subtotal	365,488	15,527	4,918	937	370,406	16,464
Corporate private-labeled residential mortgage-backed securities	32,640	720	—	—	32,640	720
Municipal securities	3,053	17	—	—	3,053	17
Other	15,274	475	41,945	5,241	57,219	5,716
Redeemable preferred stocks	9,008	1,166	—	—	9,008	1,166
Fixed maturity securities	440,080	18,474	47,692	6,183	487,772	24,657
Equity securities	11,552	599	116	57	11,668	656
Total	$451,632	$19,073	$47,808	$6,240	$499,440	$25,313

[1] Federal agency securities are not backed by the full faith and credit of the U.S. Government.

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Kansas City Life Insurance Company
Notes to Consolidated Financial Statements–(Continued) (Unaudited)

The following table provides information regarding fixed maturity and equity security investments available for sale with unrealized losses by length of time at December 31, 2012.

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government	$1,328	$18	$661	$7	$1,989	$25
Federal agency issued residential mortgage-backed securities [1]	124	3	292	1	416	4
Subtotal	1,452	21	953	8	2,405	29
Corporate obligations:						
Industrial	28,866	377	—	—	28,866	377
Energy	1,982	14	—	—	1,982	14
Communications and technology	2,709	15	—	—	2,709	15
Financial	—	—	8,241	1,467	8,241	1,467
Consumer	17,143	70	—	—	17,143	70
Public utilities	11,584	102	—	—	11,584	102
Subtotal	62,284	578	8,241	1,467	70,525	2,045
Corporate private-labeled residential mortgage-backed securities	—	—	14,050	754	14,050	754
Other	—	—	41,895	8,192	41,895	8,192
Redeemable preferred stocks	—	—	1,511	44	1,511	44
Fixed maturity securities	63,736	599	66,650	10,465	130,386	11,064
Equity securities	—	—	273	90	273	90
Total	$63,736	$599	$66,923	$10,555	$130,659	$11,154

[1] Federal agency securities are not backed by the full faith and credit of the U.S. Government.

In addition, the Company also considers as part of its monitoring and evaluation process the length of time the fair value of a security is below amortized cost. At June 30, 2013, the Company had 149 issues in its investment portfolio of fixed maturity and equity securities with unrealized losses. Included in this total, 136 security issues were below cost for less than one year; two security issues were below cost for one year or more and less than three years; and 11 security issues were below cost for three years or more. At December 31, 2012, the Company had 43 issues in its investment portfolio of fixed maturity and equity securities with unrealized losses. Included in this total, 25 security issues were below cost for less than one year; three security issues were below cost for one year or more and less than three years; and 15 security issues were below cost for three years or more. The securities having unrealized losses for three years or more include mortgage-backed securities, where discounted future cash flow calculations are the primary determinant of impairment; asset-backed securities, which continue to perform as expected but are not actively traded and market values are discounted significantly due to illiquidity; and variable-rate securities, where interest rates and spreads to indices are significant factors in market pricing.

Kansas City Life Insurance Company
Notes to Consolidated Financial Statements–(Continued) (Unaudited)

The following table provides the distribution of maturities for fixed maturity securities available for sale with unrealized losses at June 30, 2013 and December 31, 2012. The recent fluctuation in the market yields negatively impacted the fair value of securities at June 30, 2013. Expected maturities may differ from these contractual maturities since borrowers may have the right to call or prepay obligations.

	June 30, 2013		December 31, 2012	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fixed maturity securities available for sale:				
Due in one year or less	$2,622	$102	$4,141	$2
Due after one year through five years	36,424	550	8,038	45
Due after five years through ten years	331,335	14,892	43,335	578
Due after ten years	75,453	7,226	58,895	9,637
Total	445,834	22,770	114,409	10,262
Securities with variable principal payments	32,930	721	14,466	758
Redeemable preferred stocks	9,008	1,166	1,511	44
Total	$487,772	$24,657	$130,386	$11,064

The following table provides a reconciliation of credit losses recognized in earnings on fixed maturity securities held by the Company for which a portion of the other-than-temporary loss was recognized in other comprehensive income.

	Quarter Ended June 30 2013	Six Months Ended June 30 2013
Credit losses on securities held at beginning of the period in accumulated other comprehensive income	$15,384	$15,260
Additions for credit losses not previously recognized in other-than-temporary impairment	—	27
Additions for increases in the credit loss for which an other-than-temporary impairment was previously recognized when there was no intent to sell the security before recovery of its amortized cost basis	231	333
Reductions for securities sold during the period (realized)	—	—
Reductions for securities previously recognized in other comprehensive income because of intent to sell the security before recovery of its amortized cost basis	—	—
Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security	(4)	(9)
Credit losses on securities held at the end of the period in accumulated other comprehensive income	$15,611	$15,611

Kansas City Life Insurance Company
Notes to Consolidated Financial Statements–(Continued) (Unaudited)

Realized Gains (Losses)
The following table provides detail concerning realized investment gains and losses for the second quarters and six months ended June 30, 2013 and 2012.

	Quarter Ended June 30		Six Months Ended June 30	
	2013	2012	2013	2012
Gross gains resulting from:				
Sales of investment securities	$50	$—	$118	$313
Investment securities called and other	1,789	595	2,515	803
Real estate	20	1,010	20	16,180
Total gross gains	1,859	1,605	2,653	17,296
Gross losses resulting from:				
Sales of investment securities	—	(32)	—	(32)
Investment securities called and other	(178)	(151)	(360)	(204)
Sale of real estate and joint venture	—	—	(89)	—
Mortgage loans	(36)	(13)	(36)	(178)
Total gross losses	(214)	(196)	(485)	(414)
Change in allowance for potential future losses on mortgage loans	92	(32)	38	332
Amortization of DAC and VOBA	(5)	(16)	(28)	(16)
Net realized investment gains, excluding other-than-temporary impairment losses	1,732	1,361	2,178	17,198
Net impairment losses recognized in earnings:				
Other-than-temporary impairment losses on fixed maturity and equity securities	(272)	(188)	(459)	(456)
Portion of loss recognized in other comprehensive income	41	42	99	150
Net other-than-temporary impairment losses recognized in earnings	(231)	(146)	(360)	(306)
Net realized investment gains	$1,501	$1,215	$1,818	$16,892

Proceeds From Sales of Investment Securities
The table below details proceeds from the sale of fixed maturity and equity securities, excluding maturities and calls, for the second quarters and six months ended June 30, 2013 and 2012.

	Quarter Ended June 30		Six Months Ended June 30	
	2013	2012	2013	2012
Proceeds	$5,065	$2,216	$9,130	$8,616

Mortgage Loans
The Company invests on an ongoing basis in commercial mortgage loans that are secured by commercial real estate and are stated at cost, adjusted for amortization of premium and accrual of discount, less an allowance for potential future losses. This allowance is maintained at a level believed by management to be adequate to absorb estimated credit losses and was $3.7 million at June 30, 2013 and $3.3 million at December 31, 2012. The Company had 18% of its invested assets in commercial mortgage loans at June 30, 2013, and December 31, 2012. In addition to the subject

collateral underlying the mortgage, the Company typically requires some amount of recourse from borrowers as another potential source of repayment. The recourse requirement is determined as part of the underwriting requirements of each loan. The average loan to value ratio for the overall portfolio was 46% and 47%

at June 30, 2013 and December 31, 2012, respectively, and is based upon the current balance relative to the appraisal of value at the time the loan was originated or acquired.

The following table identifies the gross mortgage loan principal outstanding and the allowance for potential future losses at June 30, 2013 and December 31, 2012.

	June 30 2013	December 31 2012
Principal outstanding	$656,531	$677,380
Allowance for potential future losses	(3,703)	(3,346)
Carrying value	$652,828	$674,034

The following table summarizes the amount of mortgage loans held by the Company at June 30, 2013 and December 31, 2012, segregated by year of origination. Purchased loans are shown in the year acquired by the Company, although the individual loans may have been initially originated in prior years.

	June 30 2013	% of Total	December 31 2012	% of Total
Prior to 2004	$39,786	6 %	$48,973	7 %
2004	18,077	3 %	19,699	3 %
2005	31,316	5 %	32,666	5 %
2006	33,245	5 %	39,321	6 %
2007	29,007	4 %	31,484	5 %
2008	34,891	5 %	35,747	5 %
2009	40,372	6 %	41,691	6 %
2010	70,791	11 %	90,236	13 %
2011	123,605	19 %	130,590	19 %
2012	200,761	31 %	206,973	31 %
2013	34,680	5 %	—	— %
Total	$656,531	100 %	$677,380	100 %

The following table identifies mortgage loans by geographic location at June 30, 2013 and December 31, 2012.

	June 30 2013	% of Total	December 31 2012	% of Total
Pacific	$177,653	27 %	$183,198	27 %
West north central	104,470	16 %	106,004	16 %
West south central	109,309	16 %	110,336	16 %
Mountain	96,655	15 %	95,626	14 %
South atlantic	63,371	10 %	61,815	9 %
Middle atlantic	32,689	5 %	48,523	7 %
East north central	58,018	9 %	55,938	8 %
East south central	14,366	2 %	15,940	3 %
Total	$656,531	100 %	$677,380	100 %

The following table identifies the concentration of mortgage loans by state greater than 5% of total at June 30, 2013 and December 31, 2012.

	June 30 2013	% of Total		December 31 2012	% of Total	
California	$149,097	23	%	$156,032	23	%
Texas	99,455	15	%	100,307	15	%
Minnesota	65,715	10	%	63,402	9	%
Florida	35,666	5	%	36,521	5	%
All others	306,598	47	%	321,118	48	%
Total	$656,531	100	%	$677,380	100	%

The following table identifies mortgage loans by property type at June 30, 2013 and December 31, 2012. The Other category consists of apartments and retail properties.

	June 30 2013	% of Total		December 31 2012	% of Total	
Industrial	$294,545	45	%	$298,611	44	%
Office	252,972	38	%	261,075	39	%
Medical	43,416	7	%	48,824	7	%
Other	65,598	10	%	68,870	10	%
Total	$656,531	100	%	$677,380	100	%

The table below identifies mortgage loans by maturity at June 30, 2013 and December 31, 2012.

	June 30 2013	% of Total		December 31 2012	% of Total	
Due in one year or less	$26,562	4	%	$29,663	4	%
Due after one year through five years	178,157	27	%	195,336	29	%
Due after five years through ten years	271,639	42	%	282,453	42	%
Due after ten years	180,173	27	%	169,928	25	%
Total	$656,531	100	%	$677,380	100	%

The Company may refinance commercial mortgage loans prior to contractual maturity as a means of originating new loans that meet the Company's underwriting and pricing parameters. The Company refinanced loans with outstanding balances of $1.4 million and $4.0 million during the second quarters ended June 30, 2013 and 2012, respectively, and $7.7 million and $8.6 million during the first six months of 2013 and 2012, respectively.

In the normal course of business, the Company commits to fund commercial mortgage loans, generally up to 120 days in advance. These commitments typically have fixed expiration dates. A small percentage of commitments expire due to the borrower's failure to deliver the requirements of the commitment by the expiration date. In these cases, the Company retains the commitment fee. For additional information, please see Note 15 - Commitments.

4. Fair Value Measurements

Under GAAP, fair value represents the price that would be received to sell an asset (exit price) or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is the Company’s policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements.

The Company categorizes its financial assets and liabilities measured at fair value in three levels, based on the inputs and assumptions used to determine the fair value. These levels are as follows:

Level 1 - Valuations are based upon quoted prices for identical instruments traded in active markets.

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Level 2 - Valuations are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. Valuations are obtained from third-party pricing services or inputs that are observable or derived principally from or corroborated by observable market data.
Level 3 - Valuations are generated from techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company's assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of discounted cash flow models, spread-based models, and similar techniques, using the best information available in the circumstances.
Following is a description of valuation methodologies used for assets and liabilities recorded at fair value and for estimating fair value for financial instruments not recorded at fair value but for which fair value is disclosed.
Assets
Securities Available for Sale
Fixed maturity and equity securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon unadjusted quoted prices, if available, except as described in the subsequent paragraphs.
Cash and Short-Term Financial Assets
Short-term financial assets include cash and other short-term investments. Cash is categorized as Level 1. Other short-term assets are invested in institutional money market funds. These assets are categorized as Level 2, as the valuation is based upon the net asset value (NAV) of the fund. There are no restrictions on withdrawal of these funds.
Loans
The Company does not record loans at fair value. As such, valuation techniques discussed herein for loans are primarily for estimating fair value for purpose of disclosure.
Fair values of mortgage loans on real estate properties are calculated by discounting contractual cash flows, using discount rates based on current industry pricing or the Company's estimate of an appropriate risk-adjusted discount rate for loans of similar size, type, remaining maturity, likelihood of prepayment, and repricing characteristics. Mortgage loans are categorized as Level 3 in the fair value hierarchy.
The Company also has loans made to policyholders. These loans cannot exceed the cash surrender value of the policy. Carrying value of policy loans approximates fair value. Policy loans are categorized as Level 3.
Separate Accounts
The separate account assets and liabilities, which are equal, are recorded at fair value based upon NAV. Separate accounts are categorized as Level 2.
Liabilities
Investment-Type Liabilities Included in Policyholder Account Balances and Other Policyholder Funds
The fair values of investment-type insurance contracts included with policyholder account balances for fixed deferred annuities are estimated to be their cash surrender values. The fair values of supplementary contracts without life contingencies are estimated to be the present value of payments at a market yield. The fair values of deposits with no stated maturity are estimated to be the amount payable on demand at the measurement date. These liabilities are categorized as Level 3.
Guaranteed Minimum Withdrawal Benefits (GMWB)
The Company offers a GMWB rider that can be added to new or existing variable annuity contracts. The rider provides an enhanced withdrawal benefit that guarantees a stream of income payments to an owner or annuitant, regardless of the contract account value. Fair value for GMWB rider contracts is a Level 3 valuation, as it is based on models which utilize significant unobservable inputs. These models require actuarial and financial market assumptions, which reflect the assumptions market participants would use in pricing the contract, including adjustments for volatility, risk, and issuer non-performance.

Determination of Fair Value

The determination of the fair value of the Company's fixed maturity and equity securities is the responsibility of the Company's investment accounting group. The determination of the value of the Company's liabilities that are reported at fair value in the financial statements is the responsibility of the Company's valuation actuary group. Each of these groups manage and create the policies and processes used to determine the respective fair values. The results of the process are reviewed by the Principal Accounting Officer, the Chief Financial Officer, and other management, as necessary. The results are made known to the Company's Disclosure Committee and any significant policy or process changes are discussed with the Company's Audit Committee. Please refer to Note 5 - Fair Value Measurements of the Company's 2012 Form 10-K for additional information on these responsibilities.

The Company utilizes external independent third-party pricing services to determine the majority of its fair values on investment securities available for sale. At June 30, 2013 and December 31, 2012, approximately 96% of the carrying value of these investments was from external pricing services, 2% was from brokers, and 2% was derived from internal matrices and calculations. In the event that the primary pricing service does not provide a price, the Company utilizes the price provided by a second pricing service. The Company reviews prices received from service providers for reasonableness and unusual fluctuations but generally accepts the price identified from the primary pricing service. In the event a price is not available from either third-party pricing service, the Company pursues external pricing from brokers. Generally, the Company pursues and utilizes only one broker quote per security. In doing so, the Company solicits only brokers which have previously demonstrated knowledge and experience of the subject security. If a broker price is not available, the Company determines a fair value through various valuation techniques that may include discounted cash flows, spread-based models, or similar techniques, depending upon the specific security to be priced. These techniques are primarily applied to private placement securities. The Company utilizes available market information, wherever possible, to identify inputs into the fair value determination, primarily including prices and spreads on comparable securities.

Each quarter, the Company evaluates the prices received from third-party security pricing services and independent brokers to ensure that the prices represent a reasonable estimate of the fair value within the macro-economic environment, sector factors, and overall pricing trends and expectations. The Company corroborates and validates the primary pricing sources through a variety of procedures that include but are not limited to comparison to additional independent third-party pricing services or brokers, where possible; a review of third-party pricing service methodologies; back testing; in-depth specific analytics on randomly selected issues; and comparison of prices to actual trades for specific securities where observable data exists. In addition, the Company analyzes the primary third-party pricing service's methodologies and related inputs and also evaluates the various types of securities in its investment portfolio to determine an appropriate fair value hierarchy. Finally, the Company also performs additional evaluations when individual prices fall outside tolerance levels when comparing prices received from third-party pricing services.

Fair value measurements for assets and liabilities where there exists limited or no observable market data are calculated using the Company’s own estimates and are categorized as Level 3. These estimates are based on current interest rates, credit spreads, liquidity premium or discount, the economic and competitive environment, unique characteristics of the asset or liability, and other pertinent factors. Therefore, these estimates cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there may be inherent weaknesses in any valuation technique. Further, changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values.

The Company’s own estimates of fair value of fixed maturity and equity securities may be derived in a number of ways, including but not limited to: 1) pricing provided by brokers, where the price indicates reliability as to value; 2) fair values of comparable securities, incorporating a spread adjustment for maturity differences, collateralization, credit quality, liquidity, and other items, if applicable; 3) discounted cash flow models and margin spreads; 4) bond yield curves; 5) observable market prices and exchange transaction information not provided by external pricing services; and 6) statement values provided to the Company by fund managers.

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Categories Reported at Fair Value
The following tables present categories reported at fair value on a recurring basis.

	June 30, 2013			
	Level 1	Level 2	Level 3	Total
Assets:				
U.S. Treasury securities and obligations of U.S. Government	$12,561	$111,485	$2,558	$126,604
Federal agencies [1]	—	23,055	—	23,055
Federal agency issued residential mortgage-backed securities [1]	—	73,471	—	73,471
Subtotal	12,561	208,011	2,558	223,130
Corporate obligations:				
Industrial	4,125	519,977	2,399	526,501
Energy	—	210,471	2,243	212,714
Communications and technology	—	219,487	—	219,487
Financial	—	284,760	10,405	295,165
Consumer	—	489,510	15,162	504,672
Public utilities	—	270,296	35	270,331
Subtotal	4,125	1,994,501	30,244	2,028,870
Corporate private-labeled residential mortgage-backed securities	—	134,354	—	134,354
Municipal securities	—	149,850	3,685	153,535
Other	—	92,384	5,370	97,754
Redeemable preferred stocks	—	9,008	—	9,008
Fixed maturity securities	16,686	2,588,108	41,857	2,646,651
Equity securities	5,242	30,308	—	35,550
Total	$21,928	$2,618,416	$41,857	$2,682,201
Percent of total	1 %	97 %	2 %	100 %
Liabilities:				
Other policyholder funds				
Guaranteed minimum withdrawal benefits	$—	$—	$(3,101)	$(3,101)
Total	$—	$—	$(3,101)	