KANSAS CITY LIFE INSURANCE CO
Form 10-Q
July 29, 2011
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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, 2011 or

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

For the transition period from____________ to ____________

Commission File Number 2-40764

KANSAS CITY LIFE INSURANCE COMPANY

(Exact name of registrant as specified in its charter)

Missouri	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 ¨

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

Yes x No ¨

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 ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

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

Yes ¨ 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	11,466,905 shares
Class	Outstanding June 30, 2011

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KANSAS CITY LIFE INSURANCE COMPANY

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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 2011	December 31 2010
	(Unaudited)	
ASSETS		
Investments:		
Fixed maturity securities available for sale, at fair value	$ 2,616,374	$ 2,648,888
Equity securities available for sale, at fair value	39,631	38,321
Mortgage loans	625,275	559,167
Real estate	121,222	119,909
Policy loans	82,172	84,281
Short-term investments	36,691	15,713
Other investments	4,354	5,009
Total investments	3,525,719	3,471,288
Cash	6,289	5,445
Accrued investment income	35,801	35,742
Deferred acquisition costs	195,945	192,943
Reinsurance receivables	188,608	187,123
Property and equipment	23,143	23,514
Other assets	71,389	78,018
Separate account assets	345,306	339,029
Total assets	$ 4,392,200	$ 4,333,102
LIABILITIES		
Future policy benefits	$ 881,525	$ 884,380
Policyholder account balances	2,082,485	2,065,878
Policy and contract claims	34,447	43,866
Other policyholder funds	149,601	145,560
Other liabilities	192,702	174,917
Separate account liabilities	345,306	339,029
Total liabilities	3,686,066	3,653,630
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	41,093	41,085

Retained earnings	776,899	767,126
Accumulated other comprehensive income	24,702	7,807
Treasury stock, at cost (2011 - 7,029,775 shares; 2010 - 7,029,575 shares)	(159,681)	(159,667)
Total stockholders equity	706,134	679,472
Total liabilities and stockholders equity	$ 4,392,200	$ 4,333,102

See accompanying Notes to Consolidated Financial Statements (Unaudited)

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Kansas City Life Insurance Company

Consolidated Statements of Income

	Quarter Ended June 30		Six Months Ended June 30	
	2011	2010	2011	2010
	(Unaudited)		(Unaudited)	
REVENUES				
Insurance revenues:				
Premiums, net	$ 30,801	$ 34,165	$ 64,426	$ 69,148
Contract charges	23,752	26,668	49,986	53,342
Total insurance revenues	54,553	60,833	114,412	122,490
Investment revenues:				
Net investment income	44,893	43,272	90,284	86,576
Realized investment gains, excluding impairment losses	1,893	1,493	2,905	2,816
Net impairment losses recognized in earnings:				
Total other-than-temporary impairment losses	(238)	(1,458)	(507)	(3,049)
Portion of impairment losses recognized in other comprehensive income	56	134	114	139
Net impairment losses recognized in earnings	(182)	(1,324)	(393)	(2,910)
Total investment revenues	46,604	43,441	92,796	86,482
Other revenues	2,666	2,306	5,074	4,690
Total revenues	103,823	106,580	212,282	213,662
BENEFITS AND EXPENSES				
Policyholder benefits	38,865	42,629	84,139	90,415
Interest credited to policyholder account balances	20,766	21,540	41,247	42,740
Amortization of deferred acquisition costs	705	2,178	10,289	11,125
Operating expenses	26,498	24,398	52,363	50,580
Total benefits and expenses	86,834	90,745	188,038	194,860
Income before income tax expense	16,989	15,835	24,244	18,802
Income tax expense	5,816	5,775	8,280	7,779
NET INCOME	$ 11,173	$ 10,060	$ 15,964	$ 11,023
Comprehensive income, net of taxes:				
Change in net unrealized gains on securities available for sale	$ 16,793	$ 30,358	$ 16,895	$ 46,114
Other comprehensive income	16,793	30,358	16,895	46,114

COMPREHENSIVE INCOME	$ 27,966	$ 40,418	$ 32,859	$ 57,137
Basic and diluted earnings per share:				
Net income	$ 0.97	$ 0.88	$ 1.39	$ 0.96

See accompanying Notes to Consolidated Financial Statements (Unaudited)

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Kansas City Life Insurance Company

Consolidated Statement of Stockholders Equity

	Six Months Ended June 30, 2011 (Unaudited)
COMMON STOCK, beginning and end of period	$ 23,121
ADDITIONAL PAID IN CAPITAL	
Beginning of period	41,085
Excess of proceeds over cost of treasury stock sold	8
End of period	41,093
RETAINED EARNINGS	
Beginning of period	767,126
Net income	15,964
Stockholder dividends of $0.54 per share	(6,191)
End of period	776,899
ACCUMULATED OTHER COMPREHENSIVE INCOME, net of taxes	
Beginning of period	7,807
Other comprehensive income	16,895
End of period	24,702
TREASURY STOCK, at cost	
Beginning of period	(159,667)
Cost of 672 shares acquired	(21)
Cost of 14 shares sold	7
End of period	(159,681)
TOTAL STOCKHOLDERS EQUITY	$ 706,134

See accompanying Notes to Consolidated Financial Statements (Unaudited)

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Kansas City Life Insurance Company

Consolidated Statements of Cash Flows

	Six Months Ended June 30 2011	Six Months Ended June 30 2010
	(Unaudited)	
OPERATING ACTIVITIES		
Net income	$ 15,964	$ 11,023
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premium	1,656	1,315
Depreciation	1,468	1,483
Acquisition costs capitalized	(17,998)	(17,507)
Amortization of deferred acquisition costs	10,289	11,125
Realized investment (gains) losses	(2,512)	94
Changes in assets and liabilities:		
Reinsurance receivables	(1,485)	(3,001)
Future policy benefits	(6,249)	2,862
Policyholder account balances	(5,029)	(11,139)
Income taxes payable and deferred	3,468	9,762
Other, net	4,859	14,611
Net cash provided	4,431	20,628
INVESTING ACTIVITIES		
Purchases of investments:		
Fixed maturity securities	(102,576)	(209,849)
Equity securities	(1,398)	(401)
Mortgage loans	(105,223)	(25,856)
Real estate	(4,514)	(7,069)
Policy loans	(6,970)	(8,622)
Other investments	-	(644)
Sales of investments:		
Fixed maturity securities	51,527	14,888
Equity securities	14	198
Other investments	-	858
Net sales (purchases) of short-term investments	(20,978)	56,251
Maturities and principal paydowns of investments:		
Fixed maturity securities	120,856	124,584
Equity securities	200	-
Mortgage loans	39,111	19,484
Policy loans	9,079	9,330
Net disposition of property and equipment	(71)	(166)
Net cash used	(20,943)	(27,014)

See accompanying Notes to Consolidated Financial Statements (Unaudited)

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Kansas City Life Insurance Company

Consolidated Statements of Cash Flows (Continued)

	Six Months Ended June 30 2011	2010
	(Unaudited)	
FINANCING ACTIVITIES		
Proceeds from borrowings	$ -	$ 3,000
Repayment of borrowings	-	(3,000)
Deposits on policyholder account balances	121,982	110,518
Withdrawals from policyholder account balances	(100,727)	(101,463)
Net transfers from separate accounts	2,134	2,408
Change in other deposits	164	8,155
Cash dividends to stockholders	(6,191)	(6,208)
Net acquisition of treasury stock	(6)	(3,065)
Net cash provided	17,356	10,345
Increase in cash	844	3,959
Cash at beginning of year	5,445	4,981
Cash at end of period	$ 6,289	$ 8,940

See accompanying Notes to Consolidated Financial Statements (Unaudited)

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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 to these unaudited interim consolidated financial statements of Kansas City Life Insurance Company 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 accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting and 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 2010 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 as of June 30, 2011 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 the 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 as of 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.

Significant Accounting Policies

Deferred Acquisition Costs

Deferred acquisition costs (DAC), principally agent commissions and other selling, selection and issue costs, which vary with and are directly related to the production of new business, are capitalized as incurred. At least annually, the Company reviews its DAC capitalization policy and the specific items which are capitalized under existing guidance. These deferred costs for life insurance products are generally deferred and amortized over the premium paying period. Policy acquisition costs that relate to interest sensitive and variable insurance products are deferred and amortized with interest in relation to the estimated gross profits to be realized over the lives of the contracts.

For interest sensitive and variable insurance products, estimated gross profits are composed of net interest income, net realized investment gains and losses, fees, surrender charges, expenses, and mortality gains and losses. At the issuance of policies, projections of estimated gross profits are made which are then replaced by actual gross profits over the lives of the policies. In addition to other factors, emerging experience may lead to a revised outlook for the remaining estimated gross profits. Accordingly, DAC may be recalculated using these new assumptions and any resulting adjustment is included in income. The Company considers the following assumptions to be of significance when evaluating future estimated gross profits: mortality, interest rates and spreads, surrender and withdrawal rates, expense margins and premium persistency.

DAC is also reviewed on an ongoing basis to evaluate whether the unamortized portion exceeds the expected recoverable amounts. If it is determined from emerging experience that the premium margins or expected gross profits are insufficient to amortize deferred acquisition costs, then the asset will be adjusted downward with the adjustment recorded as an expense in the current period. No impairment adjustments have been recorded in the periods presented. The DAC asset is also adjusted at each reporting date to reflect the impact of unrealized gains and losses on fixed maturity and equity securities available for sale as though such gains and losses had been realized.

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Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited) Continued

The Company may consider refinements in estimates due to improved capabilities resulting from administrative or actuarial system upgrades. The Company considers such enhancements to determine whether and to what extent they are associated with prior periods or simply improvements in the projection of future expected gross profits due to improved functionality. To the extent they represent such improvements, these items are applied to the appropriate financial statement line items in a manner similar to unlocking adjustments.

The amortization of DAC decreased $1.5 million or 68% in the second quarter of 2011 compared to one year ago. The amortization of DAC decreased $0.8 million in the six months of 2011 versus the prior year. This decrease was primarily the result of an unlocking of the Company s assumptions on certain universal life and deposit type products. The Company considered its assumptions associated with this business, along with the impact of reinsurance, where applicable. The Company unlocked assumptions in the second quarter of 2011, resulting in an increase in the DAC asset of $8.2 million. The unlocking was the result of several factors, the largest of which was associated with future mortality experience including the use of a new industry mortality table and the corresponding reinsurance.

The Company also had an unlocking in the second quarter of 2010 that resulted in an increase to the DAC asset and a corresponding decrease in the amortization of DAC during the second quarter 2010 in the amount of $5.8 million. This unlocking primarily related to a change in the estimated future gross profits associated with the mortality assumption for certain universal life and variable universal life products. The 2010 unlocking adjustment reflected actual experience from mortality results that had emerged and which had been better than assumed in expected future profits previously established. The unlocking of the 2010 mortality assumption on the variable universal life product also included a change to a more recent industry mortality table. In addition, the Company also unlocked an interest rate assumption on selected fixed deferred annuity products in the second quarter of 2010.

In addition to unlocking, the Company had an adjustment in the amortization of DAC associated with a software enhancements to its DAC modeling system and plan specific refinements. These refinements impacted the calculation of future gross profit assumptions and the DAC amortization. The effect of the change in estimate was a decrease in the DAC asset and an increase in current period DAC amortization of $0.5 million in the second quarter of 2011.

Also in the second quarter of 2010, the Company refined its estimate as a result of the implementation of an actuarial system upgrade. This upgrade allowed the Company to refine its projection of future expected gross profits on investment-type contracts which impacted the calculation of DAC amortization. The effect of the change in estimate was an increase in the DAC asset and a decrease in current period DAC amortization of $1.1 million.

The following table identifies the effect of the DAC change in estimate and unlocking in the Consolidated Statements of Income for the six months ended June 30.

	2011	2010
Change in estimate	$ (459)	$ 1,118
Unlocking	8,235	5,831
Total	$ 7,776	$ 6,949

Value of Business Acquired

When a new block of business is acquired or when an insurance company is purchased, a portion of the purchase price is allocated to a separately identifiable intangible asset, called the value of business acquired (VOBA). VOBA is established as the actuarially determined present value of future gross profits of the business acquired and is amortized with interest in proportion to future premium revenues or the expected future profits, depending on the type of business acquired. VOBA is reported as a component of other assets with related amortization included in operating expenses. Amortization of VOBA occurs with interest over the anticipated lives of the underlying business to which it relates, initially 15 to 30 years. Similar to DAC, the assumptions regarding future experience can affect the carrying value of VOBA, including interest spreads, mortality, expense margins and policy and premium persistency experience. Significant changes in these assumptions can impact the carrying balance of VOBA and produce changes that are reflected in the current period s income as an unlocking adjustment. Profit expectations are based upon assumptions of future interest spreads, mortality margins, expense margins and policy and premium persistency experience. These assumptions involve judgment and are compared to actual experience on an ongoing basis. If it is determined that the assumptions related to the profit expectations for interest sensitive and variable insurance products should be revised, the impact of the change is reported in the current period s income as an unlocking adjustment.

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Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited) Continued

At least annually, a review is performed of the models and the assumptions used to develop expected future profits, based upon management s current view of future events. Management s view primarily reflects Company experience but can also reflect emerging trends within the industry. Short-term deviations in experience affect the amortization of VOBA in the period, but do not necessarily indicate that a change to the long-term assumptions of future experience is warranted. If it is determined that it is appropriate to change the assumptions related to future experience, then an unlocking adjustment is recognized for the block of business being evaluated. Certain assumptions, such as interest spreads and surrender rates, may be interrelated. As such, unlocking adjustments often reflect revisions to multiple assumptions. The VOBA balance is immediately impacted by any assumption changes, with the change reflected through the income statement as an unlocking adjustment in the amount of VOBA amortized. These adjustments can be positive or negative with adjustments reducing amortization limited to amounts previously deferred plus interest accrued through the date of the adjustment.

In addition, the Company may consider refinements in estimates due to improved capabilities resulting from administrative or actuarial system upgrades. The Company considers such enhancements to determine whether and to what extent they are associated with prior periods or simply improvements in the projection of future expected gross profits due to improved functionality. To the extent they represent such improvements, these items are applied to the appropriate financial statement line items in a manner similar to unlocking adjustments.

VOBA is also reviewed on an ongoing basis to determine that the unamortized portion does not exceed the expected recoverable amounts. If it is determined from emerging experience that the premium margins or gross profits are insufficient to amortize deferred acquisition costs, then the asset will be adjusted downward with the adjustment recorded as an expense in the current period. No impairment adjustments have been recorded in the periods presented.

The amortization of VOBA increased $1.0 million in both the second quarter and six months of 2011 compared to the same periods in the prior year. This increase was due primarily to an unlocking adjustment on interest-sensitive products, which increased VOBA amortization $0.9 million. The unlocking adjustment primarily related to interest spreads. There was no VOBA unlocking in 2010.

Contract Charges

Contract charges consist of cost of insurance, expense loads, the amortization of unearned revenues, and surrender charges. Cost of insurance relates to charges for mortality. These charges are applied to the excess of the mortality benefit over the account value for universal life policies. Expense loads are amounts that are assessed against the policyholder balance as consideration for origination and maintenance of the contract. Surrender charges are fees on policyholder account balances upon cancellation or withdrawal of policyholder account balances consistent with policy terms.

An additional component of contract charges is the recognition over time of the deferred revenue liability (DRL) for certain universal life policies. This liability arises from front-end loads on such policies and is recognized into the Consolidated Statements of Income in a manner, similar to the amortization of DAC.

Unlocking or other events may also have an impact on future expected gross profits on products and policies. If it is determined that it is appropriate to change the assumptions of future experience, then an unlocking adjustment is recognized for the block of business being evaluated. Certain assumptions, such as interest spreads and surrender rates, may be interrelated. As such, unlocking adjustments often reflect revisions to multiple assumptions. In addition, the Company may also consider refinements in estimates for other unusual or one-time occurrences for events such as administrative or actuarial system upgrades. These items are applied to the appropriate financial statement line items similar to unlocking adjustments.

At least annually, a review is performed regarding the assumptions related to future expected gross profits on products and policies consistent with those performed for DAC and VOBA. If it is determined that the assumptions should be revised, an adjustment may be recorded to contract charge deferred revenues in the current period as an unlocking adjustment. The Company had an unlocking in the DRL in both the second quarters of 2011 and 2010. In 2011, the unlocking was the result of several factors, the largest of which was associated with future mortality experience due to the use of a new industry mortality table and the corresponding impact of reinsurance. The impact of the unlocking in 2011 was an increase in the DRL liability and a reduction in contract charges in the amount of $1.8 million. The 2010 unlocking adjustment reflected actual experience from mortality results, premium persistency, and surrender rates that had emerged. The impact of the unlocking on DRL was a decrease in the liability and a corresponding increase in the recognition of deferred revenue in the second quarter of 2010 in the amount of $1.1 million.

The Company s refinement in methodology in 2011 was less than $0.1 million. However, in 2010, the Company had a refinement in methodology that resulted in a change in estimate. The Company refined its methodology, primarily as a result of the implementation of an actuarial system upgrade. This upgrade allowed the Company to refine its calculation of the DRL liability. The effect of the refinement in estimate on the DRL was an increase in the liability and a reduction to contract charges of $0.5 million.

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Notes to Consolidated Financial Statements (Unaudited) Continued

The following table identifies the effect of the deferred revenue change in estimate and unlocking recognized in contract charges in the Consolidated Statements of Income for six months ended June 30.

	2011	2010
Change in estimate	$ 29	$ (530)
Unlocking	(1,769)	1,107
Total	$ (1,740)	$ 577

For a full discussion of these significant accounting policies, please refer to the Company s 2010 Form 10-K.

2. New Accounting Pronouncements and Other Regulatory Activity

For a full discussion of new accounting pronouncements and other regulatory activity and their impact of the Company, please refer to the Company s 2010 Form 10-K.

In April 2011, the Financial Accounting Standards Board (FASB) issued amended guidance concerning creditor s determinations of when a restructuring is considered to be a troubled debt restructuring. In making the determination, a creditor must evaluate and conclude that the restructuring constitutes a concession and that the debtor is experiencing financial difficulties. The amended guidance provides clarifications as to whether a concession has been made and provides additional guidance on a creditor s evaluation of whether a debtor is experiencing financial difficulties. This guidance is effective for the first interim or annual period beginning after June 15, 2011 and retrospective application to the beginning of the annual period of adoption is required. The Company is currently evaluating this new guidance and its materiality to the consolidated financial statements.

In April 2011, the FASB issued new guidance concerning repurchase agreements. This guidance amends previously provided guidance as to when an entity may or may not recognize a sale upon the transfer of financial assets subject to repurchase agreements. That determination was previously based upon whether the entity has maintained effective control over the transferred financial assets. One of the relevant considerations for assessing effective control is the transferor s ability to repurchase or redeem financial assets before maturity. This update removes the assessment of effective control. The update is effective for interim or annual periods beginning on or after December 15, 2011. The Company is currently evaluating this new guidance and its materiality to the consolidated financial statements.

In May 2011, the FASB issued new guidance concerning fair value measurements and disclosure. The new guidance is the result of joint efforts by the FASB and the International Accounting Standards Board (IASB) to develop a single, converged fair value framework on how to measure fair value and the necessary disclosures concerning fair value measurements. The guidance is effective for interim and annual periods beginning after December 15, 2011 and no early adoption is permitted. The Company is currently evaluating this new guidance and its materiality to the consolidated financial statements.

In June 2011, the FASB issued revised guidance as the manner in which entities present comprehensive income in the financial statements. This guidance removes the previous presentation options and provides that entities must report comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. This guidance does not change the items that must be reported in other comprehensive income nor does it require incremental disclosures in addition to those previously required. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company is currently evaluating this new guidance and its impact to the consolidated financial statements.

3. Fair Value Measurements

Fair Values Hierarchy

The Company groups 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.

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited) Continued

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.

Determination of Fair Value

Under U.S. 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 as of 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. Accordingly, the Company utilizes a primary independent third-party pricing service to determine the majority of its fair values on investment securities available for sale.

The Company reviews prices received from service providers for unusual fluctuations but generally accepts the price identified from the primary pricing service. However, if the primary pricing service does not provide a price, the Company utilizes the price provided by the second pricing service if a price is available. 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 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.

The Company performs an analysis on 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. 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 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.

The Company owned two issues of similar securities for which values were not provided from the Company s primary pricing service as of June 30, 2011. The Company received a broker price indication for one of these securities. The Company used the most recent trade information available for the other security. Since these securities are similar, the Company utilized the mid-point of these prices to determine the fair value for these two securities.

Fair value measurements for assets and liabilities where there exists limited or no observable market data are calculated using the Company s own estimates, 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, the results 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 calculation 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 are 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.

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.

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Notes to Consolidated Financial Statements (Unaudited) Continued

Assets

Securities Available for Sale

Fixed maturities 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. If quoted prices are not available, fair values are determined as described in the preceding paragraphs.

Short-Term Financial Assets

Short-term financial assets include cash and other short-term investments and are carried at historical cost. The carrying amount is a reasonable estimate of the fair value because of the relatively short time between the purchase of the instrument and its expected repayment or maturity.

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.

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.

Liabilities

Investment-Type Liabilities Included in Policyholder Account Balances and Other Policyholder Funds

Fair values for liabilities under investment-type insurance contracts are based upon account value. The fair values of investment-type insurance contracts included with policyholder account balances for fixed deferred annuities and other policyholder funds for supplementary contracts without life contingencies are estimated to be their cash surrender values. The fair values of deposits with no stated maturity are equal to the amount payable on demand at the measurement date.

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.

Notes Payable

The Company had no borrowings as of June 30, 2011 or December 31, 2010.

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Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited) Continued

Categories Reported at Fair Value

The following tables present categories reported at fair value on a recurring basis.

	June 30, 2011			
	Level 1	Level 2	Level 3	Total
Asset:				
U.S. Treasury securities and obligations of U.S. Government	$ 11,698	$ 115,478	$ 2,118	$ 129,294
Federal agencies [1]	-	26,663	-	26,663
Federal agency issued residential mortgage-backed securities [1]	-	128,848	-	128,848
Subtotal	11,698	270,989	2,118	284,805
Corporate obligations:				
Industrial	-	406,044	26,255	432,299
Energy	-	164,583	2,276	166,859
Communications and technology	-	188,967	-	188,967
Financial	-	327,633	2,787	330,420
Consumer	-	430,738	24,839	455,577
Public utilities	-	307,188	-	307,188
Subtotal	-	1,825,153	56,157	1,881,310
Corporate private-labeled residential mortgage-backed securities	-	184,666	-	184,666
Municipal securities	-	150,124	5,255	155,379
Other	-	98,107	289	98,396
Redeemable preferred stocks	11,818	-	-	11,818
Fixed maturity securities	23,516	2,529,039	63,819	2,616,374
Equity securities	3,911	34,635	1,085	39,631
Total	$ 27,427	$ 2,563,674	$ 64,904	$ 2,656,005
Percent of total	1%	97%	2%	100%
Liabilities:				
Other policyholder funds				
Guaranteed minimum withdrawal benefits	$ -	$ -	$ (2,731)	$ (2,731)
Total	$ -	$ -	$ (2,731)	$ (2,731)

[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 (Unaudited) Continued

	December 31, 2010			
	Level 1	Level 2	Level 3	Total
Assets:				
U.S. Treasury securities and obligations of U.S. Government	$ 11,544	$ 119,624	$ 3,974	$ 135,142
Federal agencies [1]	-	26,095	-	26,095
Federal agency issued residential mortgage-backed securities [1]	-	138,056	-	138,056
Subtotal	11,544	283,775	3,974	299,293
Corporate obligations:				
Industrial	-	430,283	2,235	432,518
Energy	-	176,220	2,291	178,511
Communications and technology	-	172,946	-	172,946
Financial	-	347,884	2,775	350,659
Consumer	-	408,592	21,912	430,504
Public utilities	-	324,800	-	324,800
Subtotal	-	1,860,725	29,213	1,889,938
Corporate private-labeled residential mortgage-backed securities	-	195,055	-	195,055
Municipal securities	-	146,083	5,748	151,831
Other	-	81,136	16,866	98,002
Redeemable preferred stocks	14,769	-	-	14,769
Fixed maturity securities	26,313	2,566,774	55,801	2,648,888
Equity securities	3,871	33,270	1,180	38,321
Total	$ 30,184	$ 2,600,044	$ 56,981	$ 2,687,209
Percent of total	1%	97%	2%	100%
Liabilities:				
Other policyholder funds				
Guaranteed minimum withdrawal benefits	$ -	$ -	$ (2,799)	$ (2,799)
Total	$ -	$ -	$ (2,799)	$ (2,799)

[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 (Unaudited) Continued

The following table presents the fair value of fixed maturities and equity securities available for sale by pricing source and fair value hierarchy level.

	June 30, 2011			
	Level 1	Level 2	Level 3	Total
Fixed maturities available for sale:				
Priced from external pricing service	$ 23,516	$ 2,481,031	$ -	$ 2,504,547
Priced from independent brokers	-	48,008	-	48,008
Priced from internal matrices and calculations	-	-	63,819	63,819
Subtotal	23,516	2,529,039	63,819	2,616,374
Equity securities available for sale:				
Priced from external pricing service	3,911	-	-	3,911
Priced from independent brokers	-	-	-	-
Priced from internal matrices and calculations	-	34,635	1,085	35,720
Subtotal	3,911	34,635	1,085	39,631
Total	$ 27,427	$ 2,563,674	$ 64,904	$ 2,656,005
Percent of total	1%	97%	2%	100%

	December 31, 2010			
	Level 1	Level 2	Level 3	Total
Fixed maturities available for sale:				
Priced from external pricing service	$ 26,313	$ 2,537,287	$ -	$ 2,563,600
Priced from independent brokers	-	29,487	-	29,487
Priced from internal matrices and calculations	-	-	55,801	55,801
Subtotal	26,313	2,566,774	55,801	2,648,888
Equity securities available for sale:				
Priced from external pricing service	3,871	7,125	-	10,996
Priced from independent brokers	-	-	-	-
Priced from internal matrices and calculations	-	26,145	1,180	27,325
Subtotal	3,871	33,270	1,180	38,321
Total	$ 30,184	$ 2,600,044	$ 56,981	$ 2,687,209
Percent of total	1%	97%	2%	100%

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Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited) Continued

The changes in Level 1 assets measured at fair value on a recurring basis for the second quarter and six months ended June 30, 2011 and year ended December 31, 2010 are summarized below. The Company did not have any debt issuances in either period presented.

	Quarter Ended June 30, 2011 Assets		
	Fixed maturities available for sale	Equity securities available for sale	Total
Beginning balance	$ 26,384	$ 3,901	$ 30,285
Included in earnings	(58)	-	(58)
Included in other comprehensive income	265	10	275
Purchases, sales and other dispositions:			
Purchases	-	-	-
Sales	(1,250)	-	(1,250)
Other dispositions	(1,825)	-	(1,825)
Transfers into Level 1	-	-	-
Transfers out of Level 1	-	-	-
Ending balance	$ 23,516	$ 3,911	$ 27,427
Net unrealized gains	$ 223	$ 10	$ 233

	Six Months Ended June 30, 2011 Assets		
	Fixed maturities available for sale	Equity securities available for sale	Total
Beginning balance	$ 26,313	$ 3,871	$ 30,184
Included in earnings	(59)	-	(59)
Included in other comprehensive income	337	40	377
Purchases, sales and other dispositions:			
Purchases	-	-	-
Sales	(1,250)	-	(1,250)
Other dispositions	(1,825)	-	(1,825)
Transfers into Level 1	-	-	-
Transfers out of Level 1	-	-	-
Ending balance	$ 23,516	$ 3,911	$ 27,427
Net unrealized gains	$ 295	$ 40	$ 335

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited) Continued

	Year Ended December 31, 2010		
	Assets		
	Fixed maturities available for sale	Equity securities available for sale	Total
Beginning balance	$ 23,540	$ 3,400	$ 26,940
Included in earnings	(5)	-	(5)
Included in other comprehensive income	1,335	298	1,633
Purchases and dispositions	145	173	318
Net transfers in	1,298	-	1,298
Ending balance	$ 26,313	$ 3,871	$ 30,184
Net unrealized gains	$ 1,469	$ 298	$ 1,767

The changes in Level 2 assets measured at fair value on a recurring basis for the second quarter and six months ended June 30, 2011 and year ended December 31, 2010 are summarized below. The Company did not have any debt issuances in either period presented.

	Quarter Ended June 30, 2011		
	Assets		
	Fixed maturities available for sale	Equity securities available for sale	Total
Beginning balance	$ 2,560,276	$ 34,208	$ 2,594,484
Included in earnings	2,023	-	2,023
Included in other comprehensive income	35,818	73	35,891
Purchases, sales and other dispositions:			
Purchases	23,422	368	23,790
Sales	(36,831)	(14)	(36,845)
Other dispositions	(57,248)	-	(57,248)
Transfers into Level 2	1,634	-	1,634
Transfers out of Level 2	(55)	-	(55)
Ending balance	$ 2,529,039	$ 34,635	$ 2,563,674
Net unrealized gains	$ 38,998	$ 73	$ 39,071

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Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited) Continued

	Six Months Ended June 30, 2011		
	Assets		
	Fixed maturities available for sale	Equity securities available for sale	Total
Beginning balance	$ 2,566,774	$ 33,270	$ 2,600,044
Included in earnings	2,621	-	2,621
Included in other comprehensive income	35,504	(19)	35,485
Purchases, sales and other dispositions:			
Purchases	100,746	1,398	102,144
Sales	(37,834)	(14)	(37,848)
Other dispositions	(127,718)	-	(127,718)
Transfers into Level 2	18,500	-	18,500
Transfers out of Level 2	(29,554)	-	(29,554)
Ending balance	$ 2,529,039	$ 34,635	$ 2,563,674
Net unrealized gains (losses)	$ 39,131	$ (19)	$ 39,112

	Year Ended December 31, 2010		
	Assets		
	Fixed maturities available for sale	Equity securities available for sale	Total
Beginning balance	$ 2,393,258	$ 32,439	$ 2,425,697
Included in earnings	254	2	256
Included in other comprehensive income	107,131	116	107,247
Purchases and dispositions	72,999	713	73,712
Net transfers out	(6,868)	-	(6,868)
Ending balance	$ 2,566,774	$ 33,270	$ 2,600,044
Net unrealized gains	$ 103,635	$ 189	$ 103,824

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Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited) Continued

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the second quarter and six months ended June 30, 2011 and year ended December 31, 2010 are summarized below:

	Quarter Ended June 30, 2011			
	Assets			Liabilities
	Fixed maturities available for sale	Equity securities available for sale	Total	GMWB
Beginning balance	$ 65,004	$ 1,070	$ 66,074	$ (2,931)
Included in earnings	(17)	1	(16)	143
Included in other comprehensive income	1,195	14	1,209	-
Purchases, issuances, sales and other dispositions:				
Purchases	-	-	-	-
Issuances	-	-	-	12
Sales	-	-	-	-
Other dispositions	(784)	-	(784)	45
Transfers into Level 3	55	-	55	-
Transfers out of Level 3	(1,634)	-	(1,634)	-
Ending balance	$ 63,819	$ 1,085	$ 64,904	$ (2,731)
Net unrealized gains	$ 1,195	$ 14	$ 1,209	

	Six Months Ended June 30, 2011			
	Assets			Liabilities
	Fixed maturities available for sale	Equity securities available for sale	Total	GMWB
Beginning balance	$ 55,801	$ 1,180	$ 56,981	$ (2,799)
Included in earnings	(27)	92	65	(68)
Included in other comprehensive income	475	13	488	-
Purchases, issuances, sales and other dispositions:				
Purchases	-	-	-	-
Issuances	-	-	-	13
Sales	-	-	-	-
Other dispositions	(3,484)	(200)	(3,684)	123
Transfers into Level 3	29,554	-	29,554	-
Transfers out of Level 3	(18,500)	-	(18,500)	-
Ending balance	$ 63,819	$ 1,085	$ 64,904	$ (2,731)
Net unrealized gains	$ 475	$ 66	$ 541	

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Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited) Continued

	Year Ended December 31, 2010			
	Assets			Liabilities
	Fixed maturities available for sale	Equity securities available for sale	Total	GMWB
Beginning balance	$ 52,474	$ 1,037	$ 53,511	$ (1,642)
Included in earnings	(4			