KANSAS CITY LIFE INSURANCE CO
Form S-3/A
August 05, 2009
As filed with the Securities and Exchange Commission on August 5, 2009

Registration No. [333-160806]

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1

to

FORM S-3/A

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

KANSAS CITY LIFE INSURANCE COMPANY

(Exact name of issuer as specified in charter)

Missouri	**44-0308260**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

3520 Broadway Kansas City, Missouri	**64111-2565**
(Address of principal executive offices)	(Zip Code)

Mr. William Schalekamp

Kansas City Life Insurance Company

3520 Broadway

Kansas City, Missouri 64111-2565

(Name and address of agent for service)

(816) 753-7000

(Telephone number, including area code, of agent for service)

Copies to:

Kenda Tomes

Stinson Morrison Hecker LLP

1201 Walnut, Suite 2900

Kansas City, MO 64106

(816) 691-3211

Approximate date of commencement of proposed sale to the public: From time to time after the effective date of this registration statement in accordance with the terms of the Stock Bonus Plan For Kansas City Life Insurance Company Agents and General Agents and Contributory Deferred Compensation for Kansas City Life General Agents (hereinafter to be referred to as the "Pre-2005 Agent's Deferred Compensation Plan").

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. o

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 ("Securities Act"), other than securities offered only in connection with dividend or interest reinvestment plans, please check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a registration statement pursuant to General Instruction 1.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, please check the following box. o

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction 1.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, please check the following box. 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
Non-accelerated filer o

Accelerated filer x
Smaller reporting company o

CALCULATION OF REGISTRATION FEE

Title of Securities to Be Registered	**Amount to Be Registered**	**Proposed Maximum Offering Price Per Share**	**Proposed Maximum Aggregate Offering Price**	**Amount of Registration Fee**(1)
Common Stock (par value $1.25 per share)	20,000 Shares	$28.29(1)	$565,800(1)	$31.57
Deferred Compensation Obligations(2)	$1,000,000	100%	$1,000,000	$55.80
Totals			$1,565,800	$87.37

(1) Calculated pursuant to Rules 457(c) and 457(h) under the Securities Act solely for the purpose of calculating the amount of the registration fee on the basis of the average of the high and low prices of the common shares of beneficial interest of Kansas City Life Insurance as reported on the NASDAQ Capital Market, LLC on July 20, 2009.

(2) To be issued in accordance with the terms of the Pre-2005 Agent’s Deferred Compensation Plan. Estimated maximum number of shares of common stock and dollar amount of deferred compensation obligations of Kansas City Life Insurance Company issuable during the next two years of operation of the Pre-2005 Agent’s Deferred Compensation Plan.

The registrants hereby amend this registration statement on such date or dates as may be necessary to delay its effective date until the registrants shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The registrants hereby amend this Registration Statement to add the signature of David A. Laird, Vice President and Controller of Kansas City Life Insurance Company, (Principal Accounting Officer).

PROSPECTUS

Kansas City Life Insurance Company

$1,000,000 of Deferred Compensation Obligations **20,000 Shares of Common Stock**

Summary of Securities Offered Under the Pre-2005 Agent's Deferred Compensation Plan

General. Under this registration statement on Form S-3 ("registration statement") Kansas City Life Insurance Company (the "Company", "we", "us", "our") is registering with the Securities and Exchange Commission ("SEC"):

- Shares of our common stock, par value $1.25 per share, contributed to a grantor trust ("Trust") established in connection with our Pre-2005 Agent's Deferred Compensation Plan; and
- Our deferred compensation obligations issued in accordance with and pursuant to the Pre-2005 Agent's Deferred Compensation Plan.

Common Stock. The description of our common stock is contained in our General Form for Registration of Securities on Form 10 (File No. 001-33348) filed with the SEC on March 6, 2007; including any amendment or report filed for the purpose of updating such description.

Deferred Compensation Obligations. Under the Pre-2005 Agent's Deferred Compensation Plan, participants may elect to defer a portion of their compensation until a later date. Such deferrals create obligations owed by us to each such participant. These obligations are securities referred to herein as deferred compensation obligations. This Prospectus contains general information about the deferred compensation obligations and the terms of participation in the Pre-2005 Agent's Deferred Compensation Plan.

Our principal executive offices are located at 3520 Broadway, Kansas City, Missouri 64111-2565 and our telephone number is (816) 753-7000. Our common stock is listed on the Nasdaq Capital Market, LLC under the trading symbol "KCLI".

YOU SHOULD READ THIS PROSPECTUS AND THE PRE-2005 AGENT'S DEFERRED COMPENSATION PLAN CAREFULLY BEFORE YOU DEFER COMPENSATION. PARTICIPATING IN THE PRE-2005 AGENT'S DEFERRED COMPENSATION PLAN INVOLVES RISKS. **Please read "Risk Factors" on page 6 for information that you should consider before participating in the Pre-2005 Agent's Deferred Compensation Plan.**

Our obligation to pay any deferred compensation obligation allocated to you is unfunded and not secured by any property or assets.

We will not receive any proceeds from the issuance of the deferred compensation obligations.

Neither the Securities Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

These securities are not savings accounts, deposits or other obligations of any bank and are not insured by the Federal Deposit Insurance Corporation, the Bank Insurance Fund or any other governmental agency.

The date of this prospectus is July 27, 2009.

WHAT YOU SHOULD KNOW ABOUT THE PROSPECTUS

You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted.

You should assume that the information in this prospectus is accurate as of the date of the prospectus. Our business, financial condition, results of operations and prospects may have changed since that date.

TABLE OF CONTENTS

Prospectus

WHAT YOU SHOULD KNOW ABOUT THE PROSPECTUS	3
ABOUT THIS PROSPECTUS	4
WHERE YOU CAN FIND MORE INFORMATION	4
INCORPORATION OF DOCUMENTS BY REFERENCE.	5
RISK FACTORS	5
KANSAS CITY LIFE INSURANCE COMPANY	13
PRE-2005 AGENT'S DEFERRED COMPENSATION PLAN	14
DESCRIPTION OF DEFERRED COMPENSATION OBLIGATIONS	17
CAUTIONARY FORWARD-LOOKING STATEMENTS	18
INVESTMENT FUNDS USED AS BENCHMARK INDICES	20
PLAN OF DISTRIBUTION	20
LEGAL MATTERS	20
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM	20

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement filed by us with the Securities and Exchange Commission (SEC) to register the deferred compensation obligations to be issued by us under the Pre-2005 Agent’s Deferred Compensation Plan. The registration statement, including exhibits, provides additional important information about us and the Pre-2005 Agent’s Deferred Compensation Plan. The Pre-2005 Agent’s Deferred Compensation Plan is included as Exhibit 99.1 to the registration statement. See “Where You Can Find More Information” below for information on where you can read, and how you can obtain copies of the registration statement and exhibits.

WHERE YOU CAN FIND MORE INFORMATION

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and accordingly files reports, proxy statements and other information with the SEC. These reports, proxy statements and other information can be inspected and copied at the public reference facilities of the Commission, Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Electronic copies of all such reports are also available on the World Wide Web at http://www.sec.gov. In addition, certain of these reports may be available on our website at http://www.kclife.com/financials.aspx. The common stock is listed and traded on the Nasdaq Capital Market under the symbol “KCLI.”

As provided under “Incorporation of Documents by Reference,” upon your request, we will promptly furnish to you, and without charge, a copy of our annual report to stockholders, a copy of this prospectus and a copy of all of the information that has been incorporated by reference in this prospectus (other than exhibits to such documents which are not specifically incorporated by reference in such documents). You may also obtain additional information about the Pre-2005 Agent’s Deferred Compensation Plan and the administrators of the Pre-2005 Agent’s Deferred Compensation Plan as follows: the Committee at our principal executive offices located at 3520 Broadway, Kansas City, MO 64111-2565, 816-753-7000.

Kansas City Life has filed a registration statement on Form S-3 with the SEC covering these securities. For more information on Kansas City Life and the securities, you should refer to our registration statement which includes this prospectus and its exhibits.

This prospectus summarizes material provisions of the plan and other documents that we refer you to. Because the prospectus may not contain all the information that you may find important, you should review the full text of these documents. We have included or incorporated by reference copies of these documents as exhibits to our registration statement.

INCORPORATION OF DOCUMENTS BY REFERENCE.

The following documents previously filed by Kansas City Life Insurance Company (the "Company", "we", "us", "our") with the SEC are hereby incorporated by reference in this registration statement:

(a) Our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the SEC on February 27, 2009;

(b) Our Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 filed with the SEC on May 1, 2009;

(c) Our Current Reports on Form 8-K filed with the SEC on March 11, 2009 and May 19, 2009; and

(d) The Plan's Annual Report on Form 11-K for the year ended December 31, 2008 filed with the SEC on June 26, 2009.

(e) The description of our common stock contained in our General Form for Registration of Securities on Form 10 (File No. 001-33348) filed with the SEC on March 6, 2007; including any amendment or report filed for the purpose of updating such description.

All documents subsequently filed (other than the portions of those documents furnished or otherwise not deemed to be filed) by us pursuant to Sections 13(a), 13(c), 14 and 15(d) of the Securities Exchange Act of 1934, as amended, prior to the filing of a post-effective amendment to this registration statement which indicates that all securities offered hereby have been sold or which deregisters all securities then remaining unsold, shall be deemed to be incorporated by reference in this registration statement and to be a part hereof from the date of filing of such documents.

Any statement contained herein or in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of this registration statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such earlier statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this registration statement.

Copies of any documents (except exhibits that are not specifically incorporated by reference into this prospectus) filed by us with the SEC are also available to you without charge upon written or oral request to our corporate secretary as follows:

Corporate Secretary

Kansas City Life Insurance Company

3520 Broadway

Kansas City, MO 64111

Telephone: (816) 753-7299

You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized any person to provide you with any information that is different from what is contained in this prospectus.

THIS PROSPECTUS IS DATED JULY 27, 2009. YOU SHOULD NOT ASSUME THAT THE INFORMATION CONTAINED IN THIS PROSPECTUS IS ACCURATE AS OF ANY DATE OTHER THAN SUCH DATE, AND NEITHER THE DELIVERY TO YOU OF THIS PROSPECTUS NOR THE ISSUANCE TO YOU OF ANY SECURITIES COVERED BY THIS PROSPECTUS WILL CREATE ANY IMPLICATION TO THE CONTRARY.

RISK FACTORS

Participation in the Pre-2005 Agent's Deferred Compensation Plan and investing the securities offered by this prospectus involves certain risks. Any of the following risks or, the risks otherwise set forth herein and incorporated by reference herein, could materially adversely affect our business, cash flow operating results and financial condition and could result in a loss of your investment.

Participation in Pre-2005 Agent's Deferred Compensation Plan Risks.

You do not own the investment fund benchmark indices you select; payment of any deferred compensation obligation allocated to you depends entirely on whether we have the funds to pay you. Your deferred compensation is not required to be invested in the securities underlying the investment fund benchmark indices you select. For example, if you allocate a portion of your account to our common stock investment fund benchmark index, we will value your account based on the value of our common stock. We are not required to purchase our common stock or another investment to fund our obligations under the Pre-2005 Agent's Deferred Compensation Plan. Your only recourse for payment of the deferred compensation obligation payable to you under the Pre-2005

Agent's Deferred Compensation Plan is to us, as the entity obligated to pay that obligation to you under the Pre-2005 Agent's Deferred Compensation Plan.

Our obligation to pay the deferred compensation obligation allocated to you is not secured by any property or assets. Our obligation to pay the deferred compensation obligation payable to you under the Pre-2005 Agent's Deferred Compensation Plan is unfunded and unsecured. We are not required to establish or maintain any fund or trust to fund or pay any benefits under the Pre-2005 Agent's Deferred Compensation Plan. If we establish a fund or trust, all assets in the fund or trust will remain our general assets and will be available to our general creditors in the event of our bankruptcy or insolvency. You will not have any lien, prior claim or other security interest in any of our property or assets. Payment of any deferred compensation obligation allocated to you depends entirely on whether we have the funds to pay you.

The investment fund benchmark indices you select could go down in value, and you could lose any deferred compensation obligation allocated to you. The value of the deferred compensation obligation payable to you under the Pre-2005 Agent's Deferred Compensation Plan is measured by the investment fund benchmark indices you select. These indices might go up or down in value, and the value of any deferred compensation obligation allocated to you will correspondingly increase or decrease. The Pre-2005 Agent's Deferred Compensation Plan does not guarantee the payment of the principal amount of the compensation you defer or a minimum rate on amounts deferred. You could lose your entire investment in the Pre-2005 Agent's Deferred Compensation Plan and have no deferred compensation obligation payable to you.

You must select the investment fund benchmark indices for your account and bear the risk that you might select investment fund benchmark indices that are not suitable for you. We make no recommendations as to which investment fund benchmark indices you should select or how much of your account you should allocate to any particular investment fund benchmark indices. You must do your own analysis of the risks of selecting a particular investment fund benchmark indices. You also must determine which investment fund benchmark indices are suitable for you. We can change at any time the investment fund benchmark indices that are available under the Pre-2005 Agent's Deferred Compensation Plan. If we change investment fund benchmark indices, we are not required to offer investment fund benchmark indices that are comparable to existing investment fund benchmark indices in terms of investment objectives or risk and return.

You could lose the deferred compensation obligations we owe you if you do not meet certain thresholds or stop serving as our agent or general agent prior to your benefits vesting. An agent or general agent's failure to earn a new qualifying year in two consecutive years will be considered a "break" in service, unless such individual is fully vested in his or her account. If a break-in-service is deemed to have occurred, the agent or general agent's account will be closed and such individual will be entitled to receive the vested portion of their account within one year after the account is closed. We may waive the break in service if an agent or general agent has earned at least five qualifying years in the Plan and the break in service occurs because the individual has become totally disabled. An agent or general agent must submit sufficient evidence to the administrative committee of the Pre-2005 Agent's Deferred Compensation Plan ("Committee") for its determination as to whether a total disability has occurred. An agent or general agent will also forfeit any amount owed under Part A (except the agent or general agent's voluntary deferrals) if such individual replaces or assists in replacing a policy issued by us (or an affiliated company) with a policy of another insurer, or if the agent or general agent induces or attempts to induce an agent to leave our service (or the service of an affiliated company). An agent or general agent will also forfeit any amounts due under Part A (except voluntary deferrals) if he or she violates either the terms of his or her agent's contract, our rules or regulations, or insurance laws or regulations in the states in which the agent may solicit applications for insurance.

The Pre-2005 Agent's Deferred Compensation Plan is not subject to the provisions or protection of ERISA. The Pre-2005 Agent's Deferred Compensation Plan is not subject to the reporting, disclosure, participation, vesting, funding, fiduciary responsibility, or other requirements of the Employee Retirement Income Security Act of 1974 ("ERISA"). Accordingly, you are not entitled to the protections of ERISA.

We are not required to hedge our obligations under the Pre-2005 Agent's Deferred Compensation Plan; if we do hedge our obligations, you have no claim on any securities we might buy or any profits we might make from our hedging activities. We are not required to purchase the securities to which the investment fund benchmark indices are indexed or otherwise hedge our exposure under the Pre-2005 Agent's Deferred Compensation Plan. If we do hedge our exposure by purchasing or selling interests in the investment fund benchmark indices or purchasing or selling derivative or other instruments, you will have no interest in those securities or instruments or in the profits or losses from those hedging activities.

We cannot guarantee deferral of your taxes, and you could be subject to penalties and interest if you are required to recognize compensation in the year deferred. Our expectation is that you will not be subject to federal income tax on amounts credited to your account until we distribute those amounts to you. However, we have not obtained, nor do we intend to obtain, a ruling from the Internal Revenue Service as to the tax consequences of participating in the Pre-2005 Agent's Deferred Compensation Plan. If the IRS were to successfully challenge the deferred tax treatment or Congress change the law regarding these plans, you could be

required to recognize the compensation in the year deferred. This could subject you to penalties and interest on amounts due. See "U.S. Federal Income Tax Consequences."

Company Risks

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

Changes in the business environment and competition could negatively affect our ability to maintain or increase our profitability. In recent years, there has been substantial consolidation and convergence among companies in the financial services industry, resulting in increased competition from large, well-capitalized financial services firms. Furthermore, many of these larger competitors may have lower operating costs and an ability to absorb greater risk while maintaining their financial strength ratings, thereby allowing them to price their products more competitively. We expect consolidation to continue, thereby increasing competitive pressures.

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

We may be unable to attract agencies and sales representatives. We sell insurance and annuity products through independent agents and agencies. These agencies and sales representatives are not captive and may sell products of our competitors. Our ability to compete is dependent upon, among other things, our ability to attract and retain agents and agencies to market our insurance products, our ability to develop competitive and profitable products, our ability to maintain low unit costs, and our maintenance of strong financial strength ratings from one or more rating agencies. Sales and the results of operations and financial condition could be adversely affected if we are unsuccessful in attracting and retaining agencies and sales representatives.

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

Our ability to grow depends in large part upon the continued availability of capital. We deploy significant amounts of capital to support our sales and acquisition efforts. Although we believe it has sufficient capital to fund our immediate growth and capital needs, the amount of capital available could vary in the future due to a variety of circumstances, some of which are neither predictable nor foreseeable, nor within our control. A lack of sufficient capital could impair our ability to grow.

Adverse capital and credit market conditions may significantly affect our ability to meet liquidity needs, as well access to capital and cost of capital. The capital and credit markets have been experiencing extreme volatility and disruption since 2007. In recent months the volatility and disruption have reached unprecedented levels and the markets have exerted downward pressure on availability of liquidity and credit for certain issuers. Accordingly, our results of operations, financial condition, cash flows and statutory capital position could be materially adversely affected by continued disruptions in the capital and credit markets.

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

7

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

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

We may not realize our anticipated financial results from acquisitions. The completion of an acquisition may be more costly or take longer than expected. There may be unforeseen liabilities that arise in connection with businesses that we acquire. Additionally, in connection with our acquisitions, we assume or otherwise become responsible for the obligations of policies and other liabilities of other insurers. Any regulatory, legal, financial, or other adverse development affecting the other insurer could also have an adverse effect on us and on our business, results of operations, cash flow and financial condition.

Our policy claims fluctuate from period to period, resulting in earnings volatility. Our financial results may fluctuate from period to period due to fluctuations in policy claims incurred by us. However, we reinsure a significant amount of the mortality risk on fully underwritten and newly issued individual life insurance contracts. We regularly review retention limits for continued appropriateness and they may be changed in the future. If we were to experience adverse mortality or morbidity experience, a significant portion of that expense would be reimbursed by reinsurers.

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

Our results may be negatively affected should actual experience differ from management's assumptions and estimates. In the conduct of business, we make certain assumptions regarding the mortality, persistency, expenses, interest rates, tax liability, business mix, or other factors appropriate to the type of business we expect to experience in future periods. These assumptions are also used to estimate the amounts of deferred policy acquisition costs, value of business acquired, policy reserves and accruals, future earnings, and various components of our balance sheet. These assumptions are used in the operations of our business in making decisions crucial to our success, including the pricing of products and expense structures relating to products. Our actual experience and changes in estimates are reflected in our financial statements. Our actual experience may vary from period to period, and from established assumptions, potentially resulting in deviations in the financial statements.

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

The pattern of amortizing Deferred Acquisition Costs (DAC) and Value of Business Acquired (VOBA) may change, impacting both the level of the asset and the timing of our net income (loss). Amortization of DAC and VOBA depend on the actual and expected profits generated by the lines of business that incurred the expenses. Expected profits are dependent on assumptions regarding a number of factors including investment returns, benefit payments, expenses, mortality and policy lapse. Due to the uncertainty associated with establishing these assumptions we cannot determine the exact pattern of profit emergence. As a result, amortization of DAC and VOBA will vary from period-to-period as actual profits replace expected profits and future expected profits are re-projected based on the current status of the lines of business. To the extent that actual experience emerges less favorably than expected, or expectation for future profits decreases, the DAC and VOBA assets may be reduced, reducing the profitability in the current period.

Assumptions and estimates involve judgment and are subject to changes and revision over time. The calculations we use to estimate various components of our financial statements are necessarily complex and involve analyzing and interpreting large quantities of data. We currently employ various techniques for such calculations and, from time to time, will develop and implement more sophisticated systems and procedures capable of facilitating the calculation of more precise estimates. Accordingly, our results

8

may be affected, positively or negatively, by actual results differing from assumptions, by changes in estimates, and by changes resulting from implementing more sophisticated administrative systems and procedures that facilitate the calculation of more precise estimates.

Our reinsurers could fail to meet assumed obligations or be subject to adverse developments that could affect the Company. We follow the insurance practice of reinsuring a portion of the risks under the policies written by us (known as ceding). We cede material amounts of insurance to other insurance companies through reinsurance. This reinsurance makes the assuming reinsurer liable to us for the reinsured portion of the risk. However, reinsurance does not discharge us from primary obligation to pay policyholders for losses insured under the policies that are issued. Therefore, the failure of one or more of our reinsurers could negatively impact our business, cash flow, results of operation and financial condition.

Our ability to compete is dependent on the availability of reinsurance, cost of reinsurance or other substitute capital market solutions.
Premium rates charged by us are based, in part, on the assumption that reinsurance will be available at a certain cost. Under certain reinsurance agreements, the reinsurer may increase the rate it charges us for the reinsurance. Therefore, if the cost of reinsurance were to increase or if reinsurance were to become unavailable or if alternatives to reinsurance were not available, we could be adversely affected.

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

The use of reinsurance introduces variability in our financial statements. The timing of premium payments to and receipt of expense allowances from reinsurers may differ from our receipt of customer premium payments and incurrence of expenses. These timing differences introduce variability in certain components of our financial statements.

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

Interest rate fluctuations could negatively affect our spread income or otherwise impact our business. Because the profitability of fixed annuity and interest-sensitive whole life, universal life and the fixed portion of variable universal life insurance business depend in part on interest rate spreads, interest rate fluctuations could negatively affect profitability. Changes in interest rates may reduce both the profitability from spread businesses and the return on invested capital.

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

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

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

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

Our valuation of fixed maturity and equity securities may include methodologies, estimations and assumptions which are subject to differing interpretations and could result in changes to investment valuations that may materially adversely affect the results of operations or financial condition. Fixed maturity securities, equity securities, and short-term investments are reported at fair value on the consolidated balance sheet and represent the majority of total cash and invested assets. SFAS No. 157 establishes a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The level in the fair value hierarchy is based on the priority of the inputs to the respective valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and lowest priority to unobservable inputs (Level 3). An asset or liability's classification with the fair value hierarchy is based on the lowest level of significant input to its valuation.

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