

KANSAS CITY LIFE INSURANCE CO
Form 10-Q
July 31, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

- QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [FEE REQUIRED]
For the Quarterly Period ended June 30, 2008 or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]
For the Transition Period from _____ to _____
- Commission File Number 2-40764

KANSAS CITY LIFE INSURANCE COMPANY

(Exact Name of Registrant as Specified in its Charter)

Missouri
(State or Other Jurisdiction of
Incorporation or Organization)

44-0308260
(I.R.S. Employer
Identification Number)

3520 Broadway, Kansas City, Missouri
(Address of Principal Executive Offices)

64111-2565
(Zip Code)

Registrant's Telephone Number, including Area Code: 816-753-7000

Not Applicable

(Former name or former address, if changed since last report)

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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

No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes

No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class
Common Stock, \$1.25 par

Outstanding June 30, 2008
11,559,913 shares

KANSAS CITY LIFE INSURANCE COMPANY

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Part I Financial Information**Item 1. Financial Statements (Unaudited)**

Amounts in thousands, except share data

**KANSAS CITY LIFE INSURANCE COMPANY
CONSOLIDATED BALANCE SHEETS**

	June 30 2008 (Unaudited)	December 31 2007
ASSETS		
Investments:		
Fixed maturity securities available for sale, at fair value	\$ 2,517,393	\$ 2,631,073
Equity securities available for sale, at fair value	58,642	59,149
Mortgage loans	447,057	450,148
Real estate	89,090	96,049
Policy loans	90,213	92,803
Short-term investments	43,382	36,522
Total investments	3,245,777	3,365,744
Cash	6,062	12,158
Accrued investment income	35,317	36,499
Deferred acquisition costs	219,831	217,512
Value of business acquired	71,246	73,517
Reinsurance receivables	164,756	162,340
Property and equipment	26,707	27,781
Other assets	32,680	36,164
Separate account assets	373,586	420,393
Total assets	\$ 4,175,962	\$ 4,352,108
LIABILITIES		
Future policy benefits	\$ 852,234	\$ 851,277
Policyholder account balances	2,051,138	2,087,965
Policy and contract claims	33,061	31,742
Other policyholder funds	121,500	107,109
Notes payable	6,805	10,400
Income taxes	5,837	40,300
Other liabilities	109,849	118,521
Separate account liabilities	373,586	420,393
Total liabilities	3,554,010	3,667,707
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	33,020	30,244
Retained earnings	779,124	780,133
Accumulated other comprehensive loss	(71,161)	(19,811)

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Treasury stock, at cost (2008 - 6,936,767 shares; 2007 - 6,731,643 shares)	(142,152)	(129,286)
Total stockholders' equity	621,952	684,401
Total liabilities and stockholders' equity	\$ 4,175,962	\$ 4,352,108

See accompanying Notes to Consolidated Financial Statements (Unaudited).

KANSAS CITY LIFE INSURANCE COMPANY
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	Quarter ended		Six Months ended	
	June 30		June 30	
	2008	2007	2008	2007
REVENUES				
Insurance revenues:				
Premiums	\$45,462	\$45,212	\$89,949	\$87,980
Contract charges	26,527	26,477	53,827	55,180
Reinsurance ceded	(13,546)	(14,270)	(26,206)	(27,339)
Total insurance revenues	58,443	57,419	117,570	115,821
Investment revenues:				
Net investment income	45,616	48,671	92,079	95,755
Realized investment gains (losses)	(8,409)	38	(8,289)	5,162
Other revenues	2,639	3,757	5,248	6,174
Total revenues	98,289	109,885	206,608	222,912
BENEFITS AND EXPENSES				
Policyholder benefits	45,586	40,994	91,072	84,986
Interest credited to policyholder account balances	21,674	22,732	43,377	45,505
Amortization of deferred acquisition costs and value of business acquired	7,625	7,123	18,737	18,499
Operating expenses	21,164	22,416	45,560	45,126
Total benefits and expenses	96,049	93,265	198,746	194,116
Income before income tax expense	2,240	16,620	7,862	28,796
Income tax expense	563	4,808	2,583	8,678
NET INCOME	\$1,677	\$11,812	\$5,279	\$20,118
Basic and diluted earnings per share:				
Net income	\$0.14	\$1.00	\$0.45	\$1.70

See accompanying Notes to Consolidated Financial Statements (Unaudited).

KANSAS CITY LIFE INSURANCE COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(amounts in thousands)

	Six Months ended	
	June 30	
	2008	2007
OPERATING ACTIVITIES		
Net cash provided (used)	\$(1,791)	\$ 15,106
INVESTING ACTIVITIES		
Purchases of investments:		
Fixed maturity securities	(143,570)	(159,075)
Equity securities	(8,204)	(1,854)
Mortgage loans	(21,688)	(35,023)
Real estate	(13,724)	(846)
Other investment assets	(4,270)	—
Sales of investments:		
Fixed maturity securities	21,116	13,964
Equity securities	4,261	3,092
Real estate	20,729	16,442
Other investment assets	—	23,354
Maturities and principal paydowns of investments:		
Fixed maturity securities	150,623	162,019
Equity securities	263	18
Mortgage loans	24,778	26,345
Net (additions) dispositions to property and equipment	96	(581)
Proceeds from sale of non insurance affiliate	—	10,104
Net cash provided	30,410	57,959
FINANCING ACTIVITIES		
Net repayment of borrowings	(3,595)	(2,000)
Deposits on policyholder account balances	98,379	103,230
Withdrawals from policyholder account balances	(130,819)	(155,268)
Net transfers from separate accounts	10,042	8,811
Change in other deposits	7,657	13,224
Cash dividends to stockholders	(6,288)	(30,074)
Net acquisition of treasury stock	(10,091)	(337)
Net cash used	(34,715)	(62,414)
Increase (decrease) in cash	(6,096)	10,651
Cash at beginning of year	12,158	3,908
Cash at end of period	\$6,062	\$ 14,559

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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, the accompanying notes to these unaudited interim consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations of Kansas City Life Insurance Company include the accounts of the Company and its subsidiaries, principally Sunset Life Insurance Company of America (Sunset Life), and Old American Insurance Company (Old American).

The unaudited interim consolidated financial statements have been prepared in accordance with United States of America generally accepted accounting principles (GAAP) for interim financial reporting and with the instructions to Form 10-Q and Regulation S-X. 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 2007 Annual Report on Form 10-K. Management believes that the disclosures are adequate to make the information presented not misleading, and all normal and recurring adjustments necessary to present fairly the financial position at June 30, 2008 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 at the date of the unaudited interim consolidated financial statements, and the reported amounts of revenue and expenses during the period. These estimates are inherently subject to change and actual results could differ from these estimates.

Business Changes

On January 23, 2006, the Company entered into a definitive agreement to sell its bank subsidiary, Generations Bank, for \$10.1 million in cash to Brooke Corporation. On January 8, 2007, the Company completed the sale of Generations Bank. The gain on the sale was \$1.9 million. The bank subsidiary and the results of operations were not material to the financial statements of the Company and are not disclosed separately.

Significant Accounting Policies

A complete summary of significant accounting policies is included in Note 1 to the audited consolidated financial statements included in the Company's 2007 Annual Report on Form 10-K.

2. NEW ACCOUNTING PRONOUNCEMENTS

In September 2005, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (AcSEC) issued Statement of Position 05-1 (SOP 05-1), "*Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts*". SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance contracts other than those specifically described in Statement of Financial Accounting Standards (SFAS) No. 97, "*Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*". SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights, or coverages that occurs by exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. SOP 05-1 became effective for internal replacements occurring in fiscal years beginning after December 31, 2006. Retrospective application of SOP 05-1 to previously issued consolidated financial statements was not permitted. SOP 05-1 was adopted on January 1, 2007, with no material impact to the unaudited interim consolidated financial statements.

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation 48 "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 applies to all uncertain tax positions accounted for under SFAS No. 109 "Accounting for Income Taxes". FIN 48 addresses whether tax positions taken or to be taken on tax returns should be reflected in the financial statements before they are resolved with the appropriate taxing authority.

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited)-Continued

Previous statements provided no specific guidance related to such positions. FIN 48 was adopted on January 1, 2007, with no material impact to the unaudited interim consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. SFAS 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and established a fair value hierarchy with the highest priority being the quoted price in active markets. SFAS 157 amended SFAS 107, "Disclosure about Fair Value of Financial Instruments." This statement became effective for years beginning after November 15, 2007. The Company adopted SFAS 157 on January 1, 2008 with no material impact to the unaudited interim consolidated financial statements. Please see Note 3 – Fair Values for added disclosures pertaining to SFAS 157.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115" (SFAS 159). SFAS 159 permits an entity to measure certain financial assets and liabilities at fair value. Under SFAS 159, entities that elect the fair value option will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option may be elected on an instrument-by-instrument basis, with a few exceptions, as long as it is applied to the instrument in its entirety. Once adopted, the fair value option election is irrevocable, unless a new election date occurs. This statement became effective for years beginning after November 15, 2007. Upon the adoption of SFAS 159, the Company was also required to adopt SFAS 157 concurrently. The Company adopted SFAS 159 on January 1, 2008 with no material impact to the unaudited interim consolidated financial statements. Please see Note 3 – Fair Values for additional information pertaining to SFAS 159.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" (SFAS 161). This statement amends and expands the disclosure requirements of Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS 161 requires companies with derivative instruments to disclose information about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under Statement 133, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This statement shall be effective for financial statements issued for fiscal years beginning after November 15, 2008. The Company is currently evaluating the impact of this statement but does not believe that it will have a material impact on the consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" (SFAS 162). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. This statement shall be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board (PCAOB) amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The Company will adopt SFAS 162 on issuance, but does not believe that it will have a material impact on the consolidated financial statements.

In May 2008, the FASB issued SFAS No. 163, "Accounting for Financial Guarantee Insurance Contracts" (SFAS 163). SFAS 163 clarifies how FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, applies to financial guarantee insurance contracts, including the recognition and measurement of premium revenue and claim liabilities. This statement also requires expanded disclosures about financial guarantee insurance contracts. This statement shall be effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company has evaluated the impact of the implementation of SFAS 163 and believes that the statement is not applicable to the

Company as it does not sell financial guarantee insurance.

All other Standards and Interpretations of those Standards issued during the six months ended June 30, 2008 did not relate to accounting policies and procedures pertinent to the Company at this time.

3. FAIR VALUES

Fair Values Hierarchy

Effective January 1, 2008, in accordance with SFAS 159, the Company elected to not measure financial assets and liabilities at fair value other than those already prescribed, such as securities available for sale, securities identified in trading portfolios and certain derivatives and hedging activity that the Company participates in.

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited)-Continued

In accordance with SFAS 157, 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. Level 1 assets include U. S. Treasury Notes and Bonds, other U. S. Government securities and certain agency securities that are traded by dealers or brokers in active markets.

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 use of option pricing models, discounted cash flow models, spread-based models, and similar techniques, using the best information available in the circumstances.

Determination of Fair value

Under SFAS 157, the Company bases fair values on the price that would be received to sell an asset (exit price) or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is the Company's policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy in SFAS 157.

Fair value measurements for assets and liabilities where there exists limited or no observable market data, are often 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.

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 in accordance with SFAS 107.

Assets

Securities Available for Sale

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors, such as credit loss and liquidity assumptions.

Short-Term Financial Assets

Short-term financial assets include cash 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 SFAS 107 disclosure purposes.

The fair value estimates of mortgage loans and policy loans are calculated by discounting contractual cash flows using discount rates that are estimates of current pricing for loans with similar characteristics and remaining maturity.

Fair values of mortgage loans on real estate properties are calculated by discounting contractual cash flows, adjusted for prepayment and credit loss estimates, 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 and repricing characteristics.

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited)-Continued

The Company also has loans made to policyholders. These loans cannot exceed the cash surrender value of the policy. Fair value is calculated by discounting contractual cash flows, using discount rates based on the Company's estimate of appropriate risk-adjusted discount rates for these loans.

*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 historical cost. 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. In accordance with SFAS 107, the fair values of deposits with no stated maturity are equal to the amount payable on demand at the measurement date.

Notes Payable

All of the amounts included within Notes Payable were in short-term borrowings at June 30, 2008 and December 31, 2007. The carrying amount of these borrowings was a reasonable estimate of fair value because of the relatively short time between the origination of the borrowings and their expected repayment and maturities. See Note 6 -Notes Payable for an explanation of the terms of the debt outstanding.

Categories Reported at Fair Value

The following table presents categories reported at fair value on a recurring basis.

	June 30, 2008			
	Total	Level 1	Level 2	Level 3
Fixed maturities and equity securities available for sale	\$ 2,576,035	\$ 12,667	\$ 2,457,196	\$ 106,172
Total	\$ 2,576,035	\$ 12,667	\$ 2,457,196	\$ 106,172
	December 31, 2007			
	Total	Level 1	Level 2	Level 3
Fixed maturities and equity securities available for sale	\$ 2,690,222	\$ 15,110	\$ 2,546,388	\$ 128,724
Total	\$ 2,690,222	\$ 15,110	\$ 2,546,388	\$ 128,724

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited)-Continued

The changes in Level 3 asset and liabilities measured at fair value on a recurring basis for the second quarters and six months ended June 30, 2008 are summarized below:

	Quarter ended June 30 Securities Available For Sale	Six Months ended June 30 Securities Available For Sale
Balance, beginning of period	\$ 115,603	\$ 128,724
Total gains or losses (realized and unrealized)		
Included in earnings	373	374
Included in other comprehensive income	(3,498)	(3,905)
Purchases	—	4,893
Disposals	(13,098)	(25,630)
Transfers in	12,590	12,590
Transfers out	(5,675)	(10,742)
Non-trading activity	(123)	(132)
Balance, end of period	\$ 106,172	\$ 106,172
Net gains (losses) included in net income relating to assets held at June 30, 2008	\$ (2,843)	\$ (3,048)

The table below is a summary of fair value estimates as of June 30, 2008 and December 31, 2007 for financial instruments, as defined by SFAS 107. In accordance with SFAS 107, the Company has not included assets and liabilities that are not financial instruments in this disclosure. The total of the fair value calculations presented do not represent, and should not be construed to represent, the underlying value of the Company.

	June 30, 2008		December 31, 2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investments:				
Fixed maturity and equity securities available for sale	\$ 2,576,035	\$ 2,576,035	\$ 2,690,222	\$ 2,690,222
Mortgage loans	447,057	465,998	450,148	464,211
Policy loans	90,213	90,213	92,803	92,803
Cash and short-term investments	49,444	49,444	48,680	48,680
Liabilities:				
Individual and group annuities	963,659	942,208	987,014	963,626
Notes payable	6,805	6,805	10,400	10,400

Supplementary contracts without life contingencies	64,291	59,582	67,258	67,296
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4. UNREALIZED LOSSES ON SECURITIES

The Company assesses all investments with a greater than 10% decline in fair value and, in general, monitors all security investments as to ongoing risk. These risks are fundamentally evaluated through both a qualitative and quantitative analysis of the issuer. The Company prepares a formal review document no less often than quarterly of all investments with greater than 20% declines in fair value for six months or more, investments that have previously been written down and that remain in an unrealized loss position, and selected investments that have changed significantly from a previous period and that have a decline in fair value greater than 10% of amortized cost.

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited)-Continued

The Company has a policy and process in place to identify securities that could potentially have an impairment that is other-than-temporary. This process involves monitoring market events and other items that could impact issuers. The evaluation includes but is not limited to such factors as the issuer's intent and ability to make all principal and interest payments when due, near-term business prospects, cash flow and liquidity, credit ratings, business climate, management changes and litigation and government actions. This process also involves monitoring several factors including late payments, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections, as indicators of credit issues.

The Company considers relevant facts and circumstances in evaluating whether the impairment of a security is other-than-temporary. Relevant facts and circumstances considered include but are not limited to: (1) the current fair value of the security as compared to cost, (2) the extent and the length of time the fair value has been below cost, (3) the financial position of the issuer, including the current and future impact of any specific events, material declines in the issuer's revenues, margins, cash positions, liquidity issues, debt levels and income results, (4) consideration of information or evidence that supports timely recovery, and (5) other business factors related to the issuer's industry.

There are a number of significant risks and uncertainties inherent in the process of monitoring impairments and determining if an impairment is other-than-temporary. These risks and uncertainties include but are not limited to: (1) the risk that the Company's assessment of an issuer's ability to meet all of its contractual obligations will change based on changes in the credit characteristics of that issuer, (2) the risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated, (3) the risk that fraudulent information could be provided to the Company's credit, investment and accounting professionals who determine the fair value estimates and accounting treatment for securities, and (4) the risk that new information obtained by the Company or changes in other facts and circumstances lead the Company to change its intent to hold the security to maturity or until it recovers in value. Any of these situations could result in a charge to income in a future period. If the Company determines that a security is other-than-temporarily impaired, the difference between amortized cost and fair value would be charged to income as a realized investment loss, resulting in a permanent reduction to the cost basis of the underlying investment.

As of June 30, 2008, the Company had gross unrealized losses of \$108.4 million on investment securities, including fixed maturity and equity securities that had a fair value of \$1.5 billion. As of December 31, 2007, the Company had gross unrealized losses of \$47.0 million on investment securities, including fixed maturity and equity securities that had a fair value of \$1.3 billion. The increase in unrealized losses was primarily attributable to increased credit and liquidity risk discounts in the pricing of financial assets during the six months ended June 30, 2008. Although these changes affected the broad financial markets, specific sectors, security issuers and security issues were affected differently.

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited)-Continued

The following table provides information regarding unrealized losses on fixed maturity and equity security investment securities available for sale, as of June 30, 2008.

	Investment securities with unrealized losses					
	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	<u>Fair</u>	<u>Unrealized</u>	<u>Fair</u>	<u>Unrealized</u>	<u>Fair</u>	<u>Unrealized</u>
<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	
Bonds:						
U.S. Treasury securities and obligations of U.S. Government Federal agencies ¹	\$ 10,454	\$ 331	\$ 9,609	\$ 240	\$ 20,063	\$ 571
Federal agency issued mortgage-backed securities ¹	22,636	210	—	—	22,636	210
Subtotal	87,433	1,066	62,487	1,709	149,920	2,775
Corporate obligations:	120,523	1,607	72,096	1,949	192,619	3,556
Industrial	106,997	2,567	69,553	6,482	176,550	9,049
Energy	73,173	1,969	17,979	1,270	91,152	3,239
Technology	6,244	212	8,002	673	14,246	885
Communications	21,952	981	14,517	1,200	36,469	2,181
Financial	183,837	16,250	96,834	15,165	280,671	31,415
Consumer	120,886	3,813	65,497	5,721	186,383	9,534
Public utilities	80,209	1,978	13,101	875	93,310	2,853
Total corporate obligations	593,298	27,770	285,483	31,386	878,781	59,156
Corporate private-labeled mortgage-backed securities	141,293	12,958	98,229	12,934	239,522	25,892
Other	99,999	5,587	69,811	10,200	169,810	15,787
Redeemable preferred stocks	14,245	836	—	—	14,245	836
Fixed maturity securities	969,358	48,758	525,619	56,469	1,494,977	105,227
Equity securities	12,023	1,102	9,572	2,024	21,595	3,126
Total	\$ 981,381	\$ 49,860	\$ 535,191	\$ 58,493	\$ 1,516,572	\$ 108,353

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

All securities in the table are expected to continue to perform to the contractual terms, which may be at maturity.

5. COMPREHENSIVE INCOME (LOSS)

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Comprehensive loss for the second quarter of 2008, was \$34.9 million, which consisted of net income of \$1.7 million and other comprehensive loss of \$36.6 million. The increase in other comprehensive loss was largely due to an increase in unrealized losses, which was primarily attributable to increased credit and liquidity risk discounts in the pricing of financial assets during the quarter ended June 30, 2008. Although these changes affected the broad financial markets, specific sectors, security issuers and security issues were affected differently. Comprehensive loss for the second quarter of 2007, was \$17.0 million, which consisted of net income of \$11.8 million and other comprehensive loss of \$28.8 million. The other comprehensive loss of \$28.8 million was due primarily to a decrease in unrealized investment gains as a result of an increase in interest rates and increased credit and liquidity concerns that negatively affected the broad market during the quarter.

Comprehensive loss was \$46.1 million for the six months ended June 30, 2008, which consisted of net income of \$5.3 million and other comprehensive loss of \$51.4 million. Comprehensive loss was \$1.0 million for the six months ended June 30, 2007, which consisted of net income of \$20.1 million and other comprehensive loss of \$21.1 million. The change in other comprehensive loss in 2008 versus 2007 was due primarily to an increase in unrealized losses, primarily attributable to increased credit and liquidity risk discounts in the pricing of financial assets.

Kansas City Life Insurance Company**Notes to Consolidated Financial Statements (Unaudited)-Continued****6. NOTES PAYABLE**

The following table provides information for Notes Payable.

	June 30 2008	December 31 2007
Federal Home Loan Bank (FHLB) loans with various maturities and a weighted average interest rate, currently 2.40% , (4.87% at December 31, 2007) secured by mortgage-backed securities totaling \$128,414 (\$135,355 at December 31, 2007).	\$ 6,805	\$ 10,400
	\$ 6,805	\$ 10,400

As a member of the FHLB with a capital investment of \$5.5 million, the Company has the ability to borrow on a collateralized basis from the FHLB. The Company received dividends of \$95 in the second quarter of 2008 and \$202 in the six months on the capital investment in the FHLB.

The Company has unsecured revolving lines of credit of \$60.0 million with two major commercial banks with no balances outstanding and which are at variable interest rates, currently 2.70%. Both lines of credit will expire during 2008, and it is expected that the Company will renew these facilities at then-current market conditions.

All borrowings are used to enhance liquidity and investment strategies. Notes payable of \$6.8 million mature and are due in 2008.

7. INCOME PER SHARE

Due to the Company's capital structure and the absence of other potentially dilutive securities, there is no difference between basic and diluted earnings per common share for any of the periods reported. The average number of shares outstanding was 11,585,643 and 11,858,378 for the quarters ended June 30, 2008 and 2007, respectively. The average number of shares outstanding was 11,649,642 and 11,856,947 for the six months ended June 30, 2008 and 2007, respectively.

8. INCOME TAXES

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The second quarter income tax expense was \$0.6 million or 25% of income before tax for 2008, versus \$4.8 million or 29% of income before tax for the prior year period. The income tax expense for the six months ended June 30, 2008 was \$2.6 million or 33% of income before tax for 2008, versus \$8.7 million or 30% of income before tax for the prior year period.

The effective income tax rate in the second quarter of 2008 was lower than the prevailing corporate federal income tax rate of 35% primarily due to a change in projected effective tax rate, the dividend received deduction and other permanent deductions. The primary reason for the change in the projected effective tax rate was a revision to the projected income estimate for the year ending December 31, 2008. This estimate of earnings is one part of the income tax expense calculation for each reporting period. This determination resulted in a lower projected effective tax rate for the year, which reduced income tax expense for the second quarter. The impact of the change in projected effective tax rate was a benefit of approximately 6% of income before tax. The impact of the dividends received deduction and other permanent differences were a benefit of approximately 4% of income before tax.

The effective income tax rate in the six months ended June 30, 2008 was lower than the prevailing corporate federal income tax rate of 35% primarily due to the dividends received deduction and other permanent differences. The impact of the dividends received deduction and other permanent differences were 2% of income before tax.

The effective income tax rate in the second quarter and six months ended June 30, 2007 was lower than the prevailing corporate federal income tax rate of 35% primarily due to income tax credits generated from the Company's investments in affordable housing. The effect of the affordable housing tax credits on the effective tax rate in the second quarter and six months ended June 30, 2007 was a benefit of approximately 2% of income before tax.

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited)-Continued

9. SEGMENT INFORMATION

The Company has three reportable business segments, which are defined based on the nature of the products and services offered: Individual Insurance, Group Insurance and Old American. The Individual Insurance segment consists of individual insurance products for both Kansas City Life and Sunset Life. The Individual Insurance segment is marketed through a nationwide sales force of independent general agents. The Group Insurance segment consists of sales of group life, dental, vision and disability products. This segment is marketed through a nationwide sales force of independent general agents, group brokers and third-party marketing arrangements. Old American consists of individual insurance products designed primarily as final expense products. These products are marketed through a nationwide general agency sales force with exclusive territories, using direct response marketing to supply agents with leads.

Separate investment portfolios are maintained for each of the three life insurance companies of the Company. However, investment assets and income are allocated to the Group Insurance segment based upon its cash flows and future policy benefit liabilities. Home office functions are fully integrated for all segments in order to maximize economies of scale. Therefore, operating expenses are allocated to the segments based upon internal cost studies, which are consistent with industry cost methodologies.

Inter-segment revenues are not material. The Company operates in the United States and no individual customer accounts for 10% or more of the Company's revenue.

The following schedule provides the financial performance of each of the three reportable operating segments of the Company.

		Individual Insurance	Group Insurance	Old American	Intercompany Eliminations¹	Total
Insurance revenues:						
Second quarter:	2008	\$ 31,134	\$ 12,114	\$ 15,342	\$ (147) \$ 58,443
	2007	30,513	11,395	15,661	(150) 57,419
Six months:	2008	\$ 63,170	\$ 23,967	\$ 30,729	\$ (296) \$ 117,570
	2007	61,953	22,794	31,375	(301) 115,821
Net investment income:						
Second quarter:	2008	\$ 42,258	\$ 134	\$ 3,224	\$ —	\$ 45,616
	2007	45,216	122	3,333	—	48,671
Six months:	2008	\$ 85,336	\$ 255	\$ 6,488	\$ —	\$ 92,079
	2007	88,920	187	6,648	—	95,755
Net income (loss):						
Second quarter:	2008	\$ 2,045	\$ (1,208) \$ 840	\$ —	\$ 1,677

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	2007	10,406	(369) 1,775	—	11,812
Six months:	2008	\$5,807	\$(1,079) \$551	\$ —	\$5,279
	2007	18,433	(561) 2,246	—	20,118

¹ Elimination entries to remove intercompany transactions for life and accident and health insurance were as follows: insurance revenues from the Group Insurance segment and operating expenses from the Individual Insurance segment were eliminated to arrive at Consolidated Statements of Income.

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited)-Continued

10. PENSIONS AND OTHER POSTRETIREMENT BENEFITS

Components of net periodic benefit cost:

	Pension Benefits		Other Benefits	
	Quarter ended		Quarter ended	
	June 30		June 30	
	2008	2007	2008	2007
Service cost	\$ 602	\$ 563	\$ 194	\$ 204
Interest cost	1,942	1,856	349	327
Expected return on plan assets	(2,465)	(2,133)	(13)	(13)
Amortization of:				
Unrecognized actuarial loss	600	750	43	29
Unrecognized prior service cost	(169)	(161)	(93)	(95)
Net periodic benefit cost	\$ 510	\$ 875	\$ 480	\$ 452

	Pension Benefits		Other Benefits	
	Six Months ended		Six Months ended	
	June 30		June 30	
	2008	2007	2008	2007
Service cost	\$ 1,180	\$ 1,127	\$ 391	\$ 408
Interest cost	3,804	3,712	705	654
Expected return on plan assets	(4,829)	(4,265)	(26)	(27)
Amortization of:				
Unrecognized actuarial loss	1,176	1,499	87	57
Unrecognized prior service cost	(331)	(323)	(188)	(189)
Net periodic benefit cost	\$ 1,000	\$ 1,750	\$ 969	\$ 903

11. SHARE-BASED PAYMENT

The Company has a long-term incentive plan for senior management that awards participants for the increase in the share price of the Company's common stock through units (phantom shares) assigned by the Board of Directors. The awards are calculated over three-year intervals on a calendar year basis. At the conclusion of each three-year interval, participants will receive awards based on the increase in the share price during a defined measurement period, times the number of units. The increase in the share price will be determined based on the change in the share price from the beginning to the end of the three-year interval. Dividends are accrued and paid at the end of each three-year interval to the extent that they exceed negative stock price appreciation. Plan payments are contingent on the continued employment of the participant unless termination is due to a qualifying event such as death, disability or retirement.

The plan made a payment of \$0.1 million to plan participants for the three-year interval ended December 31, 2007 during the first six months of 2008. A payment of \$1.0 million was made in the first six months of 2007. No payments were made in the second quarters of 2008 or 2007. At each reporting period, an estimate of the share-based compensation expense is accrued, utilizing the share price at the period end. The cost of compensation accrued as an operating expense was \$106 and \$173 in the second quarters of 2008 and 2007, respectively. The associated tax benefits for those periods were \$37 and \$61, respectively.

The cost of compensation accrued as an operating expense for the six-month period ending June 30, 2008 was \$350, with an associated tax benefit of \$123. The cost of compensation credited as an operating expense for the six-month period ending June 30, 2007 was \$165, with an associated tax expense of \$58.

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited)-Continued

12. COMMITMENTS

In the normal course of business, the Company has open purchase and sale commitments. At June 30, 2008, the Company had purchase commitments to fund mortgage loans and other investments of \$10.4 million. Subsequent to June 30, 2008, the Company entered into commitments to fund additional mortgage loans of \$0.6 million.

13. CONTINGENT LIABILITIES

The life insurance industry, including the Company, has been subject to an increase in litigation in recent years. Such litigation has been pursued on behalf of purported classes of policyholders and other claims and legal actions in jurisdictions where juries often award punitive damages, which are grossly disproportionate to actual damages.

Although no assurances can be given and no determinations can be made at this time, management believes that the ultimate liability, if any, with respect to these claims and actions, would have no material effect on the Company's business, results of operations or financial position.

14. GUARANTEES AND INDEMNIFICATIONS

The Company is subject to various indemnification obligations issued in conjunction with certain transactions, primarily assumption reinsurance agreements, stock purchase agreements, mortgage servicing agreements, construction and lease guarantees and borrowing agreements whose terms range in duration and often are not explicitly defined. Generally, a maximum obligation is not explicitly stated. Therefore, the overall maximum amount of the obligation under the indemnifications cannot be reasonably estimated. While we are unable to estimate with certainty the ultimate legal and financial liability with respect to these indemnifications, we believe the likelihood is remote that material payments would be required under such indemnifications. The Company believes that such indemnifications would not result in a material adverse effect on the financial position or results of operations.

Kansas City Life Insurance Company

Notes to Consolidated Financial Statements (Unaudited)-Continued

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Except as otherwise noted, amounts are stated in thousands, except share data.

Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to provide in narrative form the perspective of the management of Kansas City Life Insurance Company (the Company) on its financial condition, results of operations, liquidity and certain other factors that may affect its future results. The following is a discussion and analysis of the results of operations for the six months ended June 30, 2008 and 2007 and the financial condition of the Company as of June 30, 2008. This discussion should be read in conjunction with the consolidated financial statements and accompanying notes included in this document, as well as the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

Overview

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

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

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

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

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The Company operates in the life insurance sector of the financial services industry in the United States. This industry is highly competitive with respect to pricing, selection of products and quality of service. No single competitor or any small group of competitors dominate any of the markets in which the Company operates. General economic conditions may affect future results. Interim results are not necessarily indicative of results for the entire year and should be read in conjunction with the Company's 2007 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission.

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

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

- The sales of life, annuity, and accident and health products;
- The rate of morbidity, disability and incurrence of other policyholder benefits;
- The effectiveness of reinsurance programs;
- The amount of investment assets under management;
- Investment spreads earned on policyholder account balances;
- The ability to maximize investment returns and minimize risks such as interest rate risk, credit risk and equity risk;
- The rate of mortality, lapse and surrenders of future policy benefits and policyholder account balances;
- Interest rates credited to policyholders;
- Timely and cost-effective access to liquidity;
- Management of distribution costs and operating expenses;
- Persistency of existing insurance policies.

Strong competition presents a challenge from a new sales perspective. However, the Company's continued focus is on delivering competitive products, superior customer service, financial strength and superior sales and marketing support to customers and agents. The Company places an emphasis on expanding sales of individual life insurance products.

The Company generates cash largely through premiums and deposits collected through the sale of insurance products, through the sale of universal life-type and deposit-type products and through investment activity. The principal uses of cash are for the insurance operations, including the purchase of investments, payment of insurance benefits, operating expenses, dividends, income taxes, withdrawals from policyholder accounts and costs related to acquiring new business.

Starting in 2007 and continuing into 2008, negative market conditions have significantly impacted the financial markets and accordingly, the Company's investments and revenues. The interest rate and credit environment continues to present a significant challenge to the markets as a whole and specifically to companies invested in fixed maturity and equity securities. These negative conditions may persist into the future as the credit and equity markets continue to be severely challenged, particularly in the financial services sector. Nevertheless, the Company is broadly diversified and has high quality investments, as 94% of all fixed maturity securities were investment grade at June 30, 2008.

The largest factor in net income being lower for the second quarter of 2008 compared to the second quarter of 2007 was realized investment losses. The Company had a net realized loss of \$8.4 million in the second quarter of 2008 compared to a small investment gain in the second quarter of 2007. In the second quarter of 2008, write-downs of investments due to the recognition of other-than-temporary impairments totaled \$10.2 million. There were no investments written down for other-than-temporary impairments during the second quarter of 2007. The decline in net income for the first half of 2008 compared to the first half of 2007 was primarily due to realized investment losses. The Company had a net realized loss of \$8.3 million in the first six months of 2008 compared to a \$5.2 million net gain in the same period in 2007. Write-downs of other-than-temporarily impaired investments totaled \$10.2 million, for the first six months of 2008, while no investments were written down during the first six months of 2007.

Significant Risks

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The Company is subjected to a variety of risk factors that may affect current and future results. Risk factors and cautionary factors that may affect future results were identified in Item 1A. of the Company's 2007 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission. Please refer to the Company's 2007 Form 10-K at Company's website www.kclife.com. Risk factors that are specifically pertinent to the current-period financial statements are listed below.

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

The Company's invested assets, primarily including fixed income securities, are subject to customary risks of credit defaults and changes in market values.

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

The Company's financial results may fluctuate from period to period due to fluctuations in policy claims incurred by the Company. However, the Company reinsures a significant amount of the mortality risk on fully underwritten and newly issued, individual life insurance contracts.

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

In the conduct of business, the Company makes certain assumptions regarding the mortality, persistency, expenses, interest rates, tax liability, business mix, or other factors appropriate to the type of business it expects to experience in future periods. These assumptions are also used to estimate the amounts of deferred policy acquisition costs, policy reserves and accruals, future earnings, and various components of the Company's balance sheet.

Cautionary Statement on Forward-Looking Information

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

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

- Changes in general economic conditions, including the performance of financial markets and interest rates;
- Increasing competition and changes in customer behavior, which may affect the Company's ability to sell its products and retain business;
- Customer and agent response to new products, distribution channels and marketing initiatives;

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- Fluctuations in experience regarding current mortality, morbidity, persistency and interest rates relative to expected amounts used in pricing the Company's products;
- Changes in assumptions related to deferred acquisition costs and the value of business acquired;
- Regulatory, accounting or tax changes that may affect the cost of, or the demand for, the Company's products or services;
- Unanticipated changes in industry trends and ratings assigned by nationally recognized rating organizations.

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

Consolidated Results of Operations

Summary of Results

The Company's net income decreased \$10.1 million or 86% in the second quarter of 2008, versus the same quarter in the prior year, to a total of \$1.7 million. Net income per share decreased \$0.86 or 86% and was \$0.14 per share versus \$1.00 per share in last year's second quarter. Net income for the six months decreased \$14.8 million or 74% compared to last year to total \$5.3 million. Net income per share decreased \$1.25 or 74% and was \$0.45 per share.

The decline in the second quarter results can be attributed to several factors. The largest contributor to the decline was realized investment losses, which totaled \$8.4 million in 2008 versus a small realized investment gain in 2007. Policyholder benefits increased \$4.6 million or 11% versus a year ago and net investment income decreased \$3.1 million or 6%. Partially offsetting these factors, total insurance revenues increased \$1.0 million or 2%, interest credited to policyholder account balances decreased \$1.1 million or 5% and operating expenses decreased \$1.3 million or 6%.

The decline in net income for the six months largely resulted from a \$13.5 million decline in realized investment gains versus a year ago. The Company had a net realized investment loss of \$8.3 million in 2008 versus a net realized investment gain of \$5.2 million in 2007. Net investment income decreased \$3.7 million or 4% and policyholder benefits increased \$6.1 million or 7%. These were partially offset by a \$1.7 million or 2% increase in total insurance revenues and a \$2.1 million or 5% decrease in interest credited to policyholder account balances.

Sales

The Company measures sales in terms of new premiums and deposits. Premiums are included in insurance revenues in the Consolidated Statements of Income (Unaudited), while deposits are shown as a Financing Activity in the Consolidated Statements of Cash Flows (Unaudited). The first set of tables below reconciles premiums included in insurance revenues and provides detail by new and renewal business. New premiums are also detailed by product. The second set of tables reconciles deposits with the Consolidated Statements of Cash Flows (Unaudited) and provides detail by new and renewal deposits. New deposits are also detailed by product.

The Company's marketing plan has been to focus its primary growth strategies on individual life insurance business in both the Individual Insurance and Old American segments. This growth strategy includes new premiums for individual life products and new deposits for universal life and variable universal life products. The marketing plan includes strategies to grow the business through its existing sales force and the addition of new agents and general agents. The Company believes that growth in both the number of general agents and agents is essential to this strategy. Accordingly, the Company has placed an emphasis on recruiting new general agents and agents over the past two years. In addition, the growth strategy also encourages a product mix between life products and fixed annuity, immediate annuity and variable annuity products.

The Company also markets a series of group products, as identified in the Group Insurance segment discussed below. These products include group life, dental and disability products. The primary growth strategies for this segment include increased productivity of the existing group representatives and continued expansion of the group distribution system. Further, growth is to be supported by the addition of new products to the portfolio, particularly voluntary-type products which tend to be more profitable.

Consolidated total premiums increased 1% in the second quarter versus the same period in the prior year. Total new premiums increased 16% while total renewal premiums declined 3%. New premiums increased \$1.4 million, largely due to a \$0.8 million increase in immediate annuity premiums. New individual life premiums increased 8%, which includes a 13% increase in new premiums in the Old American segment. New group life premiums increased 62%, and new group accident and health premiums increased 6%. The Company exited the stop loss market during 2006 but continued to process existing business until the stop loss contracts expired in 2007. Excluding this product line from 2007 premiums would result in a 2% increase in total premiums, a 25% increase in total new premiums and a 38% increase in new group accident and health premiums. The increase in new group accident and health premiums was largely due to a 43% increase in group dental premiums.

Total premiums for the six months increased 2% versus last year. Total new premiums increased 23% while total renewal premiums declined 2%. New premiums increased \$3.7 million, largely due to a \$2.8 million increase in immediate annuity premiums. New individual life premiums increased 7%, which includes a 13% increase in new premiums in the Old American segment. New group life premiums increased 63%, and new group accident and health premiums increased 1%. Renewal premiums declined 3% in the second quarter, compared with 2007. This

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decrease was largely the result of a 4% decline in total individual life renewal premiums. Renewal premiums declined 2% in the six months, reflecting a 3% decrease in total individual life renewal premiums. Excluding the stop loss product line from 2007 premiums would result in a 4% increase in total premiums, a 33% increase in total new premiums and a 29% increase in new group accident and health premiums. The increase in new group accident and health premiums was largely due to a 30% increase in group dental premiums.

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	Quarter ended June 30			
	2008	%	2007	%
New premiums:				
Individual life insurance	\$3,258	8	\$ 3,020	(3)
Immediate annuities	3,613	29	2,790	144
Group life insurance	566	62	350	42
Group accident and health insurance	2,872	6	2,710	(4)
Total new premiums	10,309	16	8,870	21
Renewal premiums	35,153	(3)	36,342	(2)
Total premiums	\$45,462	1	\$ 45,212	2

	Six Months ended June 30			
	2008	%	2007	%
New premiums:				
Individual life insurance	\$6,411	7	\$ 5,995	(6)
Immediate annuities	6,588	74	3,782	33
Group life insurance	1,080	63	664	37
Group accident and health insurance	5,484	1	5,406	(4)
Total new premiums	19,563	23	15,847	3
Renewal premiums	70,386	(2)	72,133	(1)
Total premiums	\$89,949	2	\$ 87,980	—

Total new deposits were flat in the second quarter and increased 2% in the six months compared with the prior year. New universal life sales decreased 13% in both the second quarter and six months. New variable universal life sales decreased 2% in the second quarter and 28% in the six months. While new fixed deferred annuities increased 4% in the second quarter, they decreased 5% for the six months. These declines can largely be attributed to three factors: the economic environment, increased competition, and the continued impact of alternative products in the marketplace. Offsetting these declines, new variable annuity deposits increased 2% in the second quarter and 17% or \$2.2 million in the six months. Sales of variable annuity deposits were aided by the addition of the guaranteed minimum withdrawal benefit rider that was introduced by the Company in the second half of 2007. Renewal deposits declined 2% in the second quarter and 8% in the six months. For the second quarter, renewal universal life, variable universal life, and fixed deferred annuity deposits declined, while variable annuity deposits increased. For the six months, renewal universal life, variable universal life and variable annuity deposits decreased while fixed deferred annuity deposits increased.

	Quarter ended June 30			
	2008	%	2007	%
New deposits:				
Universal life insurance	\$2,346	(13)	\$2,684	11
Variable universal life insurance	505	(2)	513	(18)
Fixed deferred annuities	5,885	4	5,672	(36)
Variable annuities	7,302	2	7,173	61
Total new deposits	16,038	—	16,042	(2)
Renewal deposits	33,679	(2)	34,204	(2)
Total deposits	\$49,717	(1)	\$50,246	(2)

	Six Months ended June 30			
	2008	%	2007	%
New deposits:				
Universal life insurance	\$4,741	(13)	\$5,435	13
Variable universal life insurance	1,009	(28)	1,397	2
Fixed deferred annuities	11,435	(5)	12,000	(21)
Variable annuities	15,011	17	12,806	36
Total new deposits	32,196	2	31,638	3
Renewal deposits	66,183	(8)	71,592	(1)
Total deposits	\$98,379	(5)	\$103,230	—

Insurance Revenues

Insurance revenues consist of premiums and contract charges less reinsurance ceded. In the second quarter of 2008, total insurance revenues increased 2% as premiums increased 1%, reinsurance ceded declined 5% and contract charges were flat. Total annuity premiums increased 30% while total individual life premiums decreased 2% and total accident and health premiums decreased 1%. Total group life premiums increased 5%, while total individual life premiums from the Individual Insurance segment and the Old American segment both declined 2%. For the six months, total insurance revenues increased 2% as total premiums increased 2%, reinsurance ceded decreased 4% and contract charges declined 2%. Total annuity premiums rose 74% while total individual life and total accident and health premiums both declined by 1%. Total group life premiums increased 8%, while total individual life premiums from the Individual Insurance segment declined 1% and total individual life premiums from the Old American segment declined 2%.

Total contract charges were flat for the second quarter and declined 2% in the six months. Two components within contract charges had significant fluctuations in the periods presented. First, as identified in previous reports, expense loads were corrected by \$1.7 million for the portion representing unearned revenues in the second quarter of 2007, of which \$1.4 million was attributable to earlier periods. There was no similar adjustment to expense loads during 2008. Second, deferred revenue declined significantly in both the second quarter and six months compared to a year ago. Certain contract charges for universal life insurance are not recognized in income immediately but are deferred as unearned revenues and are amortized into income in a manner similar to the amortization of deferred acquisitions costs (DAC). These contract charges, which are recorded as unearned revenues, are recognized into income in proportion to the expected future gross profits of the business. In the same manner as DAC, profit expectations are based upon assumptions of future interest margins, mortality margins, expense margins and policy and premium persistency experience. At least annually, a review is performed of the assumptions related to profit expectations. If it is determined that the assumptions should be revised, the impact is recorded as a change in the revenue reported in the current periods as an unlocking adjustment. As a result of the unlocking in the second quarter of 2008, front-end load liabilities increased, which resulted in a reduction in deferred revenue. There was no significant unlocking related to the front-end load liabilities during 2007.

Reinsurance ceded decreased 5% in the second quarter and 4% in the six months. Reinsurance ceded on group products declined, largely due to the elimination of the stop loss business. Reinsurance ceded also declined in the Old American segment, reflecting the runoff of a large closed block of reinsured business.

Investment Revenues

Net investment income declined 6% in the second quarter and 4% in the six months compared with the same periods one year ago. Net investment income results are primarily impacted by changes in the Company's invested asset base and yields available on the portfolio. In addition, expenses associated with investment income also impact results.

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Gross investment income in the second quarter declined \$2.3 million compared with the same period in 2007. This decrease primarily resulted from a \$1.4 million decline in gross investment income on reduced investment assets and a \$0.9 million decline from lower investment yields. The decline in yields includes reductions due to lower rate resets of floating rate notes, maturities and calls on securities with yields greater than the portfolio average and reduced returns on non-fixed-maturity investments.

Gross investment income in the six months declined \$3.2 million compared with a year ago. This decrease primarily resulted from a \$3.0 million decline in gross investment income on reduced investment assets. Gross investment income decreased \$0.2 million as a result of decreased yields.

Investment expenses increased 42% for the second quarter and 9% for the six months. The increase in the second quarter was largely due to an increase in real estate investment expenses. The increase for the six months was largely the result of a \$0.6 million increase in interest on short-term borrowed money. The Company has an investment in the Federal Home Loan Bank from which it is allowed to borrow money at favorable interest rates. The Company periodically borrows and subsequently reinvests these proceeds in higher-yielding investments. The Company had increased its borrowings during the first quarter of 2008 and subsequently reduced these borrowings during the second quarter.

The Company recorded net realized investment losses of \$8.4 million in the second quarter of 2008 compared with a small investment gain in the second quarter of 2007. Investment losses of \$10.2 million were due to write-downs of certain investment securities that were considered other-than-temporarily impaired. These were partially offset by \$0.6 million of investment gains realized on the sale of real estate and \$0.6 million of investment gains realized on securities called. The financial sector has been hit hard by economic pressures and sub-prime residential mortgage issues. These pressures have resulted in large price dislocations that have affected many securities and companies in the financial sector.

Realized investment losses for the six months totaled \$8.3 million in 2008 compared to \$5.2 million in realized investment gains in 2007. Investment losses of \$10.2 million were due to write-downs of investment securities. These were partially offset by \$0.6 million of investment gains realized on the sale of real estate, \$0.8 million of investment gains realized on securities called and \$0.4 million of investment gains realized on the sale of securities. The realized investment gain reported in the six months of 2007 was largely due to the sale of real estate properties, which generated realized investment gains of \$3.5 million, \$1.9 million gain from the sale of Generations Bank and \$0.7 million in gains realized on investment securities called. Partially offsetting these gains, \$0.9 million of losses were realized on the sale of investment securities.

The Company's analysis of securities for the quarter ended June 30, 2008 resulted in the determination that seven fixed-maturity securities had other-than-temporary impairments. These securities were written down by a combined \$10.2 million in the second quarter. The total fair value of the affected securities after the write-downs was \$16.8 million. Three of the securities were written down by a total of \$3.3 million, primarily as a result of declines in price and rating agency downgrades on debt issues from issuers that have recently completed leveraged buyout (LBO) transactions. These LBO transactions greatly increased the debt level of each issuer. One of these securities had been written down previously, and the other two securities were below cost by 20% or more for at least six consecutive months. Two securities were collateralized debt obligations (CDOs) and were written down by \$2.8 million, primarily due to price declines that had persisted for periods longer than the Company considered temporary. Both securities were below cost by 20% or more for at least six consecutive months. One security was written down by \$3.3 million due to combination of a decline in price that had persisted for a period longer than the Company considered temporary, rating agency downgrades and a debt restructuring during the quarter. The final security was written down by \$0.8 million due to a combination of a decline in price that had persisted for a period longer than the Company considered temporary and a further deterioration in fair value during the second quarter of 2008.

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The following table provides detail concerning realized investment gains and losses for the second quarters of 2008 and 2007.

	Quarter ended		Six Months ended	
	June 30		June 30	
Realized Investment Gains and Losses	2008	2007	2008	2007
Gross gains resulting from:				
Sales of investment securities	\$ —	\$ 21	\$ 362	\$ 24
Investment securities called	647	5	836	723
Sales of real estate	562	150	576	3,490
Sale of Generations Bank	—	—	—	1,904
Other investment gains	—	—	1	—
Total gross gains	1,209	176	1,775	6,141
Gross losses resulting from:				
Sales of investment securities	(3)	(137)	(448)	(887)
Other-than-temporarily impaired write-downs of investment securities	(10,225)	—	(10,225)	—
Investment securities called	—	(16)	—	(49)
Other investment losses	—	—	—	—
Total gross losses	(10,228)	(153)	(10,673)	(936)
Amortization of DAC and VOBA	610	15	609	(43)
Realized investment gains (losses)	\$ (8,409)	\$ 38	\$ (8,289)	\$ 5,162

Investment Accounting Policy and Analysis of Investments

The Company seeks to protect policyholders' benefits by optimizing risk and return on an ongoing basis through managing asset and liability cashflows, monitoring credit risk, avoiding high levels of investments that may be redeemed by the issuer, maintaining sufficiently liquid investments and avoiding undue asset concentrations through diversification, among other things. The Company has three primary sources of investment risk:

- Credit risk, relating to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest;
- Interest rate risk, relating to the market price and/or cash flow associated with changes in market yield and curves; and
- Equity risk, relating to the adverse fluctuations in a particular equity position.

The Company's ability to manage these risks is essential to the success of the Company. In particular, the Company devotes considerable resources to the credit analysis of each new investment and the ongoing credit positions. Credit risk is managed primarily through industry, issuer, structure and asset diversification. In addition, the Company's Investment Committee is appointed by the Board of Directors and is responsible for establishing investment policies and approving or authorizing all investments.

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The following table provides information regarding fixed maturities by sector as of June 30, 2008.

	Total Carrying Value	Carrying Value of Securities with Gross Unrealized Gains	Gross Unrealized Gains	Carrying Value of Securities with Gross Unrealized Losses	Gross Unrealized Losses
Bonds:					
U.S. Treasury securities and obligations of U.S. Government Federal agencies ¹	\$ 69,579	\$ 49,516	\$ 1,582	\$ 20,063	\$ 571
Federal agency issued mortgage-backed securities ¹	75,638	53,002	1,011	22,636	210
Subtotal	210,434	60,514	1,140	149,920	2,775
Corporate obligations:	355,651	163,032	3,733	192,619	3,556
Industrial	393,337	216,787	6,884	176,550	9,049
Energy	211,687	120,535	6,999	91,152	3,239
Technology	34,286	20,040	887	14,246	885
Communications	82,370	45,901	1,566	36,469	2,181
Financial	396,207	115,536	3,144	280,671	31,415
Consumer	290,576	104,193	3,727	186,383	9,534
Public utilities	229,917	136,607	7,741	93,310	2,853
Total corporate obligations	1,638,380	759,599	30,948	878,781	59,156
Corporate private-labeled mortgage-backed securities	256,180	16,658	286	239,522	25,892
Other	252,937	83,127	532	169,810	15,787
Redeemable preferred stocks	14,245	—	—	14,245	836
Fixed maturity securities	\$ 2,517,393	\$ 1,022,416	\$ 35,499	\$ 1,494,977	\$ 105,227

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

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The following table provides information regarding fixed maturities by sector as of December 31, 2007.

	Total Carrying Value	Carrying Value of Securities with Gross Unrealized Gains	Gross Unrealized Gains	Carrying Value of Securities with Gross Unrealized Losses	Gross Unrealized Losses
Bonds:					
U.S. Treasury securities and obligations of U.S. Government Federal agencies ¹	\$ 72,440	\$ 52,853	\$ 1,638	\$ 19,587	\$ 409
Federal agency issued mortgage-backed securities ¹	105,471	93,281	2,527	12,190	113
Subtotal	228,841	62,402	1,047	166,439	2,977
Corporate obligations:	406,752	208,536	5,212	198,216	3,499
Industrial	438,593	276,653	11,209	161,940	6,358
Energy	212,829	157,104	9,883	55,725	946
Technology	37,802	26,902	1,104	10,900	794
Communications	95,004	53,680	2,989	41,324	2,242
Financial	447,863	203,810	6,915	244,053	13,439
Consumer	305,914	161,514	6,752	144,400	5,337
Public utilities	253,141	194,279	11,318	58,862	1,284
Total corporate obligations	1,791,146	1,073,942	50,170	717,204	30,400
Corporate private-labeled mortgage-backed securities	246,205	48,403	590	197,802	4,910
Other	182,043	36,583	1,161	145,460	6,236
Redeemable preferred stocks	4,927	—	—	4,927	124
Fixed maturity securities	\$ 2,631,073	\$ 1,367,464	\$ 57,133	\$ 1,263,609	\$ 45,169

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

At December 31, 2007, the Company had \$45.2 million in gross unrealized losses on fixed maturities which were offset by \$57.1 million in gross unrealized gains. At June 30, 2008, the Company's unrealized losses had increased to \$105.2 million and were partially offset by \$35.5 million in gross unrealized gains. Approximately 56% of the gross unrealized losses at June 30, 2008 were in the category of corporate obligations. The financial sector was the single largest contributor to that category, primarily due to the direct and indirect impact of the troubled residential real estate and mortgage market. In addition, at June 30, 2008, corporate private-labeled mortgage-backed securities, also related to the residential real estate and mortgage industry, accounted for 25% of the gross unrealized losses. This represented an increase from 11% at December 31, 2007.

The following table identifies fixed maturity securities available for sale by rating.

<u>Equivalent S&P Rating</u>	June 30, 2008		December 31, 2007	
	Fair Value	% of Total	Fair Value	% of Total
AAA	\$837,626	33 %	\$885,230	34 %
AA	227,577	9 %	215,383	8 %
A	654,120	26 %	665,713	25 %
BBB	653,490	26 %	703,897	27 %
Total investment grade	2,372,813	94 %	2,470,223	94 %
BB	96,143	4 %	115,493	4 %
Other	48,437	2 %	45,357	2 %
Total below investment grade	144,580	6 %	160,850	6 %
	\$2,517,393	100 %	\$2,631,073	100 %

As of June 30, 2008 and December 31, 2007 94% of all fixed maturity securities were investment grade, reflecting the high quality of securities maintained by the company.

Analysis of Unrealized Losses on Securities

The Company reviews all new security investments, specifically assesses all investments with greater than 10% declines in fair value and, in general, monitors all security investments as to ongoing risk. These risks are fundamentally evaluated through both a qualitative and quantitative analysis of the issuer. The Company also prepares a formal review document no less often than quarterly of all investments with greater than 20% declines in fair value for six months or more, investments that have previously been written down and that remain in an unrealized loss position, and selected investments that have changed significantly from a previous period and that have a decline in fair value greater than 10% of amortized cost.

The Company has a policy and process in place to identify securities that could potentially have an impairment that is other-than-temporary. This process involves monitoring market events and other items that could impact issuers such as:

- Intent and ability to make all principal and interest payments when due
- Near-term business prospects
- Cash flow and liquidity
- Credit ratings
- Business climate
- Management changes
- Litigation and government actions
- Other similar factors

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This process also involves monitoring several factors including late payments, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections, as indicators of credit issues.

All securities are reviewed to determine whether impairments should be recorded. This process includes an assessment of the credit quality of each investment in the entire securities portfolio. Additional reporting and review procedures are conducted for those securities where fair value is less than 90% of amortized cost. Further, detailed analysis is performed for each issue or issues having experienced a formal restructuring or where the security has experienced material deterioration in fair value or where the fair value is less than 80% of amortized cost.

The Company considers relevant facts and circumstances in evaluating whether the impairment of a security is other-than-temporary. Relevant facts and circumstances considered include but are not limited to: (1) the current fair value of the security as compared to cost, (2) the extent and the length of time the fair value has been below cost, (3) the financial position of the issuer, including the current and future impact of any specific events, material declines in the issuer's revenues, margins, cash positions, liquidity issues, debt levels and income results, (4)

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significant management or organizational changes, (5) significant uncertainty regarding the issuer's industry, (6) violation of financial covenants, (7) consideration of information or evidence that supports timely recovery, and (8) other business factors related to the issuer's industry.

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

- Risk that the Company's assessment of an issuer's ability to meet all of its contractual obligations will change based on changes in the credit characteristics of that issuer
- Risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated
- Risk that fraudulent information could be provided to the Company's credit, investment and accounting professionals who determine the fair value estimates and accounting treatment for securities
- Risk that new information obtained by the Company or changes in other facts and circumstances lead the Company to change its intent to hold the security to maturity or until it recovers in value.

Any of these situations could result in a charge to income in a future period. If the Company determines that a security is other-than-temporarily impaired, the difference between amortized cost and fair value would be charged to income as a realized investment loss, resulting in a permanent reduction to the cost basis of the underlying investment.

The following table provides information regarding unrealized losses on fixed maturity and equity security investments available for sale, as of June 30, 2008.

	Investment securities with unrealized losses					
	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
Bonds:						
U.S. Treasury securities and obligations of U.S. Government Federal agencies ¹	\$ 10,454	\$ 331	\$ 9,609	\$ 240	\$ 20,063	\$ 571
Federal agency issued mortgage-backed securities ¹	22,636	210	—	—	22,636	210
Subtotal	87,433	1,066	62,487	1,709	149,920	2,775
Corporate obligations:	120,523	1,607	72,096	1,949	192,619	3,556
Industrial	106,997	2,567	69,553	6,482	176,550	9,049
Energy	73,173	1,969	17,979	1,270	91,152	3,239
Technology	6,244	212	8,002	673	14,246	885
Communications	21,952	981	14,517	1,200	36,469	2,181
Financial	183,837	16,250	96,834	15,165	280,671	31,415
Consumer	120,886	3,813	65,497	5,721	186,383	9,534
Public utilities	80,209	1,978	13,101	875	93,310	2,853
Total corporate obligations	593,298	27,770	285,483	31,386	878,781	59,156
Corporate private-labeled mortgage-backed securities	141,293	12,958	98,229	12,934	239,522	25,892
Other	99,999	5,587	69,811	10,200	169,810	15,787
Redeemable preferred stocks	14,245	836	—	—	14,245	836

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Fixed maturity securities	969,358	48,758	525,619	56,469	1,494,977	105,227
Equity securities	12,023	1,102	9,572	2,024	21,595	3,126
Total	\$981,381	\$49,860	\$535,191	\$58,493	\$1,516,572	\$108,353

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

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The following table provides information regarding unrealized losses on fixed maturity and equity security investments available for sale, as of December 31, 2007.

	Investment securities with unrealized losses					
	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
Bonds:						
U.S. Treasury securities and obligations of U.S. Government Federal agencies ¹	\$ 100	\$ —	\$ 19,487	\$ 409	\$ 19,587	\$ 409
Federal agency issued	—	—	12,190	113	12,190	113