KANSAS CITY LIFE INSURANCE CO
Form 10-Q
October 30, 2009

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2009 or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from_______to______
Commission file number 2-40764

KANSAS CITY LIFE INSURANCE COMPANY
(Exact name of registrant as specified in its charter)

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

816-753-7000
Registrant's telephone number, including area code

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [ ] No [ ]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer, "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ] Accelerated filer [X]

Non-accelerated filer [ ] Smaller reporting company [ ]

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ] No [X]

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

Class	Outstanding September 30, 2009
Common Stock, $1.25 par	11,649,400 shares

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Part I Financial Information
Item 1. Financial Statements
Amounts in thousands, except share data, or as otherwise noted

KANSAS CITY LIFE INSURANCE COMPANY
CONSOLIDATED BALANCE SHEETS

	September 30 2009 (Unaudited)	December 31 2008
ASSETS		
Investments:		
Fixed maturity securities available for sale, at fair value	$ 2,561,070	$ 2,342,873
Equity securities available for sale, at fair value	44,495	44,537
Mortgage loans	446,369	445,389
Real estate	109,939	99,576
Policy loans	86,067	88,304
Short-term investments	37,950	35,138
Total investments	3,285,890	3,055,817
Cash	12,134	9,720
Accrued investment income	38,745	33,689
Deferred acquisition costs	207,058	263,756
Value of business acquired	68,471	82,855
Reinsurance receivables	172,404	168,390
Property and equipment	24,564	25,922
Income taxes	4,328	39,628
Other assets	35,659	28,749
Separate account assets	302,507	258,565
Total assets	$ 4,151,760	$ 3,967,091
LIABILITIES		
Future policy benefits	$ 859,223	$ 853,456
Policyholder account balances	2,041,436	2,030,656
Policy and contract claims	33,247	34,913
Other policyholder funds	135,482	125,826
Other liabilities	152,747	136,568
Separate account liabilities	302,507	258,565
Total liabilities	3,524,642	3,439,984
STOCKHOLDERS' EQUITY		
Common stock, par value $1.25 per share		
Authorized 36,000,000 shares,		
issued 18,496,680 shares	23,121	23,121
Additional paid in capital	41,065	36,281
Retained earnings	758,310	750,600
Accumulated other comprehensive loss	(41,134)	(130,799)
Treasury stock, at cost (2009 - 6,847,280 shares;		
2008 - 7,061,476 shares)	(154,244)	(152,096)

Total stockholders' equity	627,118	527,107
Total liabilities and stockholders' equity	$ 4,151,760	$ 3,967,091

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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KANSAS CITY LIFE INSURANCE COMPANY
CONSOLIDATED STATEMENTS OF INCOME

	Quarter Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
REVENUES	(Unaudited)		(Unaudited)	
Insurance revenues:				
Premiums	$53,432	$44,861	$143,148	$134,810
Contract charges	26,448	27,227	79,418	81,054
Reinsurance ceded	(14,645)	(13,279)	(40,446)	(39,485)
Total insurance revenues	65,235	58,809	182,120	176,379
Investment revenues:				
Net investment income	44,521	44,337	132,265	136,416
Realized investment gains, excluding impairment losses	1,202	3,167	5,208	5,103
Net impairment losses recognized in earnings:				
Total other-than-temporary impairment losses	(2,522)	(32,462)	(28,353)	(42,687)
Portion of impairment losses recognized in other comprehensive income (loss)	203	-	15,894	-
Net impairment losses recognized in earnings	(2,319)	(32,462)	(12,459)	(42,687)
Total investment revenues	43,404	15,042	125,014	98,832
Other revenues	3,413	4,241	8,303	9,489
Total revenues	112,052	78,092	315,437	284,700
BENEFITS AND EXPENSES				
Policyholder benefits	50,514	43,783	135,601	134,855
Interest credited to policyholder account balances	21,898	21,742	64,772	65,119
Amortization of deferred acquisition costs and value of business acquired	9,949	10,727	29,155	29,464
Operating expenses	22,779	25,282	73,476	70,842
Total benefits and expenses	105,140	101,534	303,004	300,280
Income (loss) before income tax expense (benefit)	6,912	(23,442)	12,433	(15,580)
Income tax expense (benefit)	1,731	(8,264)	3,756	(5,681)
NET INCOME (LOSS)	$5,181	$(15,178)	$8,677	$(9,899)
Other comprehensive income (loss), net of taxes:				
Change in net unrealized gains and losses on securities available for sale	$51,133	$(22,414)	$91,598	$(73,764)
Change in minimum pension liability	-	-	4,666	-
Other comprehensive income (loss)	51,133	(22,414)	96,264	(73,764)

OTHER COMPREHENSIVE INCOME (LOSS)	$56,314	$(37,592)	$104,941	$(83,663)
Basic and diluted earnings per share:				
Net income (loss)	$0.45	$(1.30)	$0.75	$(0.85)

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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KANSAS CITY LIFE INSURANCE COMPANY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Nine Months Ended 2009 (Unaudited)	Year Ended 2008
COMMON STOCK, beginning and end of period	$ 23,121	$ 23,121
ADDITIONAL PAID IN CAPITAL		
Beginning of period	36,281	30,244
Excess of proceeds over cost of treasury stock sold	4,784	6,037
End of period	41,065	36,281
RETAINED EARNINGS		
Beginning of period	750,600	780,133
Cumulative effect of change in accounting principle (See Note 6)	8,399	-
Net income (loss)	8,677	(17,050)
Stockholder dividends of $0.81 per share (2008 - $1.08)	(9,366)	(12,483)
End of period	758,310	750,600
ACCUMULATED OTHER COMPREHENSIVE LOSS		
Beginning of period	(130,799)	(19,811)
Cumulative effect of change in accounting principle (See Note 6)	(6,599)	-
Other comprehensive income (loss)	96,264	(110,988)
End of period	(41,134)	(130,799)
TREASURY STOCK, at cost		
Beginning of period	(152,096)	(129,286)
Cost of 312,236 shares acquired (2008 - 552,520 shares)	(9,623)	(25,972)
Cost of 526,432 shares sold (2008 - 222,687 shares)	7,475	3,162
End of period	(154,244)	(152,096)
TOTAL STOCKHOLDERS' EQUITY	$ 627,118	$ 527,107

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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KANSAS CITY LIFE INSURANCE COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30	
	2009	2008
	(Unaudited)	
OPERATING ACTIVITIES		
Net cash provided (used)	$18,460	$(3,991)
INVESTING ACTIVITIES		
Purchases of investments:		
Fixed maturity securities	(267,700)	(198,806)
Equity securities	(2,166)	(8,204)
Mortgage loans	(34,735)	(34,598)
Real estate	(14,510)	(24,541)
Other investment assets	(2,812)	-
Sales of investments:		
Fixed maturity securities	48,490	28,523
Equity securities	3,652	5,718
Real estate	3,852	20,694
Other investment assets	2,237	9,891
Maturities and principal paydowns of investments:		
Fixed maturity securities	184,290	204,102
Mortgage loans	33,755	39,825
Net dispositions (acquisitions) of property and equipment	178	(102)
Net cash provided (used)	(45,469)	42,502
FINANCING ACTIVITIES		
Proceeds from borrowings	1,500	98,250
Repayment of borrowings	(4,400)	(101,095)
Deposits on policyholder account balances	182,002	147,374
Withdrawals from policyholder account balances	(155,102)	(185,195)
Net transfers from separate accounts	6,635	13,864
Change in other deposits	5,518	7,626
Cash dividends to stockholders	(9,366)	(9,394)
Net disposition (acquisition) of treasury stock	2,636	(14,177)
Net cash provided (used)	29,423	(42,747)
Increase (decrease) in cash	2,414	(4,236)
Cash at beginning of year	9,720	12,158
Cash at end of period	$12,134	$7,922

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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

1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

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 (the 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 2008 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 September 30, 2009 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.

Significant Accounting Policies
Presented below is a summary of significant accounting policies used by the Company. This is not intended to be an exhaustive list of all accounting policies used by the Company. For a full discussion, please refer to the Company's 2008 Form 10-K as filed with the Securities and Exchange Commission.

Investments
Investment income is recognized when earned. Realized gains and losses on the sale of investments are determined on the basis of specific security identification recorded on the trade date. Securities available for sale are stated at fair value. Unrealized gains and losses, net of adjustments to deferred acquisition costs (DAC), value of business acquired (VOBA), policyholder account balances and deferred income taxes, are reported as a separate component of accumulated other comprehensive loss in stockholders' equity. Unrealized losses represent the difference between amortized cost and fair value on the valuation date. The adjustments to DAC and VOBA represent changes in the amortization of DAC and VOBA that would have been required as a charge or credit to income had such unrealized amounts been realized. The adjustment to policyholder account balances represents the increase from using a discount rate that would have been required if such unrealized gains had been realized and the proceeds reinvested at current market interest rates, which were lower than the then-current effective portfolio rate.

The Company's fair value of fixed maturity and equity securities are determined by management, primarily by relying on external pricing services or brokers. When external sources are not able to provide prices for certain securities or

when the external prices are deemed to be unreliable, the Company utilizes internally generated matrices and calculations to determine fair value.

The Company reviews and analyzes its securities on an ongoing basis to determine whether impairments exist that are other-than-temporary. Based upon these analyses, specific securities' credit impairments may be written down through earnings as a realized investment loss if the security's value is considered to be an other-than-temporary impairment. Non-credit impairments are charged to other comprehensive income (loss).

Investment income on mortgage-backed securities is initially based upon yield, cash flow, and prepayment assumptions at the date of purchase. Subsequent revisions in those assumptions are recorded using the retrospective method, except for adjustable rate mortgage-backed securities where the prospective method is used. Under the retrospective method, the amortized cost of the security is adjusted to the amount that would have existed had the revised assumptions been in place at the time of purchase.

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

Under the prospective method, future cash flows are estimated and interest income is recognized going forward using the new internal rate of return. The adjustments to amortized cost under both methods are recorded as a charge or credit to net investment income. The Company bases its historical results from individual securities and internal assessments of likely future results for these securities. These results are based upon validations and comparisons to similar securities provided by third parties such as rating agency analysis. Mortgage loans are stated at cost, adjusted for amortization of premium and accrual of discount, less a valuation reserve for probable losses. A loan is considered impaired if it is probable that contractual amounts due will not be collected. The valuation reserve is determined based upon historical impairment experience, insurance industry studies and estimates of value for individual loans in foreclosure. Such estimates are based upon the value of the expected cash flows and the underlying collateral on a net realizable basis. Loans in foreclosure and loans considered to be impaired are placed on a non-accrual status.

Real estate consists of directly owned investments and real estate joint ventures. Real estate that is directly owned is carried at depreciated cost. Real estate joint ventures consist primarily of office buildings, industrial warehouses, unimproved land for future development and low income housing tax credit (LIHTC) investments. Real estate joint ventures are consolidated where required or are valued at cost, adjusted for the Company's equity in earnings.

Policy loans are carried at cost, less principal payments received. Short-term investments are stated at cost, adjusted for amortization of premium and accrual of discount.

Valuation of Investments
The Company's principal investments are in fixed maturity securities, mortgage loans and real estate; all of which are exposed to three primary sources of investment risk: credit, interest rate and liquidity. The fixed maturity securities, which are all classified as available for sale, are carried at their fair value in the Company's balance sheet, with unrealized gains or losses recorded in accumulated other comprehensive loss. The unrealized gains or losses are recorded net of the adjustment to policyholder account balances to reflect what would have been earned had those gains or losses been realized and the proceeds reinvested. The Company's fair value of fixed maturity and equity securities are derived from external pricing sources, brokers, and internal matrices and calculations. At September 30, 2009, approximately 90% of the carrying value of these investments were from an external pricing service and 10% were derived from brokers, internal matrices and calculations. The investment portfolio is monitored regularly to ensure that investments which may be other-than-temporarily impaired are identified in a timely fashion and properly valued. Other-than-temporary impairments that are determined to be due to credit are charged against earnings as realized investment losses. The valuation of the investment portfolio involves a variety of assumptions and estimates.

The Company monitors the various markets in which its investments are traded. The Company utilizes an independent third-party pricing service to determine the majority of its fair values. The Company reviews values received from independent pricing sources for validity. In addition, the Company tests a limited number of securities each reporting period to further validate reliance on the fair values provided. When fair values are not available from external service providers, where possible, the Company utilizes quotes from brokers. When the Company cannot obtain reliable broker pricing, a fair value is determined based upon an assessment of several factors appropriate for the specific issue, including but not limited to: the issuer's industry; liquidity; cash flows; marketability, ratings and the ability of the issuer to satisfy the obligation; government intervention or regulations; fair value of comparable securities in actively traded or quoted markets; or other factors. The Company creates a matrix of factors from which to calculate an estimable value. However, all factors may not be known or publicly available from which to determine a value and, as such, the fair value used by the Company may not be truly indicative of the actual value available in an active market or an actual exit price if the Company were to place the security for sale in the current market.

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 that could impact issuers' credit ratings, business climate, management changes, litigation and government actions, and other similar factors. This process also involves monitoring late payments, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts, asset quality and cash flow projections as indicators of credit issues.

At the end of each quarter, all securities are reviewed to determine whether impairments exist and whether other-than-temporary impairments should be recorded. This quarterly process includes an assessment of the credit quality of each investment in the entire securities portfolio. Additional reporting and review procedures are conducted for those securities where fair value is less than 90% of amortized cost. The Company prepares a formal review document no less often than quarterly of all investments 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 greater than 20% of their value, 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 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:

- The current fair value of the security as compared to cost;
- The credit rating of the security;
- The extent and the length of time the fair value has been below cost;
- 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, asset quality, debt levels and income results;
- Significant management or organizational changes;
- Significant uncertainty regarding the issuer's industry;
- Violation of financial covenants;
- Consideration of information or evidence that supports timely recovery;
- The Company's intent and ability to hold a security until it recovers in value;
- Whether the Company intends to sell the investment and whether it is not more likely than not that the Company will be required to sell the investment before recovery of the amortized cost basis; and
- Other business factors related to the issuer's industry.

To the extent the Company determines that a security is deemed to be other-than-temporarily impaired, the portion of the impairment that is deemed to be due to credit is charged to the income statement and the cost basis of the underlying investment is reduced. The portion of the impairment that is deemed to be non-credit is charged to other comprehensive income (loss).

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

- 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;
- The risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated;
- The risk that the performance of the underlying collateral for securities could deteriorate in the future and the Company's credit enhancement levels and recovery values do not provide sufficient protection to the Company's contractual principal and interest;
- The risk that fraudulent, inaccurate or misleading information could be provided to the Company's credit, investment and accounting professionals who determine the fair value estimates and accounting treatment for securities;
- The risk that new information obtained by the Company or changes in other facts and circumstances may lead the Company to change its intent to sell the security before it recovers in value;
- The risk that facts and circumstances change such that it becomes more likely than not that the Company will be required to sell the investment before recovery of the amortized cost basis; and
- The risk that the methodology or assumptions used to develop estimates of the portion of impairments due to credit prove, over time, to be inaccurate or insufficient.

Any of these situations could result in a charge to income in a future period. To the extent the Company determines that a security is deemed to be other-than-temporarily impaired, the portion of the impairment that is deemed to be due to credit is charged to the income statement and the cost basis of the underlying investment is reduced. The portion of the impairment that is deemed to be non-credit is charged to other comprehensive income (loss).

Deferred Acquisition Costs and Value of Business Acquired

Deferred acquisition costs (DAC), principally agent commissions and other selling, selection and issue costs, which vary with and are directly related to the production of new business, are capitalized as incurred. These deferred costs are then amortized in proportion to future premium revenues or the expected future profits of the business, depending upon the type of product.

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

When a new block of business is acquired or when an insurance company is purchased, a portion of the purchase price is allocated to a separately identifiable intangible asset, called the value of business acquired (VOBA). VOBA is established as the actuarially determined present value of future gross profits of the business acquired and is amortized in proportion to future premium revenues, or the expected future profits, depending on the type of business acquired.

The Company considers the following assumptions to be of significance when evaluating the amortization of DAC and VOBA: expected mortality, interest spreads, surrender rates and expense margins. Mortality relates to the occurrence of death. Interest spreads are the difference between the investment returns earned and the crediting rates of interest applied to policyholder account balances. Surrender rates relate to the relative volume of policy terminations. Expense margins involve the expenses incurred for maintaining and servicing in-force policies.

At least annually, a review is performed of the models and the assumptions used to develop expected future profits, based upon management's current view of future events. DAC is reviewed on an ongoing basis to determine that the unamortized portion does not exceed the expected recoverable amounts. Management's view primarily reflects Company experience but can also reflect emerging trends within the industry. Short-term deviations in experience affect the amortization of DAC and VOBA in the period, but do not necessarily indicate that a change to the long-term assumptions of future experience is warranted. If it is determined that it is appropriate to change the long-term assumptions of future experience, then an unlocking adjustment is recognized for the block of business being evaluated. Certain assumptions, such as interest spreads and surrender rates, may be interrelated. As such, unlocking adjustments often reflect revisions to multiple assumptions. The balances of DAC and VOBA are immediately impacted by any assumption changes, with the change reflected through the income statement as an unlocking adjustment in the amount of DAC or VOBA amortized. These adjustments can be positive or negative. The impact of unlocking adjustments from the changes in estimates for the periods reported are included in the Consolidated Results of Operations and Operating Results by Segment sections of the Management's Discussion and Analysis of Financial Condition and Results of Operations contained within this document.

The following table reflects the estimated pre-tax impact to DAC and VOBA on universal life, variable universal life, and fixed and variable deferred annuity products that could occur in a twelve-month period for an unlocking adjustment due to reasonably likely changes in significant assumptions. Changes in assumptions of the same magnitude in the opposite direction would have an impact of a similar magnitude but opposite direction of the examples provided.

Critical Accounting Estimate	Determination Methodology	Potential Effect on DAC, VOBA and Related Items
Mortality Experience	Based on Company mortality experience. Industry experience and trends are also considered.	A 2.5% increase in expected mortality experience for all future years would result in a reduction in DAC and VOBA, and a 2% increase in current period amortization.
Surrender Rates	Based on Company surrender experience. Industry experience and trends are also considered.	A 10% increase in expected surrender rates for all future years would result in a reduction in DAC and VOBA, and a 1% increase in current period amortization

		expense.
Interest Spreads	Based on expected future investment returns and expected future crediting rates applied to policyholder account balances; future crediting rates include constraints imposed by policy guarantees.	A 10 basis point reduction in future interest rate spreads would result in a reduction in DAC and VOBA, and a 1% increase in current period amortization expense.
Maintenance Expenses	Based on Company experience using an internal expense allocation methodology.	A 10% increase in future maintenance expenses would result in a reduction in DAC and VOBA, and a 1% increase in current period amortization expense.

Separate Accounts

Separate account assets and liabilities arise from the sale of variable life insurance and annuity products. The separate account represents funds segregated for the benefit of certain policyholders who bear the investment risk. The assets are legally segregated and are not subject to claims which may arise from any other business of the Company. The separate

account assets and liabilities, which are equal, are recorded at fair value. Policyholder account deposits and withdrawals, investment income and realized investment gains and losses are excluded from the amounts reported in the Consolidated Statements of Income. Revenues to the Company from separate accounts consist principally of contract charges, which include maintenance charges, administrative fees and mortality and risk charges.

The total separate account assets were $302.5 million as of September 30, 2009. Variable life and variable annuity assets comprised 29% and 71% of this amount, respectively. Guarantees are offered under variable life and variable annuity contracts: a guaranteed minimum death benefit rider is available on certain variable universal life contracts and guaranteed minimum death benefits are provided on variable annuities. The guaranteed minimum death benefit rider for variable universal life contracts guarantees the death benefit for specified periods of time, regardless of investment performance, provided cumulative premium requirements are met. The Company introduced a guaranteed minimum withdrawal benefit (GMWB) rider in 2007 that can be added to new or existing variable annuity contracts. The rider provides a minimum guarantee that the owner can make annual withdrawals equal to 5% of the initial annuity deposit for twenty years, or for life if withdrawals were started at age 65 or later, regardless of market returns. The current value of variable annuity separate accounts with the GMWB rider was $53.1 million and the fair value of the GMWB rider was $(0.8) million at September 30, 2009. The value of the GMWB rider is recorded at fair value. The change in this value is included in policyholder benefits in the Consolidated Statements of Income.

Future Policy Benefits

The Company establishes liabilities for amounts payable under insurance policies, including traditional life insurance, annuities and accident and health insurance. Generally, amounts are payable over an extended period of time. Liabilities for future policy benefits of traditional life insurance have been computed by a net level premium method based upon estimates at the time of issue for investment yields, mortality and withdrawals. These estimates include provisions for experience less favorable than initially expected.

Liabilities for future policy benefits of immediate annuities and supplementary contracts with life contingencies are also computed by a net level premium method, based upon estimates at the time of issue for investment yields and mortality.

Liabilities for future policy benefits of accident and health insurance represent estimates of payments to be made on reported insurance claims, as well as claims incurred but not yet reported. These liabilities are estimated using actuarial analyses and case basis evaluations that are based upon past claims experience, claim trends and industry experience.

Policyholder Account Balances

Policyholder account balances include universal life insurance, fixed deferred annuity contracts and investment-type contracts. Liabilities for these policyholder account balances are included without reduction for potential surrender charges and deferred front-end contract charges. The account balances for universal life contracts are equal to cumulative premiums, less contract charges and withdrawals, plus interest credited. The account balances for fixed deferred annuities and investment-type contracts are equal to the cumulative deposits, less any applicable contract charges and withdrawals, plus interest credited. Front-end contract charges are amortized over the term of the policies. Policyholder benefits incurred in excess of related policyholder account balances are charged to policyholder benefits expense. Interest on policyholder account balances is credited as earned.

Recognition of Revenues

Premiums for traditional life insurance products are reported as revenue when due. Premiums on accident and health, disability and dental insurance are reported as earned ratably over the contract period in proportion to the amount of insurance protection provided. A reserve is provided for the portion of premiums written which relate to unexpired terms of coverage.

Deposits related to universal life, fixed deferred annuity contracts and investment-type products are credited to policyholder account balances. Revenues from such contracts consist of amounts assessed against policyholder account balances for mortality, policy administration and surrender charges, and are recognized in the period in which the benefits and services are provided. The cash flows from deposits are credited to policyholder account balances. Deposits are not recorded as revenue under FASB Accounting Standards Codification (ASC) 944, "Financial Services - Insurance." Deposits are shown as a Financing Activity in the Consolidated Statements of Cash Flows.

The Company measures its sales or new business production with two components: new premiums recorded and new deposits received. Premiums and deposits are subdivided into two categories: new and renewal. New premiums and deposits are measures of sales or new business production. Renewal premiums and deposits occur as continuing business
from existing customers.

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Reinsurance

Reinsurance is one of the tools that the Company uses to accomplish its business objectives. A variety of reinsurance vehicles are currently in use, including individual and bulk arrangements on both coinsurance and mortality/morbidity only basis. Reinsurance supports a multitude of corporate objectives, including managing statutory capital, reducing volatility and surplus strain. At the customer level, reinsurance increases the Company's capacity, provides access to additional underwriting expertise, and generally makes it possible for the Company to offer products at competitive levels that could not otherwise be made available. Reinsurance is an actively managed tool that has increased in importance over recent years and will continue to play a role in the Company's future.

The Company remains contingently liable if the reinsurer should be unable to meet obligations assumed under the reinsurance contract. The Company monitors the relative financial strength and viability of its reinsurance partners. The Company has one reinsurance counterparty whose credit rating was below investment grade at September 30, 2009. Total GAAP reserves ceded to this reinsurer were $3.0 million at September 30, 2009. Should this reinsurer become insolvent, the Company could recapture the business ceded to this reinsurer, resulting in an increase in GAAP reserves of $3.0 million.

Reinsurance receivables include amounts related to paid benefits and estimated amounts related to unpaid policy and contract claims, future policy benefits and policyholder account balances.

2. NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued new guidance to provide a single definition of fair value, together with a framework for measuring it, and required additional disclosure about the use of fair value to measure assets and liabilities. The FASB emphasized that fair value is a market-based measurement, not an entity-specific measurement, and it established a fair value hierarchy with the highest priority being the quoted price in active markets. This guidance became effective for years beginning after November 15, 2007. The Company adopted it on January 1, 2008 with no material impact to the consolidated financial statements. Please see Note 3 – Fair Values for disclosures pertaining to this guidance.

In February 2007, the FASB issued new guidance to permit an entity to measure certain financial assets and liabilities at fair value. Under this guidance, entities that elect the fair value option 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 guidance became effective for years beginning after November 15, 2007. The Company adopted it on January 1, 2008 with no material impact to the consolidated financial statements. 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. Please see Note 3 – Fair Values for additional information pertaining to this guidance.

In March 2008, the FASB issued new guidance to require 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, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This guidance became effective for financial statements issued for fiscal years beginning after November 15, 2008. The Company adopted it on January 1, 2009 with no material impact on the

consolidated financial statements. Please see Note 3 – Fair Values for additional information pertaining to this guidance.

In May 2008, the FASB issued new guidance regarding financial guarantee insurance contracts, including the recognition and measurement of premium revenue and claim liabilities, including expanded disclosure requirements. This guidance became effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company adopted it on January 1, 2009 with no material impact to the consolidated financial statements as it does not sell financial guarantee insurance contracts.

In October 2008, the FASB issued new guidance to clarify the application of fair value accounting in a market that is not active and to provide an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The Company adopted this guidance upon issuance, with no material impact to the consolidated financial statements.

In April 2009, the FASB issued new guidance to clarify fair valuation in inactive markets and includes all assets and liabilities subject to fair valuation measurements. Enhanced disclosures related to fair valued assets and liabilities became required. This guidance became effective for financial statements issued for interim and annual periods ending after June 15, 2009. The Company elected early adoption effective for the period ended March 31, 2009 with no material impact on the unaudited interim consolidated financial statements. Please see Note 3 – Fair Values for additional information pertaining to this guidance.

In April 2009, the FASB issued new guidance regarding other-than-temporary impairment of debt securities and changes in the recognition and presentation of debt securities determined to be other-than-temporarily impaired. The guidance requires an enterprise to bifurcate any other-than-temporary impairment between credit and non-credit impairments and then establish accounting treatment for each aspect, in current and subsequent periods. Retroactive application became required to other-than-temporary impairments recorded in prior periods by making a cumulative-effect adjustment to the opening balance of retained earnings and accumulated other comprehensive income (loss) in the period of adoption. This guidance became effective for financial statements issued for interim and annual periods ending after June 15, 2009. The Company elected early adoption effective for the period ended March 31, 2009 with retroactive application effective January 1, 2009. For additional information pertaining to this guidance, please see Note 3 – Fair Values and Note 6 – Accumulated Effect of Change in Accounting Principle.

In April 2009, the FASB issued new guidance to expand the fair value disclosures required for financial instruments for interim periods. The guidance also requires entities to disclose the methods and significant assumptions used to estimate the fair value of financial instruments in financial statements on an interim and annual basis and to highlight any changes from prior periods. This guidance became effective for financial statements issued for interim and annual periods ending after June 15, 2009. The Company elected early adoption effective for the period ended March 31, 2009 with no material impact on the unaudited interim consolidated financial statements. Please see Note 3 – Fair Values for additional information pertaining to this guidance.

In May 2009, the FASB issued new guidance that established general accounting standards and disclosure for events occurring subsequent to the balance sheet date but before the financial statements are issued. This guidance became effective for interim and annual accounting periods ending after June 15, 2009. The Company adopted it upon issuance, with no material impact to the consolidated financial statements.

In June 2009, the FASB issued new guidance to improve the information that a reporting entity provides in its financial reports related to a transfer of financial assets. It addresses the effects of a transfer on financial position, financial performance, cash flows and a transferor's continuing involvement in transferred financial assets. In addition, this guidance also eliminates the concept of a qualifying special-purpose entity. This guidance will become effective for interim and annual accounting periods beginning after November 15, 2009. The Company is currently evaluating the new guidance and does not expect it to have a material impact to the consolidated financial statements.

In June 2009, the FASB issued new guidance to improve financial reporting by enterprises involved with variable interest entities (VIEs). This guidance changes the approach to determining a VIE's primary beneficiary and requires companies to continuously reassess whether investments in VIEs must be consolidated. This guidance will become effective for interim and annual accounting periods beginning after November 15, 2009. The Company is currently evaluating the new guidance and does not expect it to have a material impact to the consolidated financial statements.

In June 2009, the FASB issued new guidance to establish the FASB ASC as a source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial

statements in conformity with GAAP. This guidance replaced previous guidance related to the same issue and became effective for interim and annual reporting periods ending after September 15, 2009. The Company adopted it upon issuance, with no material impact to the consolidated financial statements.

All other FASB guidance issued during the nine months ended September 30, 2009 did not relate to accounting policies and procedures pertinent to the Company at this time.

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3. FAIR VALUES

Fair Values Hierarchy

In accordance with FASB ASC 820, "Fair Value Measurements and Disclosures," 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 common and preferred stocks 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 2 assets include debt securities, preferred stocks and asset-backed securities that are model priced by vendors using observable inputs.

Level 3 – Valuations are generated from techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company's assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models, spread-based models, and similar techniques, using the best information available in the circumstances. Level 3 assets include corporate securities and private placements.

Determination of Fair Value

Under FASB ASC 820, 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 FASB ASC 820. Accordingly, the Company uses an independent third-party pricing service to price a significant portion of its fixed maturity securities and equity securities.

The Company reviews prices received from service providers for unusual fluctuations but generally accepts the price identified from the pricing service. In the event a price is not available from the third-party pricing service, the Company pursues external pricing from brokers. Generally, the Company pursues and utilizes only one broker quote per security. In doing so, the Company solicits only brokers which have previously demonstrated knowledge and experience of the subject security. If a broker price is not available, the Company determines a carrying value through various valuation techniques that use option pricing models, discounted cash flows, spread-based models or similar techniques depending upon the specific security to be priced. These techniques are primarily applied to private placement securities. The Company utilizes available market information, wherever possible, to identify inputs into the fair value determination, primarily including prices and spreads on comparable securities.

The Company performs an analysis on the prices received from third-party security pricing services and independent brokers to ensure that the prices represent a reasonable estimate of the fair value. The Company corroborates and validates the primary pricing sources through a variety of procedures that include but are not limited to comparison to additional independent third-party pricing services or brokers, where possible, a review of third-party pricing service methodologies, back testing and comparison of prices to actual trades for specific securities where observable data

exists. In addition, in accordance with FASB ASC 820, the Company analyzed the third-party pricing services' methodologies and related inputs and has also evaluated the various types of securities in its investment portfolio to determine an appropriate FASB ASC 820 fair value hierarchy.

The Company owned six issues of similar securities for which values were not provided from the Company's primary pricing service as of September 30, 2009. The Company received quoted prices from brokers for each security and utilized the mid-point of these prices to determine the fair value of these similar securities.

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

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The Company's own estimates of fair value are derived in a number of ways including, but not limited to: 1) pricing provided by brokers, where the price indicates reliability as to value; 2) fair values of comparable securities incorporating a spread adjustment for maturity differences, collateralization, credit quality, liquidity, marketability and other items, if applicable; 3) discounted cash flow models and margin spreads; 4) bond yield curves; 5) Trace trade quotes; 6) observable market prices and exchange quotes not provided by external pricing services; 7) statement values provided to the Company by fund managers; and 8) option pricing models.

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 FASB ASC 825, "Financial Instruments."

Assets

Securities Available for Sale

Fixed maturities and equity securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are determined as described in the preceding paragraphs.

Short-Term Financial Assets

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

Loans

The Company does not record loans at fair value. As such, valuation techniques discussed herein for loans are primarily for estimating fair value.

Fair values of mortgage loans on real estate properties are calculated by discounting contractual cash flows, using discount rates based on current industry pricing or the Company's estimate of an appropriate risk-adjusted discount rate for loans of similar size, type, remaining maturity and repricing characteristics.

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 account value. The fair values of investment-type insurance contracts included with policyholder account balances for fixed deferred annuities and other policyholder funds for supplementary contracts without life contingencies are estimated to be their cash surrender values. In accordance with FASB ASC 825, the fair values of deposits with no stated maturity are equal to the amount payable on demand at the measurement date.

Guaranteed Minimum Withdrawal Benefits (GMWB)

The Company introduced a GMWB rider in 2007 that can be added to new or existing variable annuity contracts. The rider provides a minimum guarantee that the owner can make annual withdrawals equal to 5% of the initial annuity

deposit for twenty years, or for life if withdrawals were started at age 65 or later, regardless of market returns. The value of variable annuity separate accounts with the GMWB rider was $53.1 million and the fair value of the rider was $(0.8) million at September 30, 2009. The value of the GMWB rider is recorded at fair value, and the change in this value is included in policyholder benefits in the Consolidated Statements of Income. The value of variable annuity separate accounts with the GMWB rider is recorded in separate account liabilities and the value of the rider is included in other policyholder funds in the Consolidated Balance Sheets. Fair value for GMWB rider contracts results in a Level 3 valuation as it is based on models which utilize significant unobservable inputs. These models require actuarial and financial market assumptions, which reflect the assumptions market participants would use in pricing the contract, including adjustments for risk and issuer non-performance.

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

Notes Payable
There were no borrowings at September 30, 2009. All of the amounts included within Notes Payable were in other liabilities in the Consolidated Balance Sheets at December 31, 2008. 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 7 - 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.

	September 30, 2009			
Assets:	Level 1	Level 2	Level 3	Total
Fixed maturities available for sale	$ 15,324	$ 2,458,530	$ 87,216	$ 2,561,070
Equity securities available for sale	11,580	26,681	6,234	44,495
Total	$ 26,904	$ 2,485,211	$ 93,450	$ 2,605,565
Liabilities:				
Other policyholder funds				
Guaranteed minimum withdrawal benefits	$ -	$ -	$ (796)	$ (796)
Total	$ -	$ -	$ (796)	$ (796)

	December 31, 2008			
Assets:	Level 1	Level 2	Level 3	Total
Fixed maturities available for sale	$15,876	$2,237,498	$89,499	$2,342,873
Equity securities available for sale	12,504	26,892	5,141	44,537
Total	$28,380	$2,264,390	$94,640	$2,387,410
Liabilities:				
Other policyholder funds				
Guaranteed minimum withdrawal benefits	$-	$-	$755	$755
Total	$-	$-	$755	$755

The following table presents the fair value of fixed maturities and equity securities available for sale by pricing source and fair value hierarchy level as of September 30, 2009.

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Fixed maturities available for sale:				
Priced from external pricing service	$ 15,324	$2,307,962	$ -	$2,323,286
Priced from independent broker quotations	-	124,594	-	124,594
Priced from internal matrices and calculations	-	25,974	87,216	113,190
Subtotal	15,324	2,458,530	87,216	2,561,070

Equity securities available for sale:				
Priced from external pricing service	11,580	2,307	-	13,887
Priced from independent broker quotations	-	-	-	-
Priced from internal matrices and calculations	-	24,374	6,234	30,608
Subtotal	11,580	26,681	6,234	44,495
Total	$ 26,904	$2,485,211	$ 93,450	$2,605,565
Percent of Total	1 %	95 %	4 %	100 %

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

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the third quarter and nine months ended September 30, 2009 are summarized below:

Quarter Ended September 30, 2009

	Beginning Balance as of June 30 2009	Total Realized and Unrealized Gains and (Losses) Included in Earnings	Included in Other Comprehensive Income (Loss)	Purchases and Dispositions	Net Transfers in (out)	Ending Balance as of September 30 2009	Net Unrealized Gains (Losses) Relating to Assets Held at September 30, 2009
Assets:							
Fixed maturities available for sale	$77,704	$-	$ 5,125	$(828)	$5,215	$ 87,216	$ 4,518
Equity securities available for sale	5,141	-	285	-	808	6,234	285
Total	$82,845	$-	$ 5,410	$(828)	$6,023	$ 93,450	$ 4,803
Liabilities:							
Other policyholder funds- guaranteed minimum withdrawal benefits	$(879)	$53	$ -	$30	$-	$ (796)	$ 53

Nine Months Ended September 30, 2009

	Beginning Balance as of December 31, 2008	Total Realized and Unrealized Gains and (Losses) Included in Earnings	Included in Other Comprehensive Income (Loss)	Purchases and Dispositions	Net Transfers in (out)	Ending Balance as of September 30, 2009	Net Unrealized Gains (Losses) Relating to Assets Held at September 30, 2009
Assets:							
Fixed maturities available							

for sale	$89,499	$-	$ 9,336	$(888)	$(10,731)	$ 87,216	$ 8,729
Equity securities available							
for sale	5,141	-	285	-	808	6,234	285
Total	$94,640	$-	$ 9,621	$(888)	$(9,923)	$ 93,450	$ 9,014
Liabilities:							
Other policyholder funds-							
guaranteed minimum							
withdrawal benefits	$755	$(1,632)	$ -	$81	$-	$ (796)	$ (1,632)

The roll forward of Level 3 assets begins with the prior period balance and adjusts the balance for the gains or losses (realized and unrealized) that occurred during the current period. Any new purchases that are identified as Level 3 securities are then added and any sales of securities which were previously identified as Level 3 are subtracted. Next, any securities which were previously identified as Level 1 or Level 2 securities and which are currently identified as Level 3 are added. Finally, securities which were previously identified as Level 3 and which are now designated as Level 1 or as Level 2 are subtracted. The ending balance represents the current fair value of securities which are designated as Level 3.

The roll forward of Level 3 liabilities begins with the prior period balance and adjusts for the realized gains or losses that occurred during the current period. These realized gains or losses are reflected as policyholder benefits in the Consolidated Statements of Income. Issuances, or new sales, are then added and settlements are subtracted. The ending balance represents the current fair value of liabilities which are designated as Level 3.

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

The Company had six transfers into Level 3 and five transfers out of Level 3 for the third quarter and nine months ended September 30, 2009.

The following table provides amortized cost and fair value for securities by sector at September 30, 2009.

	Amortized	Gross Unrealized		Fair
Bonds:	Cost	Gains	Losses	Value
U.S. Treasury securities and				
obligations of U.S. Government	$109,933	$5,670	$252	$115,351
Federal agencies 1	62,560	2,973	-	65,533
Federal agency issued				
mortgage-backed securities 1	174,489	7,796	132	182,153
Subtotal	346,982	16,439	384	363,037
Corporate obligations:				
Industrial	421,213	22,877	3,148	440,942
Energy	194,475	10,812	464	204,823
Technology	41,349	2,428	526	43,251
Communications	86,191	4,489	1,679	89,001
Financial	395,925	11,198	23,206	383,917
Consumer	309,173	18,358	2,267	325,264
Public utilities	275,550	18,565	2,187	291,928
Total corporate obligations	1,723,876	88,727	33,477	1,779,126
Corporate private-labeled				
mortgage-backed securities	248,878	437	50,512	198,803
Other	232,065	3,701	20,654	215,112
Redeemable preferred stocks	5,000	-	8	4,992
Fixed maturity securities	2,556,801	109,304	105,035	2,561,070
Equity securities	44,541	1,744	1,790	44,495
Total	$2,601,342	$111,048	$106,825	$2,605,565

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

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

The following table provides amortized cost and fair value for securities by sector at December 31, 2008.

	Amortized	Gross Unrealized		Fair
Bonds:	Cost	Gains	Losses	Value
U.S. Treasury securities and				
obligations of U.S. Government	$63,686	$2,732	$399	$66,019
Federal agencies 1	72,135	4,074	-	76,209
Federal agency issued				
mortgage-backed securities 1	217,964	4,193	635	221,522
Subtotal	353,785	10,999	1,034	363,750
Corporate obligations:				
Industrial	389,580	6,501	27,368	368,713
Energy	201,172	4,261	15,693	189,740
Technology	37,264	1,109	3,056	35,317
Communications	73,035	699	7,677	66,057
Financial	387,927	3,430	45,793	345,564
Consumer	302,433	4,900	27,458	279,875
Public utilities	260,529	6,013	10,918	255,624
Total corporate obligations	1,651,940	26,913	137,963	1,540,890
Corporate private-labeled				
mortgage-backed securities	272,405	90	52,795	219,700
Other	241,172	545	37,217	204,500
Redeemable preferred stocks	15,070	52	1,089	14,033
Fixed maturity securities	2,534,372	38,599	230,098	2,342,873
Equity securities	45,152	1,143	1,758	44,537
Total	$2,579,524	$39,742	$231,856	$2,387,410

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

The table below is a summary of fair value estimates as of September 30, 2009 and December 31, 2008 for financial instruments, as defined by FASB ASC 825. In accordance with this guidance, 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.

	September 30, 2009		December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Investments:				
Fixed maturities available for sale	$2,561,070	$2,561,070	$2,342,873	$2,342,873
Equity securities available for sale	44,495	44,495	44,537	44,537
Mortgage loans	446,369	455,845	445,389	449,228
Policy loans	86,067	86,067	88,304	88,304
Cash and short-term investments	50,084	50,084	44,858	44,858
Liabilities:				

Individual and group annuities	988,860	966,845	956,216	938,023
Notes payable	-	-	2,900	2,900
Supplementary contracts without				
life contingencies	60,016	57,359	61,268	54,327

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4. UNREALIZED LOSSES ON SECURITIES

The Company reviews all security investments, particularly including those having unrealized losses. Further, the Company 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 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. The evaluation includes but is not limited to such factors as the issuer's stated 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, asset quality 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:

- The current fair value of the security as compared to cost;
- The credit rating of the security;
- The extent and the length of time the fair value has been below cost;
- 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, asset quality, debt levels and income results;
- Significant management or organizational changes;
- Significant uncertainty regarding the issuer's industry;
- Violation of financial covenants;
- Consideration of information or evidence that supports timely recovery;
- The Company's intent and ability to hold a security until it recovers in value;
- Whether the Company intends to sell the investment and whether it is not more likely than not that the Company will be required to sell the investment before recovery of the amortized cost basis; and
- Other business factors related to the issuer's industry.

To the extent the Company determines that a security is deemed to be other-than-temporarily impaired, the portion of the impairment that is deemed to be due to credit is charged to the income statement and the cost basis of the underlying investment is reduced. The portion of the impairment that is deemed to be non-credit is charged to other comprehensive
income (loss).

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

- 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;
- The risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated;
- The risk that the performance of the underlying collateral for securities could deteriorate in the future and the Company's credit enhancement levels and recovery values do not provide sufficient protection to the Company's contractual principal and interest;
- The risk that fraudulent, inaccurate or misleading information could be provided to the Company's credit, investment and accounting professionals who determine the fair value estimates and accounting treatment for securities;
- The risk that new information obtained by the Company or changes in other facts and circumstances may lead the Company to change its intent to sell the security before it recovers in value;
- The risk that facts and circumstances change such that it becomes more likely than not that the Company will be required to sell the investment before recovery of the amortized cost basis; and
- The risk that the methodology or assumptions used to develop estimates of the portion of impairments due to credit prove, over time, to be inaccurate or insufficient.

Any of these situations could result in a charge to income in a future period. To the extent the Company determines that a security is deemed to be other-than-temporarily impaired, the portion of the impairment that is deemed to be due to credit is charged to the income statement and the cost basis of the underlying investment is reduced. The portion of the impairment that is deemed to be non-credit is charged to other comprehensive income (loss).

At September 30, 2009, the Company had gross unrealized losses of $106.8 million on investment securities, including fixed maturity and equity securities that had a fair value of $806.7 million. In addition, included in the gross unrealized losses are securities that the Company determined had other-than-temporary impairments in accordance with FASB ASC 320, "Investments – Debt and Equity Securities." Accordingly, the Company bifurcated these impairments between credit and non-credit impairments. As identified in the Consolidated Statements of Income, the Company had non-credit impairments of $15.9 million on securities considered to be impaired for the nine months ended September 30, 2009. As of December 31, 2008, the Company had gross unrealized losses of $231.9 million on investment securities, including fixed maturity and equity securities that had a fair value of $1.5 billion. The decrease in unrealized losses was primarily attributable to decreased credit and liquidity risk discounts in the pricing of financial assets. Although these changes affected the broad financial markets, specific sectors, security issuers and security issues were affected differently. Partially offsetting the decrease in unrealized losses was the implementation of FASB ASC 320 in the first quarter. The Company reviewed all previously-recorded other-than-temporary impairments of securities to develop an estimate of the portion of such impairments that were not due to credit. This resulted in an opening balance adjustment to increase gross unrealized losses in the amount of $13.5 million.

Once a security is determined to have met certain of the criteria for consideration as being other-than-temporarily impaired, further information is gathered and evaluated pertaining to the particular security. If the security is an unsecured obligation, the additional research is a top-down approach with particular emphasis on the likelihood of the issuer to meet the contractual terms of the obligation. If the security is secured by an asset or guaranteed by another

party, the value of the underlying secured asset or the financial ability of the third-party guarantor is evaluated as a secondary source of repayment. Such research is based upon a top-down approach, narrowing to the specific estimates of value and cash flow of the underlying secured asset or guarantor. If the security is a collateralized obligation, such as a mortgage-backed or other asset-backed instrument, research is also conducted to obtain and analyze the performance of the collateral relative to expectations at the time of acquisition and with regard to projections for the future. Such analyses are based upon historical results, trends, comparisons to collateral performance of similar securities and analyses performed by third parties. This information is used to develop projected cash flows that are compared to the amortized cost of the security.

If a determination is made that an unsecured security, secured security or security with a guaranty of payment by a third-party is other-than-temporarily impaired, an estimate is developed of the portion of such impairment that is due to credit. The estimate of the portion of impairment due to credit is based upon a comparison of ratings and maturity horizon

for the security and relative historical default probabilities from one or more nationally recognized rating organizations. When appropriate for any given security, sector or period in the business cycle, the historical default probability is adjusted to reflect periods or situations of distress by adding to the default probability increments of standard deviations from mean historical results. The credit impairment analysis is supplemented by estimates of potential recovery values for the specific security, including the potential impact of the value of any secured assets, in the event of default. This information is used to determine the Company's best estimate, derived from probability-weighted cash flows.

If the cash flow for a collateralized security is determined to be less than the amortized cost, the difference is recorded as an other-than-temporary impairment due to credit in the income statement.

The total impairment for any security that is deemed to have an other-than-temporary impairment is recorded in the statement of income as a net realized loss from investments. The portion of such impairment that is determined to be non-credit-related is deducted from net realized loss in the statement of income and reflected in other comprehensive income (loss) and accumulated other comprehensive loss, which is a component of stockholders' equity in the balance sheets.

As part of the required accounting for unrealized gains and losses, the Company also adjusts the DAC and VOBA assets to recognize the adjustment to those assets as if the unrealized gains and losses from securities classified as available-for-sale actually had been realized.

The following table provides information regarding investment securities with unrealized losses on fixed maturity and equity security investments available for sale as of September 30, 2009.

	Less Than 12 Months		12 Months or Longer		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
Bonds:	Value	Losses	Value	Losses	Value	Losses
U.S. Treasury securities and obligations of U.S. Government	$11,692	$133	$3,203	$119	$14,895	$252
Federal agencies 1	-	-	-	-	-	-
Federal agency issued mortgage-backed securities 1	16,179	55	3,893	77	20,072	132
Subtotal	27,871	188	7,096	196	34,967	384
Corporate obligations						
Industrial	15,795	242	56,908	2,906	72,703	3,148
Energy	16,873	337	12,295	127	29,168	464
Technology	-	-	7,178	526	7,178	526
Communications	4,009	463	22,638	1,216	26,647	1,679
Financial	12,483	2,613	156,914	20,593	169,397	23,206
Consumer	10,837	182	40,872	2,085	51,709	2,267
Public utilities	16,274	650	25,954	1,537	42,228	2,187
Total corporate obligations	76,271	4,487	322,759	28,990	399,030	33,477
Corporate private-labeled mortgage-backed securities	12,451	2,101	176,436	48,411	188,887	50,512
Other	57,270	3,872	112,173	16,782	169,443	20,654
Redeemable preferred stocks	-	-	4,992	8	4,992	8

Fixed maturity securities	173,863	10,648	623,456	94,387	797,319	105,035
Equity securities:						
Financial	3,859	875	5,556	915	9,415	1,790
Other	-	-	-	-	-	-
Equity securities	3,859	875	5,556	915	9,415	1,790
Total	$177,722	$11,523	$629,012	$95,302	$806,734	$106,825

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

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The table below provides sales of investment securities available for sale, excluding maturities and calls, for the third quarter and nine months ended September 30, 2009. Realized gains and losses on the sale of investments are determined on the basis of specific security identification.

	Quarter Ended September 30	Nine Months Ended September 30
Proceeds	$ 8,156	$ 22,218
Gross realized gains	1,256	3,699
Gross realized losses	-	-

5. OTHER COMPREHENSIVE INCOME (LOSS)

Other comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes the unrealized investment gains or losses on securities available for sale (net of adjustments for realized investment gains or losses) net of adjustments to DAC, VOBA and policyholder account balances. In addition, other comprehensive income (loss) includes the change in the additional minimum pension liability. Other comprehensive income (loss) also includes deferred income taxes on these items. The table below provides information about other comprehensive income (loss) for the third quarters and nine months ended September 30, 2009 and 2008.

	Quarter Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Total unrealized gains (losses) arising during the year	$116,381	(108,558)	$201,468	(201,840)
Less:				
Realized investment gains (losses), excluding impairment losses	1,240	1,430	4,083	2,182
Other-than-temporary impairment losses recognized in earnings	(2,522)	(32,462)	(28,353)	(42,687)
Other-than-temporary impairment losses recognized in other comprehensive income (loss)	203	-	15,894	-
Net unrealized gains (losses) excluding impairment losses	117,460	(77,526)	209,844	(161,335)
Additional minimum pension liability	-	-	4,666	-
Effect on DAC and VOBA	(38,794)	42,891	(68,924)	47,304
Policyholder account balances	-	152	-	548
Deferred income taxes	(27,533)	12,069	(49,322)	39,719
Other comprehensive income (loss)	51,133	(22,414)	96,264	(73,764)
Net income (loss)	5,181	(15,178)	8,677	(9,899)
Other comprehensive income (loss)	$56,314	(37,592)	$104,941	(83,663)

The following table provides accumulated balances related to each component of accumulated other comprehensive loss at September 30, 2009.

	Unrealized Gain (Loss) on Non-Impaired Securities	Unrealized Gain (Loss) on Impaired Securities	Additional Minimum Pension Liability	DAC/ VOBA Impact	Tax Effect	Total
Beginning of year	$ (189,916)	$ (2,197)	$(48,523)	$65,534	$44,303	$(130,799)
Cumulative effect of change in accounting principle	-	(13,507)	-	3,355	3,553	(6,599)
Other comprehensive income (loss)	211,759	(1,915)	4,666	(68,924)	(49,322)	96,264
End of period	$ 21,843	$ (17,619)	$(43,857)	$(35)	$(1,466)	$(41,134)

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

The following table provides a rollforward of credit losses recognized in earnings for the third quarter and nine months ended September 30, 2009.

	Quarter Ended September 30 2009	Nine Months Ended September 30 2009
Credit losses on securities held at beginning of period in other comprehensive income (loss)	$ 9,505	$ 5,713
Additions for credit losses not previously recognized in other-than-temporary impairment	-	6,500
Additions for increases in the credit loss for which an other-than-temporary impairment previously recognized when there was no intent to sell the security before recovery of its amortized cost basis	319	597
Reductions for securities sold during the period (realized)	(1,880)	(3,952)
Reductions for securities previously recognized in other comprehensive income (loss) earnings because of intent to sell the security before recovery of its amortized cost basis	-	-
Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security	-	(914)
Credit losses on securities held at the end of period in other comprehensive income (loss)	$ 7,944	$ 7,944

6. ACCUMULATED EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE

Effective for the period ended March 31, 2009, the Company adopted FASB ASC 320. Pursuant to this guidance, the Company reviewed all previously-recorded other-than-temporary impairments of securities and developed an estimate of the portion of such impairments using a methodology consistent with that applied to the current period other-than-temporary bifurcation of credit and non-credit as of January 1, 2009. As a result, the Company determined that $13.5 million in previously recorded other-than-temporary impairments had been due to non-credit impairments.

The process used by the Company in estimating the portion of previously recorded other-than-temporary impairments due to credit is consistent with the methodology employed for those securities determined to be other-than-temporarily impaired for the nine-month period ended September 30, 2009. Specifically, if the security is unsecured, secured by an asset or includes a guaranty of payment by a third-party, the estimate of the portion of impairment due to credit was based upon a comparison of ratings and maturity horizon for the security relative to historical default probabilities from one or more nationally recognized rating organizations. When appropriate for any given security, sector or period in the business cycle, the historical default probability was adjusted to reflect periods or situations of distress by adding to the default probability increments of standard deviations from mean historical results. The credit impairment analysis was supplemented by estimates of potential recovery values for the specific security, including the potential impact of the value of any secured assets, in the event of default. This information is used to determine the Company’s best estimate, derived from probability-weighted cash flows.

Estimates of impairment due to credit involving collateralized securities were based upon review of projected cash flows relative to amortized cost at the time the security was determined to be other-than-temporarily impaired. The credit component of the impairment for these securities was determined to be the difference between the amortized cost of the security and the projected cash flows.

In addition, as an insurance enterprise, the Company must also consider the impact of DAC and VOBA on any realized and unrealized loss and the appropriate tax effect. The establishment of non-credit impairments to accumulated other comprehensive income (loss) in accordance with the guidance from retained earnings also requires a netting of applicable DAC and VOBA and income taxes. The methodology by which DAC and VOBA are calculated and applied to realized gains and losses is different than the methodology employed to calculate DAC and VOBA charges on unrealized gains and losses and results in differences among the transfer between retained earnings and accumulated other comprehensive loss.

In the implementation of this guidance, the Company recorded an opening balance adjustment that increased retained earnings in the amount of $8.4 million and increased accumulated other comprehensive loss in the amount of $6.6 million.

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

The adjustment to retained earnings consisted of an increase of $8.8 million related to non-credit impairments taken in prior periods, net of tax. This adjustment also included a $0.4 million decrease due to offsetting adjustments to DAC and VOBA, net of tax. The adjustment to accumulated other comprehensive loss consisted of a decrease of $8.8 million related to non-credit impairments taken in prior periods, net of tax. This adjustment also included a $2.2 million increase due to offsetting adjustments to DAC and VOBA, net of tax.

7. NOTES PAYABLE

All borrowings are used to enhance liquidity and investment strategies, and the following table provides information for Notes Payable.

	September 30 2009	December 31 2008
Federal Home Loan Bank (FHLB) loans with various maturities and a weighted average interest rate, currently no borrowings, (0.95% at December 31, 2008), secured by mortgage-backed securities totaling $71,706 ($102,155 at December 31, 2008)	$ -	$ 2,900
	$ -	$ 2,900

As a member of the FHLB with a capital investment of $5.1 million, the Company has the ability to borrow on a collateralized basis from the FHLB. The Company received dividends on the capital investment in the FHLB of less than $0.1 million in the third quarter and equal to $0.1 million for the nine-month period ended September 30, 2009. Dividends received in the third quarter of 2008 were $0.1 million and were $0.3 million in the nine-month period ended September 30, 2008.

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. These lines of credit will expire in June of 2010. The Company anticipates renewing these lines as they come due.

8. 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 11,621,405 and 11,520,384 for the quarters ended September 30, 2009 and 2008, respectively. The average number of shares outstanding was 11,535,374 and 11,606,911 for the nine months ended September 30, 2009 and 2008, respectively.

9. INCOME TAXES

The third quarter income tax expense was $1.7 million or 25% of income before tax for 2009, versus a tax benefit of $8.3 million or 35% of income before tax for the prior year period. The income tax expense for the nine months ended September 30, 2009 was $3.8 million or 30% of income before tax, versus a tax benefit of $5.7 million or 36% of income before tax for the prior year period.

The effective income tax rate in the third quarter of 2009 was less than the prevailing corporate federal income tax rate of 35%. Favorable permanent differences resulted in a benefit of approximately 11% of income before tax. These permanent differences primarily consisted of the dividends received deduction and differences between the prior year tax provision and the Company's filed 2008 tax return. A decrease in the income tax contingency resulted in a benefit of approximately 5% of income before tax. These favorable differences were partially offset by an expense of approximately 6% of income before tax related to the Company's investments in affordable housing.

The effective income tax rate in the third quarter of 2008 was equal to the prevailing corporate federal income tax rate of 35%, primarily due to the benefit of a reduction in the income tax contingency being equally offset by differences between the prior year tax provision and the Company's filed 2007 tax return. The impact of reducing the income tax contingency was a benefit of approximately 1% of income before tax. The impact of the true-up of prior year taxes was an expense of approximately 1% of income before tax.

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The effective income tax rate in the nine months ended September 30, 2009 was less than the prevailing corporate federal income tax rate of 35%. Favorable permanent differences resulted in a benefit of approximately 7% of income before tax. These permanent differences were primarily from the dividends received deduction and differences between the prior year tax provision and the Company's filed 2008 tax return. A decrease in the income tax contingency resulted in a benefit of approximately 2% of income before tax. These favorable differences were partially offset by an expense of approximately 4% of income before tax related to the Company's investments in affordable housing.

The effective income tax rate in the nine months ended September 30, 2008 was greater than the prevailing corporate federal income tax rate of 35% due to a 3% benefit resulting primarily from the dividends received deduction, a reduction in tax contingency and affordable housing tax credits, partially offset by a 2% expense related to differences between the prior year tax provision and the Company's filed 2007 tax return.

Federal income taxes paid were $0.2 million and $10.0 million for the first nine months of 2009 and 2008, respectively.

10. 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 and third-party marketing arrangements. 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. 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 solely 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:						
Third quarter:	2009	$38,630	$11,103	$15,634	$ (132)	$65,235
	2008	31,214	12,268	15,446	(119)	58,809
Nine months:	2009	100,317	35,757	46,460	(414)	182,120

	2008	94,384	36,235	46,175	(415)	176,379
Net investment income:						
Third quarter:	2009	$41,052	$136	$3,333	$ -	$44,521
	2008	41,057	134	3,146	-	44,337
Nine months:	2009	122,307	406	9,552	-	132,265
	2008	126,393	389	9,634	-	136,416
Net income (loss):						
Third quarter:	2009	$5,384	$(958)	$755	$ -	$5,181
	2008	(14,365)	(396)	(417)	-	(15,178)
Nine months:	2009	8,248	(1,735)	2,164	-	8,677
	2008	(8,589)	(1,444)	134	-	(9,899)

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 to arrive at Consolidated Statements of Income.

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

11. PENSIONS AND OTHER POSTRETIREMENT BENEFITS

Components of net periodic benefit cost:

	Pension Benefits Quarter Ended September 30		Other Benefits Quarter Ended September 30	
	2009	2008	2009	2008
Service cost	$474	$421	$217	$192
Interest cost	1,985	1,360	510	346
Expected return on plan assets	(1,867)	(1,726)	(11)	(13)
Amortization of:				
Unrecognized actuarial loss	1,081	421	3	43
Unrecognized prior service cost	(148)	(118)	(62)	(91)
Net periodic benefit cost	$1,525	$358	$657	$477

	Pension Benefits Nine Months Ended September 30		Other Benefits Nine Months Ended September 30	
	2009	2008	2009	2008
Service cost	$1,592	$1,601	$479	$583
Interest cost	5,969	5,164	1,051	1,051
Expected return on plan assets	(5,552)	(6,555)	(26)	(39)
Amortization of:				
Unrecognized actuarial loss	3,442	1,597	(197)	130
Unrecognized prior service cost	(471)	(449)	(139)	(279)
Net periodic benefit cost	$4,980	$1,358	$1,168	$1,446

12. 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.

No payments were made during the first nine months of 2009 for the three-year interval ended December 31, 2008. In the first nine months of 2008, the plan made a payment of $0.1 million to plan participants for the three-year interval ended December 31, 2007.

At each reporting period, an estimate of the share-based compensation expense is accrued, utilizing the share price at the period end. No accrual was required for the third quarter of 2009. The cost of share-based compensation accrued as an operating expense in the third quarter of 2008 was $0.9 million, net of tax. The change in accrual for share-based compensation that reduced operating expense in the first nine months of 2009 was $0.1 million, net of tax. The cost of compensation accrued as an operating expense for the nine-month period ended September 30, 2008 was $1.1 million, net of tax.

13. COMMITMENTS

In the normal course of business, the Company has open purchase and sale commitments. At September 30, 2009, the Company had purchase commitments to fund mortgage loans and other investments of $17.5 million. Subsequent to September 30, 2009, the Company entered into commitments to fund additional mortgage loans of $2.7 million.

14. 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 not have a material effect on the Company's business, results of operations or financial position.

15. 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.

16. SUBSEQUENT EVENTS

On October 26, 2009, the Kansas City Life Board of Directors declared a quarterly dividend of $0.27 per share that will be paid on November 11, 2009 to stockholders of record on November 5, 2009.

Subsequent to September 30, 2009, the United States and the global financial system continued to recover from the credit and liquidity crisis that generated substantial volatility in the financial markets and the banking system during the past several periods. Should this environment and similar events re-occur, such subsequent events could have a significant impact on the Company's investment portfolio. The Company has continued to monitor this subsequent event activity and has concluded that the assessment of other-than-temporary impairment as of September 30, 2009 has not changed.

Subsequent events have been evaluated through October 30, 2009, which is the date that the financial statements have been issued.

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

Amounts are stated in thousands, except share data, or as otherwise noted.

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 third quarters and nine months ended September 30, 2009 and 2008 and the financial condition of the Company as of September 30, 2009. 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 2008 Form 10-K.

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, vision 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.

The Company offers investment products and broker dealer services through its subsidiary Sunset Financial Services, Inc. (SFS) for both proprietary and non-proprietary variable insurance products, mutual funds and other securities.

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 dominates 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 2008 Form 10-K.

The Company earns revenues primarily from premiums received from the sale of life, immediate annuity and accident and health policies, from earnings on its investment portfolio and from the sale of investment assets. Revenues from the sale of traditional life insurance and immediate annuity products and accident and health products are reported as premium income for financial statement purposes. Considerations for supplemental contracts with life contingencies are reported as part of other revenues. 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 mortality, lapse and surrenders of future policy benefits and policyholder account balances;

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- The rate of morbidity, disability and incurrence of other policyholder benefits;
- Persistency of existing insurance policies;
- Interest rates credited to policyholders;
- 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;
- Realized gains and losses on investments;
- Timely and cost-effective access to liquidity;
- Management of distribution costs and operating expenses.

Strong sales competition, highly competitive products and a very difficult economic environment present significant challenges to the Company from a new sales perspective. The Company's primary emphasis is on expanding sales of individual life products. The Company's continued focus is on delivering competitive products for a reasonable cost, superior customer service, excellent financial strength and superior sales and marketing support to the field force.

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 and other withdrawals from policyholder accounts, operating expenses, premium taxes, and costs related to acquiring new business. In addition, cash is used to pay income taxes and stockholder dividends as well as to fund potential acquisition opportunities.

Starting in 2007 and continuing into 2009, wildly fluctuating market conditions have significantly impacted the financial markets and accordingly, the Company's investments and revenues. The interest rate and credit environments continue to present a significant challenge to the markets as a whole and specifically to companies invested in fixed maturity and equity securities. These conditions may persist into the future as the credit and equity markets continue to be severely challenged, particularly in the financial services sector. The Company is broadly diversified and has high quality investments, as 93% of all fixed maturity securities were investment grade at September 30, 2009. However, as a result of the consolidations currently occurring in the financial services sector, diversification in this sector will be a challenge until greater market stabilization occurs. In addition, the U.S. Government's entrance into private company arrangements and specific guarantees may add further complications to a variety of issues, yet to be fully determined.

The improvement in net income for the third quarter of 2009 compared to the third quarter of 2008 was due to several factors. First, the Company had a net realized investment loss of $1.1 million in the third quarter of 2009 compared to $29.3 million in the third quarter of 2008. In the third quarter of 2009, write-downs of investments due to the recognition of other-than-temporary impairments totaled $2.3 million, compared to $32.5 million in the third quarter of 2008. A second factor was reduced operating expenses. Partially offsetting these favorable factors, policyholder benefits increased, primarily due to an increase in benefit and contract reserves. In addition, income tax expense increased largely due to higher pretax income.

The largest factor in the increase in net income for the first nine months of 2009 compared to the same period in 2008 was a reduction in realized investment losses. The Company had a net realized loss of $7.3 million in the first nine months of 2009, compared to $37.6 million one year ago. Partially offsetting this improvement, net investment income and contract charges declined and operating expenses increased during the nine months.

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 expressions with similar meaning.

Actual results may differ materially from those included in the forward-looking statements as a result of risks and uncertainties. Those risks and uncertainties include, but are not limited to the risk factors listed in Item 1A. Risk Factors and Cautionary Factors that may Affect Future Results as filed in the Company's 2008 Form 10-K.

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Consolidated Results of Operations

Summary of Results

The Company's net income increased $20.4 million or 134% in the third quarter of 2009, versus the same quarter in the prior year, to a total of $5.2 million from a loss of $15.2 million. Net income per share increased $1.75 or 135% and was $0.45 per share versus a loss of $1.30 per share in the third quarter of 2008. Net income for the nine months increased $18.6 million or 188% compared to last year, to $8.7 million from a loss of $9.9 million. Net income per share increased $1.60 or 188% and was $0.75 per share versus a loss of $0.85 per share for the first nine months of 2008.

The largest factor in the increase in the third quarter of 2009 was a decline in realized investment losses, which totaled $1.1 million versus $29.3 million in the third quarter of 2008. Operating expenses decreased $2.5 million or 10% and income tax expense increased during the third quarter, reflecting higher pretax income.

The improvement in net income for the nine months versus the same period one year ago largely resulted from a $30.3 million reduction in realized investment losses, as these losses declined from $37.6 million for the first nine months of 2008 to $7.3 million in 2009. Partially offsetting this improvement were reductions in net investment income and contract charges of $4.2 million and $1.6 million, respectively, and a $2.6 million increase in operating expenses. In addition, income tax expense increased during the nine months, reflecting higher pretax income.

Sales

The Company measures sales in terms of new premiums and deposits. Premiums are included in insurance revenues in the Consolidated Statements of Income, while deposits are shown as a Financing Activity in the Consolidated Statements of Cash Flows.

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 the Company's existing sales force and the addition of new general agents and 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 and on providing more training and direct support within the field. In addition, the growth strategy also encourages a product mix that includes both life and annuity products. The Company's marketing and product strategy also allows the Company the flexibility to identify niches in the existing market environments and to react quickly to be able to take advantage of short-term opportunities when they occur.

The Company also markets a series of group products, as identified in the Group Insurance segment discussed below. These products include group life, dental, disability, and vision products. The primary growth strategies for this segment include increased productivity of the existing group representatives and planned 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.

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The following table reconciles premiums included in insurance revenues and provides detail by new and renewal business for the third quarters and nine months ended September 30, 2009 and 2008. New premiums are also detailed by product.

	Quarter Ended September 30			
	2009	% Change	2008	% Change
New premiums:				
Individual life insurance	$3,643	8	$3,358	9
Immediate annuities	10,842	347	2,426	41
Group life insurance	359	(31)	518	19
Group accident and health insurance	2,764	1	2,748	22
Total new premiums	17,608	95	9,050	21
Renewal premiums	35,824	-	35,811	1
Total premiums	$53,432	19	$44,861	4

	Nine Months Ended September 30			
	2009	% Change	2008	% Change
New premiums:				
Individual life insurance	$10,330	6	$9,769	7
Immediate annuities	16,842	87	9,014	64
Group life insurance	1,134	(29)	1,598	45
Group accident and health insurance	7,545	(8)	8,232	7
Total new premiums	35,851	25	28,613	23
Renewal premiums	107,297	1	106,197	(1)
Total premiums	$143,148	6	$134,810	3

Consolidated total premiums increased 19% in the third quarter of 2009 versus the same period in the prior year, as total new premiums increased 95% and total renewal premiums were flat. New premiums increased $8.6 million, largely due to a $8.4 million increase in immediate annuities. The increase in immediate annuity sales represents a continuing demand for fixed-rate products by consumers and an increase in sales from a third-party marketing arrangement. New individual life premiums increased 8%, as new premiums in the Old American segment increased 22%. The increase in new premiums from the Old American segment reflects a combination of expanded distribution and improved agent contracts. New group life premiums decreased 31% while new group accident and health premiums increased 1%.

Total premiums for the nine months of 2009 increased 6% compared to one year ago, as total new premiums increased 25% and total renewal premiums increased 1%. New immediate annuity premiums increased $7.8 million or 87%, reflecting continued demand for fixed-rate products by consumers and an increase in sales from a third-party marketing arrangement. New individual life premiums increased 6%, reflecting a 16% increase in new individual life premiums at the Old American segment. Partially offsetting these increases, new group life insurance premiums declined 29% and new group accident and health insurance premiums declined 8%. The decrease in new group accident and health premiums was primarily due to a 21% decline in new dental premiums in the Group Insurance segment. The Company periodically adjusts its pricing on its dental product to align with its product profit expectations. Total renewal premiums increased $1.1 million, reflecting an 8% increase in group accident and health premiums. The increase in group accident and health premiums was largely due to a 9% increase in renewal dental premiums.

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The following table reconciles deposits with the Consolidated Statements of Cash Flows and provides detail by new and renewal deposits for the third quarters and nine months ended September 30, 2009 and 2008. New deposits are also detailed by product.

Quarter Ended September 30