

# **American Family Mutual Insurance Company and Subsidiaries**

**Consolidated Financial Statements  
December 31, 2014 and 2013**

**American Family Mutual Insurance Company and Subsidiaries**  
**Contents**  
**December 31, 2014 and 2013**

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## Independent Auditor's Report

To the Board of Directors of  
American Family Mutual Insurance Company and Subsidiaries:

We have audited the accompanying consolidated financial statements of American Family Mutual Insurance Company and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of comprehensive income, of changes in policyholders' equity and of cash flows for the years then ended.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. At December 31, 2013, we did not audit the financial statements of Homesite Group, Inc., an indirect wholly-owned subsidiary of American Family Mutual Insurance Company acquired on December 31, 2013, which statements reflected total assets constituting 4.9 percent of consolidated total assets at December 31, 2013. These financial statements were audited by other auditors whose report thereon was furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Homesite Group, Inc., at December 31, 2013 is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



**pwc**

*Opinion*

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Family Mutual Insurance Company and Subsidiaries at December 31, 2014 and 2013 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

February 27, 2015

**American Family Mutual Insurance Company and Subsidiaries**  
**Consolidated Balance Sheets**  
**December 31, 2014 and 2013**

<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>		<b>2014</b>	<b>2013</b>
<b>Assets</b>			<b>Liabilities</b>		
Bonds, available-for-sale and trading	\$ 12,414,275	\$ 11,733,949	Property and casualty loss and loss adjustment expense reserve	\$ 3,718,485	\$ 3,692,509
Common stocks, available-for-sale	2,208,948	1,950,648	Liabilities for life policies and contracts	4,008,620	3,999,524
Mortgage loans on real estate	483,404	424,217	Property and casualty unearned premiums	2,922,530	2,768,832
Real estate	6,892	6,792	Life policyholders' dividends payable	9,678	12,933
Policy loans	218,498	224,696	Drafts outstanding	87,053	93,422
Cash and cash equivalents	522,828	513,409	Income tax payable	68,968	13,570
Short-term investments	166,072	114,284	Agent termination benefits	675,164	575,156
Other invested assets	<u>663,525</u>	<u>618,977</u>	Employee pension and other benefits	376,901	187,743
			Long-term debt (includes \$624,021 and \$496,176 at fair value, respectively)	660,104	532,259
Total cash and investments	16,684,442	15,586,972	Deferred tax liabilities	-	33,461
			Accrued expenses	312,092	333,759
Property and casualty premiums receivable and agents' balances	1,282,142	1,188,865	Ceded premiums payable	92,101	-
Accrued investment income	127,367	122,188	Other liabilities	335,143	347,158
Deferred policy acquisition costs	644,671	618,821	Separate account liabilities	<u>318,096</u>	<u>319,028</u>
Property and equipment (net of accumulated depreciation of \$838,358 and \$790,455)	595,389	565,889			
Reinsurance recoverable	272,136	264,103	Total liabilities	<u>13,584,935</u>	<u>12,909,354</u>
Prepaid reinsurance premium	83,722	166,824			
Goodwill	221,627	219,208	<b>Policyholders' Equity</b>		
Intangible assets	209,334	282,139	Retained earnings	6,294,043	5,781,836
Deferred tax assets	21,994	-	Accumulated other comprehensive income (loss)	<u>671,065</u>	<u>799,110</u>
Other assets	89,123	156,263			
Separate account assets	<u>318,096</u>	<u>319,028</u>	Total policyholders' equity	<u>6,965,108</u>	<u>6,580,946</u>
Total assets	<u>\$ 20,550,043</u>	<u>\$ 19,490,300</u>	Total liabilities and policyholders' equity	<u>\$ 20,550,043</u>	<u>\$ 19,490,300</u>

The accompanying notes are an integral part of these financial statements.

# American Family Mutual Insurance Company and Subsidiaries

## Consolidated Statements of Comprehensive Income

### Years Ended December 31, 2014 and 2013

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<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>
<b>Revenues</b>		
Property and casualty premiums earned	\$ 6,563,709	\$ 5,786,539
Life insurance premiums, fees and other considerations	308,190	314,561
Net investment income	376,829	558,006
Net impairment losses recognized in earnings	(17,106)	(11,035)
Other realized capital gain (loss)	558,480	151,767
Other income	142,664	154,377
Total revenues	7,932,766	6,954,215
<b>Benefits and expenses</b>		
Property and casualty losses and loss adjustment expenses incurred	4,610,965	4,197,470
Life insurance claims and other benefits	177,559	183,848
Life insurance dividends to policyholders	21,825	25,524
Change in future life policy benefits	101,438	74,410
Commissions	643,265	603,397
Other property and casualty underwriting expenses	1,468,624	1,166,842
Other expenses	164,392	176,764
Total benefits and expenses	7,188,068	6,428,255
Income (loss) before income tax expense (benefit)	744,698	525,960
<b>Income tax expense (benefit)</b>		
Current	206,271	66,204
Deferred	23,233	80,921
Total income tax expense (benefit)	229,504	147,125
<b>Net income (loss)</b>	515,194	378,835
<b>Other comprehensive income (loss)</b>		
Changes in unrealized gains (losses) on securities (net of tax of \$175,643 and \$4,837 and deferred policy acquisition cost adjustments of \$15,497 and \$(55,243) in 2014 and 2013, respectively)	310,144	3,912
Less: reclassification adjustment for net gains included in other realized capital gain (loss) (net of tax of \$160,412 and \$68,483 in 2014 and 2013, respectively)	281,915	119,643
Change in defined benefit obligations (net of tax of \$(90,914) and \$103,847 in 2014 and 2013, respectively)	(156,282)	181,014
Other comprehensive income (loss)	(128,053)	65,283
<b>Comprehensive income (loss)</b>	\$ 387,141	\$ 444,118

The accompanying notes are an integral part of these financial statements.

**American Family Mutual Insurance Company and Subsidiaries**  
**Consolidated Statements of Changes in Policyholders' Equity**  
**Years Ended December 31, 2014 and 2013**

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<i>(in thousands of dollars)</i>	<u>2014</u>	<u>2013</u>
<b>Retained earnings</b>		
Balance at beginning of year	\$5,781,836	\$5,403,001
Net income (loss)	515,194	378,835
Acquisition of noncontrolling interest	<u>(2,987)</u>	<u>-</u>
Balance at end of year	<u>6,294,043</u>	<u>5,781,836</u>
<b>Accumulated other comprehensive income (loss)</b>		
Net unrealized gain (loss) on investments		
Balance at beginning of year	807,641	958,977
Change in unrealized gains (losses) on common stocks, bonds, and other assets	58,955	(234,620)
Income tax benefit/(expense)	<u>(20,758)</u>	<u>83,284</u>
Balance at end of year	845,838	807,641
Net unrealized gain (loss) on deferred acquisition costs		
Balance at beginning of year	(18,225)	(53,830)
Change in period, net of income tax (expense) benefit	<u>(9,960)</u>	<u>35,605</u>
Balance at end of year	(28,185)	(18,225)
Change in pension and other post-retirement benefit obligations		
Balance at beginning of year	9,694	(171,320)
Change in period, net of income tax (expense) benefit	<u>(156,282)</u>	<u>181,014</u>
Balance at end of year	<u>(146,588)</u>	<u>9,694</u>
Total accumulated other comprehensive income (loss)	<u>671,065</u>	<u>799,110</u>
Total policyholders' equity	<u>\$6,965,108</u>	<u>\$6,580,946</u>

The accompanying notes are an integral part of these financial statements.

**American Family Mutual Insurance Company and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2014 and 2013**

<i>(in thousands of dollars)</i>	<u>2014</u>	<u>2013</u>
<b>Cash flows from operating activities</b>		
Net income (loss)	\$ 515,194	\$ 378,835
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities		
Depreciation and amortization	183,886	101,801
Fair value option of long-term debt	127,845	(3,824)
Net realized (gains) losses on sales of investments	(541,860)	(138,971)
Unearned premiums	(102,239)	107,903
Deferred income tax provision	23,233	80,921
Deferred policy acquisition costs	(41,347)	6,679
Earnings of equity method investments	(42,012)	(40,871)
Change in value of trading securities	14,331	17,091
Change in value of derivatives	56,114	(51,669)
Insurance reserves	204,768	79,812
Other changes in operating assets and liabilities	233,286	(32,570)
Net cash provided by (used in) operating activities	<u>631,199</u>	<u>505,137</u>
<b>Cash flows from investing activities</b>		
Proceeds from sales, maturities or calls of bonds	5,647,618	4,765,692
Purchases of bonds	(5,990,802)	(5,070,644)
Proceeds from sales of common stocks	1,022,965	323,068
Purchases of common stocks	(1,095,774)	(174,025)
Net (increase) decrease in finance receivables	1,061	2,365
Net purchases and sales of short term investments	(27,541)	(24,359)
Purchases of other investments	(399,187)	(371,194)
Proceeds from sales of other investments	344,746	281,682
Proceeds from sales of mortgages	58,049	82,646
Purchases of mortgages	(117,231)	(99,461)
Purchases of property and equipment	(59,054)	(92,925)
Acquisition of businesses, net of cash acquired	(4,692)	(601,062)
Other investing activities	5,338	15,688
Net cash provided by (used in) investing activities	<u>(614,504)</u>	<u>(962,529)</u>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of long-term debt	-	500,000
Deposits to investments-type and universal life contracts	83,450	90,129
Withdrawals from investment-type and universal life contracts	(90,726)	(89,464)
Net cash provided by (used in) financing activities	<u>(7,276)</u>	<u>500,665</u>
Net change in cash and cash equivalents	9,419	43,273
<b>Cash and cash equivalents</b>		
Beginning of year	<u>513,409</u>	<u>470,136</u>
End of year	<u>\$ 522,828</u>	<u>\$ 513,409</u>
Income taxes paid (received)	\$ 119,911	\$ 87,390
Interest paid (received)	27,281	2,161

The accompanying notes are an integral part of these financial statements.

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

### December 31, 2014 and 2013

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#### 1. Nature of Operations and Significant Accounting Policies

American Family Mutual Insurance Company (AFMIC) is the parent of its wholly-owned subsidiaries, American Family Brokerage, Inc. (AFBI), American Family Securities, LLC (AFS), The AssureStart Insurance Agency LLC (AIA), and AmFam, Inc. AmFam, Inc.'s wholly-owned subsidiaries are American Family Life Insurance Company (AFLIC), American Standard Insurance Company of Wisconsin (ASIC), American Family Financial Services, Inc. (AFFS), American Family Insurance Company (AFIC), American Standard Insurance Company of Ohio (ASICO), PGC Holdings Corp. (PGC), Homesite Group, Inc. (Homesite) and Midvale Indemnity Company (MIC). In 2013, Lumbermens Casualty Insurance Company (LCIC) was renamed to MIC. AmFam, Inc., a non-insurance holding company, is the managing member and AFLIC is a non-managing member of New Ventures, LLC (NV), an indirect, wholly-owned subsidiary of AFMIC. AFMIC and its consolidated subsidiaries are herein referred to collectively as the "Companies" or the "Company".

AFMIC and AFIC are engaged principally in the writing of automobile insurance, homeowners insurance, commercial insurance, and other property and casualty insurance. ASIC and ASICO are engaged principally in the writing of non-standard automobile and cycle insurance. In 2011, ASIC started assuming property reinsurance mainly outside the Companies' existing geographic operating territory in order to diversify the Companies' risk. AFLIC principally markets whole life, term life, and universal life products to provide financial protection for qualified individuals, families and business enterprises. These companies sell these lines of business predominantly through a multi-line, exclusive agency force in nineteen states. AFLIC also supports a small amount of group life insurance and structured settlement business primarily as a service to its affiliates. AFFS was substantially engaged in the business of making direct loans to qualified individuals and business enterprises. AFFS ceased issuing new loans on November 1, 2007, and existing loans are in run-off. ASICO sells insurance in the states of Ohio and Georgia only. AFBI is an insurance agency which provides brokerage services to its affiliates and administers the federal Write Your Own Flood Program on behalf of AFMIC. In 2014, articles of dissolution for AFS, a non-clearing registered broker-dealer, were filed with and approved by the state of Wisconsin, at which time the assets were distributed to AFMIC. NV was formed in 2010 to support the Companies' non-insurance business development efforts. On April 1, 2013, AFLIC ceded 100% of its variable universal life (VUL) and variable annuity (VA) business under a 100% reinsurance agreement with Kansas City Life Insurance Company (see Note 1(i)).

On January 14, 2013, AFMIC obtained control of Business Insurance Direct, LLC (BID). On August 31, 2013 AFMIC exchanged its existing investment in BID for 100% of the Class A units of AIA. On November 26, 2014, AFMIC purchased 100% of the Class B units of AIA (see Note 3). AIA is a managing general agent and utilizes MIC to underwrite policies for small commercial businesses direct to the consumer. On December 31, 2013, AmFam, Inc. acquired 100% of the ownership interest in Homesite (see Note 2). Homesite specializes in direct-to-consumer homeowners, renters and condominium insurance. Homesite sells its products primarily through alliances with other insurers, mortgage companies, and real estate companies.

AmFam, Inc. owns 100% of the interest in PGC. PGC is the ultimate parent of the group of companies referred to generally as the Permanent General Companies. The Permanent General Companies specialize in writing non-standard private passenger personal automobile insurance, primarily to consumers interested in acquiring an insurance policy to comply with state minimum insurance requirements. PGC's business is primarily written online and over the phone.

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

### December 31, 2014 and 2013

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Property and casualty insurance represented 96% and 95% of total net premiums written for 2014 and 2013, respectively. Life insurance represented 4% and 5% of total net premiums written for 2014 and 2013, respectively. The Companies are licensed in 50 states and the District of Columbia.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Significant accounting policies used in the preparation of these statements include:

**a. Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of the Companies after elimination of all significant intercompany balances and activities.

**b. Cash and Investments**

The Companies may dispose of bonds prior to their scheduled maturity due to changes in market interest rates, tax and credit considerations, liquidity or regulatory capital requirements, or other similar factors. As a result, the Companies consider all of their bonds and common stocks available-for-sale with the exception of the Company's investment in convertible bonds, which are considered trading securities. Available-for-sale investments are reported at fair value, with unrealized gains and losses, net of applicable deferred taxes, reported as a component of accumulated other comprehensive income until realized. If there is a decline in an investment's net realizable value that is other-than-temporary, the decline is recorded as a realized loss and the cost of the investment is reduced to its fair value or present value of expected future cash flows. Trading securities are reported at fair value with unrealized gain or loss reported in earnings.

Other invested assets consist primarily of investments in limited partnerships. The limited partnerships are reported in the financial statements according to the Company's percentage of equity ownership in the limited partnerships. The Company has determined an ownership percentage of 5% or greater is more than a minor interest in a limited partnership, and these investments are accounted for using the equity method of accounting. The cost method of accounting is generally used to account for limited partnerships with a less than 5% ownership interest, as the Company's interest is so minor that it exercises virtually no influence over the investee's operations. Because the nature and structure of these cost method investments, they do not meet the characteristics of an equity security in accordance with applicable accounting standards. These investments typically reflect a reporting lag of up to three months, dependent upon receipt of the limited partnership financial statements. The Company also holds low income housing tax credits that are recorded at amortized cost.

For the limited partnerships accounted for under the equity method of accounting, all income from these partnerships, including net investment income, realized capital gains and losses, and changes in unrealized gains and losses, are recorded as net investment income on the consolidated statements of comprehensive income.

Derivative instruments are accounted for on a fair value basis and reported as other assets or other liabilities, as applicable, on the consolidated balance sheets. When derivatives meet

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

### December 31, 2014 and 2013

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specific criteria, they may be designated as accounting hedges and accounted for as fair value, cash flow, or foreign currency hedges. The Company did not elect to apply hedge accounting for the derivative instruments that were utilized during the reporting period. As a result, unrealized gains and losses on open derivative positions are recognized as a component of net investment income, with an adjustment to the derivative instrument. Interim settlements involving the receipt or payment of cash as well as the gain or loss recognized upon exiting a derivative position are also included as a component of net investment income. Cash flows from derivatives are reported in cash flows from investing activities within the consolidated statements of cash flows.

Prepayment assumptions for mortgage-backed and asset-backed securities are obtained from external sources when the securities are purchased. These allow the Company to recognize income using a constant effective yield based on those prepayment assumptions and the economic life of the securities. Updated prepayment assumptions are obtained on a monthly basis, and the effective yield is recalculated to reflect actual payments received and expected future payments.

Real estate assets consist of land, buildings, and building improvements held for the production of income. Land is reported at cost. Buildings and improvements are carried at cost, less accumulated depreciation computed on the straight-line method over estimated useful lives ranging from twenty to forty-five years.

Mortgage loans on real estate are carried at their aggregate unpaid principal balances, net of a valuation allowance for estimated uncollectible amounts. Policy loans are reported at their outstanding principal balance and are limited to the cash value of the policy.

Cash and cash equivalents represent cash and securities that have maturities of three months or less at purchase and consist primarily of money market mutual funds carried at cost, which approximates fair value.

Investment income is recorded when earned. Dividend income is recorded on the ex-dividend date. Realized gains and losses on sales of investments are determined on a specific identification basis and are recorded in the accompanying consolidated statements of comprehensive income.

#### **c. Fair Value Measurements**

Financial assets and financial liabilities recorded on the consolidated balance sheets at fair value are categorized based on the reliability of inputs to the valuation techniques as follows:

*Level 1* Financial assets and financial liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company can access.

*Level 2* Financial assets and financial liabilities whose values are based on the following:  
Quoted prices for similar assets or liabilities in active markets;  
Quoted prices for identical or similar assets or liabilities in non-active markets; or  
Valuation models whose inputs are observable, directly or indirectly, for substantially the full term of the asset or liability.

*Level 3* Financial assets and financial liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

### December 31, 2014 and 2013

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the overall fair value measurement. These inputs may reflect the Company's estimates of the assumptions that market participants would use in valuing the financial assets and financial liabilities.

The availability of observable inputs varies by instrument. In situations where fair value is based on internally developed pricing models or inputs that are unobservable in the market, the determination of fair value requires more judgment. In many instances, inputs used to measure fair value fall into different levels of the fair value hierarchy. In those instances, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement is categorized is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

**d. Premiums Written on Property and Casualty Insurance and Life Insurance**

Property and casualty premiums written are recorded on the effective date of the contract and earned on a pro rata basis over the terms of the policies. Premiums earned include premiums assumed and are presented net of premiums ceded under various reinsurance contracts. Premiums receivable and agents' balances are net of an allowance for doubtful accounts of \$10,648,000 and \$10,348,000 at December 31, 2014 and 2013, respectively.

The Company considers an account delinquent if payment is not received according to the contractual terms of the related insurance policy. Typically, accounts are charged off after attempts to collect the funds are exhausted by internal and external sources. The Company generally does not charge interest on delinquent accounts.

The Company annually evaluates whether a premium deficiency exists relating to short-duration contracts for each of its major lines of business. With the exception of short-duration contracts written by PGC, anticipated investment income is considered as part of the evaluation. A gross premium deficiency reserve of \$889,000 and \$3,088,000 existed attributable to health lines at December 31, 2014 and 2013, respectively. 50% of the reserve is subject to ceding under a reinsurance contract. GAAP requires that any related DAC is eliminated before a liability is recorded. After taking into account the 50% cession and adjusting for approximately \$1,412,000 of related DAC eliminations, net premium deficiency reserves of \$0 and \$132,000 were reported as of December 31, 2014 and 2013, respectively.

Term life and whole life insurance premiums are generally recognized as premium income when received. Revenue from immediate annuities and supplemental contracts with life contingencies is recognized at the time of issue. Benefits and expenses are associated with earned premiums so as to result in recognition of profits over the life of the contracts. The association is accomplished by means of the provision for liabilities for future policy benefits and the amortization of deferred policy acquisition costs. Premium income is recorded net of premiums due to reinsurers. Commissions and other expenses are recorded net of allowances received from reinsurers.

For investment-type and universal life insurance contracts, premium deposits and benefit payments are recorded as increases or decreases in a liability account, rather than as revenue and expense. Revenue is recognized for any amounts charged against the liability account for the cost of insurance, policy administration, and surrender penalties. Expense is recorded for any interest credited to the liability account and any benefit payments which exceed the contract liability account balance.

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**Notes to Consolidated Financial Statements**  
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**e. Deferred Policy Acquisition Costs (DAC)**

Costs that are directly related to the successful acquisition of new or renewal insurance contracts are deferred to the extent that such costs are deemed recoverable. These costs include, but are not limited to, commissions, certain costs of policy issuance and underwriting, and certain agency expenses. For property and casualty contracts, deferred costs are amortized as the related premiums are earned. For term life insurance contracts, deferred costs are amortized with interest in relation to future anticipated premium revenue, using the same assumptions that are used in calculating the insurance liabilities. For traditional whole life insurance contracts, deferred costs are amortized in relation to the present value of expected gross margins, discounted using the interest rate earned on the underlying assets. For deposit contracts without significant mortality risk (investment-type contracts) and for contracts that permit the Company or the policyholder to make changes in the contract terms (universal life insurance contracts), deferred costs are amortized in relation to the present value of expected gross profits from these contracts, discounted using the interest rate credited to the policy or the expected earnings rate, depending on the type of policy.

The Companies regularly evaluate the recoverability of the unamortized balance of DAC. For property and casualty insurance, if DAC were to exceed the sum of unearned premiums and related anticipated investment income less expected losses and loss adjustment expenses and policy maintenance costs, the excess cost would be expensed immediately. For term life insurance contracts, the unamortized asset balance is reduced by a charge to income only when the estimated remaining gross premium reserve exceeds the GAAP reserves reduced by unamortized DAC. For traditional whole life insurance contracts, the accumulated amortization is adjusted (whether an increase or a decrease) whenever there is a material change in the estimated gross margins expected over the life of a block of business in order to maintain a constant relationship between the cumulative amortization and the present value (discounted at the rate of interest earned on the underlying assets) of expected gross margins. For universal life and investment-type insurance contracts, the accumulated amortization is adjusted (whether an increase or a decrease) whenever there is a material change in the estimated gross profits expected over the life of a block of business in order to maintain a constant relationship between the cumulative amortization and the present value of expected gross profits.

DAC is also adjusted when bonds are recorded at fair value for traditional whole life, universal life, and investment-type insurance contracts. This adjustment, which is recorded as part of the net appreciation (depreciation) of securities in Accumulated Other Comprehensive Income, reflects the change in cumulative amortization that would have been recorded if these bonds had been sold at their fair values and the proceeds were reinvested at current yields.

**f. Property and Casualty Loss and Loss Adjustment Expense Reserve**

The property and casualty loss and loss adjustment expense reserve, including health insurance, includes amounts determined on the basis of claim evaluation and other estimates for reported losses, and includes estimates for losses incurred but not reported and anticipated salvage and subrogation recoveries (health insurance does not include salvage). These estimates are continually reviewed and updated and any adjustments are reflected currently. Accordingly, losses and loss adjustment expenses are charged to income as incurred.

Reinsurance recoveries are recorded as a reduction of losses and loss adjustment expenses in accordance with contract terms.

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

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The liability for gross long-term care claims has been discounted on a tabular basis using morbidity from the 1982 through 1994 National Long-term Care Surveys and 1985 National Nursing Home Surveys at 4.5%. The liabilities include \$8,373,000 and \$7,376,000 of such discounted reserves at December 31, 2014 and 2013, respectively. As of July 1, 2010, the Companies' long-term care business was 100% ceded to Ability Insurance Company, a nonaffiliated company.

Due to the reasonably complex and dynamic process of establishing these reserves, which can be influenced by a variety of factors and assumptions, the actual ultimate losses and loss adjustment expenses which may emerge in future years may vary from the amounts recorded in these consolidated financial statements.

**g. Liabilities for Life and Deposit-Type Contracts**

For term life insurance contracts, reserves are calculated using the net level premium method, based on assumptions as to investment yields, mortality, withdrawals, expenses and dividends. These assumptions are made at the time the contract is issued and are consistent with assumptions used in the product pricing process. Assumptions are based on projections from past Company experience and are modified only as necessary to reflect loss recognition. In addition, an allowance is made for possible unfavorable deviations from selected assumptions.

For traditional whole life insurance contracts, reserves are calculated based on the net level policy benefit reserve. Interest assumptions are consistent with the policy dividend formula and mortality assumptions and are based on the 1958, 1980 or 2001 CSO table. The interest rate on current issues is 4.0% in both 2014 and 2013. Interest rates on all other issues are between 2.5% and 5.0% in both 2014 and 2013.

For universal life, deposit-type and investment-type insurance contracts, reserves are based on the contract account balance. Reserves for annuities in payout status are calculated as the present value of future benefits using contract interest rates and either the 1971, 1983 or 2000 Immediate Annuity Mortality table.

**American Family Mutual Insurance Company and Subsidiaries**  
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Gross reserves by type of contract at December 31 are as follows:

<i>(in thousands of dollars)</i>	<b>2014</b>		<b>2013</b>	
<b>Deposit-type liabilities</b>				
Universal life	\$ 491,154	12.0 %	\$ 492,258	12.3 %
Deferred annuities	263,225	6.4	256,389	6.4
Dividend accumulations	239,430	5.9	239,149	6.0
Structured settlements	48,284	1.2	51,376	1.3
Variable universal life	14,622	0.4	12,131	0.3
Variable annuities	13,127	0.3	13,846	0.3
Supplemental contracts without life contingencies, retained assets and premium deposits	92,060	2.3	95,450	2.4
<b>Accident &amp; health liabilities</b>				
Long-term care	*	1.9	72,657	1.8
<b>Insurance-type liabilities</b>				
Traditional whole life	2,347,750	57.4	2,284,214	57.1
Traditional term life	440,413	10.8	423,342	10.6
Payout annuities	50,497	1.2	50,518	1.3
Other insurance reserves	8,058	0.2	8,194	0.2
Total liabilities for life policies and deposit contracts	<u>\$ 4,008,620</u>	<u>100.0 %</u>	<u>\$ 3,999,524</u>	<u>100.0 %</u>

\* In 2014, the Accident & health liabilities long-term care is eliminated in consolidation

**h. Life Policyholders Dividends Payable**

Approximately 98.1% of the Company's life contracts are considered participating policies. The Company accounts for policyholder dividends based upon dividend scales approved by AFLIC's Board of Directors. The amount of dividends to be paid is determined annually. Participating policyholders generally have the option to direct their dividends to be paid in cash, used to reduce future premiums due, used to purchase additional insurance benefits or left on deposit with the Company to accumulate interest. Dividends used by policyholders to purchase additional insurance benefits are reported as premiums in the consolidated statements of comprehensive income. The Company's annual declaration includes a guarantee of a minimum aggregate amount of dividends to be paid to policyholders as a group in the subsequent year. The portion of the Company's earnings allocated as dividends is included in policyholders' dividends payable.

**i. Reinsurance**

In the normal course of business, the Companies seek to limit their exposure to loss on any single insured and to certain aggregate loss limits. This is accomplished by ceding insurance to other insurance companies or reinsurers under quota share, excess of loss contracts and coinsurance contracts. Liabilities related to insurance contracts are reported gross of the effects of reinsurance. Estimated reinsurance recoverable is recognized in a manner consistent with the liabilities related to the underlying reinsured contracts.

In 2011, ASIC started assuming property reinsurance mainly outside the Companies' existing geographic operating territory in order to diversify the Companies' risk. Property and casualty

# American Family Mutual Insurance Company and Subsidiaries

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earned premiums assumed under reinsurance contracts under this program during 2014 and 2013 were \$76,581,000 and \$68,478,000, respectively.

Property and casualty earned premiums ceded under reinsurance contracts during 2014 and 2013 were \$320,965,000 and \$172,243,000, respectively. Gross written premiums ceded during 2014 and 2013 were \$229,428,000 and \$175,510,000, respectively. Unearned premiums ceded under reinsurance contracts were \$83,192,000 and \$167,214,000 at December 31, 2014 and 2013, respectively. Loss and loss adjustment expenses ceded under reinsurance contracts were \$74,558,000 and \$83,585,000 for the years ended December 31, 2014 and 2013, respectively.

Life reinsurance premiums ceded were \$75,814,000 and \$68,462,000 in 2014 and 2013, respectively. Life reserves ceded under reinsurance contracts were \$194,474,000 and \$184,064,000 at December 31, 2014 and 2013, respectively. Reinsurance commissions and expense allowances were \$22,684,000 and \$46,387,000 in 2014 and 2013, respectively. Life and Accident and Health insurance benefits on ceded claims were \$31,478,000 and \$22,123,000 in 2014 and 2013, respectively.

Effective April 1, 2013, AFLIC ceded all of its VUL and VA in-force block of business under a 100% reinsurance agreement with Kansas City Life Insurance Company (KCL). Pursuant to the agreement, AFLIC transferred all of the net policy liabilities on the reinsured policies (with an outstanding gross carrying value of \$27,596,000 at April 1, 2013) with the exception of the separate account liabilities which are retained by AFLIC under the modified coinsurance agreement relating to the separate accounts. A corresponding decrease to "change in future policy benefits" was recorded in the 2013 consolidated statement of comprehensive income. DAC in the amount of \$27,386,000 was written off at the time of the initial transaction. As part of this transaction, former registered representatives were also paid a one-time lump sum commission payment of \$5,162,000 which was recorded as commission expense. A ceding commission of \$25,016,000 was recorded as a reduction of "salaries and other expenses" in the 2013 consolidated statement of comprehensive income. This reinsurance transaction resulted in a total gain of \$20,063,000 which has been deferred because the transaction was structured as indemnity reinsurance whereby AFLIC's obligation to policyholders was not legally extinguished. The gain is being amortized over the remaining expected life of the policies (27 years for VUL and 25 years for VA). The deferral of this gain was recorded as an increase to "salaries and other expenses" in the 2013 consolidated statement of comprehensive income and an increase to "other liabilities" in the consolidated balance sheet. Straight-line amortization of the deferred gain is being utilized. A deferred gain of \$725,000 and \$544,000 was recognized at December 31, 2014 and 2013, respectively. The total gain was recognized immediately for tax return purposes. However, the increase in current income tax expense was completely offset by an equivalent decrease in deferred tax expense as a deferred income tax asset was recorded for the tax effect of this deferred gain. All legal and consulting expenses as part of the transaction were expensed in 2013.

The Companies do not enter into finite reinsurance contracts; all reinsurance contracts involve a significant transfer of risk. Ceded reinsurance transactions do not relieve the Company of its primary obligation to the policyholder.

#### **j. Federal Income Taxes**

The Companies file a consolidated federal income tax return and are subject to a tax allocation agreement under which each member's tax liability equals or approximates

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separate return calculations with current credit for net losses and tax credits utilized by other members of the group. Deferred taxes are established for the future tax effects of temporary differences between the tax and financial reporting bases of assets and liabilities using currently enacted tax rates. The effect on deferred taxes of a change in tax rates is recognized in income in the period of enactment. Deferred tax assets (DTAs) are valued based upon the expectation of future realization on a "more likely than not" basis. A valuation allowance is established for that portion of DTAs which cannot meet this realization standard. Based on all available evidence, a valuation allowance is not needed as of December 31, 2014 and 2013.

**k. Property and Equipment**

Property and equipment, including software, is carried at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, ranging from three to forty-five years. The Company reviews fixed assets for impairment when there is reason to believe that a fixed asset's carrying value might not be recoverable, and charges any impairments to earnings.

The gross cost, accumulated depreciation and net cost of major classes of property and equipment as of December 31 are as follows:

<i>(in thousands of dollars)</i>	2014			2013		
	Gross Cost	Accumulated Depreciation	Net	Gross Cost	Accumulated Depreciation	Net
Property occupied by the Company	\$ 454,175	\$ (222,587)	\$ 231,588	\$ 441,677	\$ (212,408)	\$ 229,269
Furniture and equipment	212,913	(133,616)	79,297	231,920	(143,248)	88,672
Computer software and equipment	766,659	(482,155)	284,504	682,747	(434,799)	247,948
	<u>\$1,433,747</u>	<u>\$ (838,358)</u>	<u>\$ 595,389</u>	<u>\$1,356,344</u>	<u>\$ (790,455)</u>	<u>\$ 565,889</u>

**l. Goodwill**

Goodwill represents the excess of cost over the fair value of net assets acquired in business combinations. Goodwill is not amortized, but is reviewed for impairment at least annually and whenever there is an impairment indicator, using a fair value based approach.

**m. Intangible Assets**

The establishment of intangible assets and the determination of estimated useful lives are primarily based on valuations received from qualified independent appraisers. The calculations of these amounts are based on estimates and assumptions using historical and pro forma data and recognized valuation methods. Different estimates or assumptions could produce different results. Contractual or separable intangible assets that have finite useful lives are amortized against income over their estimated useful lives using either a straight-line method or a weighted-average method based on projected pre-tax income generated by the intangible assets over their estimated useful lives. Indefinite-lived intangible assets are not subject to amortization.

The Company at least annually evaluates the remaining useful lives of its intangible assets with a finite life to determine whether events or circumstances warrant a revision to the remaining period of amortization. The Company evaluates its indefinite-lived intangible assets for impairment on at least an annual basis. The Company evaluates its finite-lived intangible assets for impairment when circumstances indicate an impairment may have occurred.

See Note 8 for more information on intangible assets.

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**n. Leases**

The Company leases various office equipment and real estate under various noncancelable operating lease agreements with various expiration dates through 2019 and thereafter. Lease expense for 2014 and 2013 was \$38,098,000 and \$38,673,000, respectively.

As of December 31, 2014, the minimum aggregate lease commitments were as follows:

<i>(in thousands of dollars)</i>	<b>Operating Leases</b>
<b>Year ending December 31</b>	
2015	\$ 37,825
2016	37,550
2017	35,422
2018	34,094
2019 and thereafter	48,134
Total	<u>\$ 193,025</u>

Certain lease commitments have renewal options extending through the year 2034. Some of these renewals are subject to adjustments in future periods.

**o. Separate Accounts**

Separate account assets include segregated funds invested by the Company as designated by variable universal life insurance and variable annuity policy owners in shares of mutual funds managed by outside fund managers offered as investment vehicles for American Family Variable Accounts I or II. The assets (investments) and liabilities (to policy owners) of each account are clearly identifiable and distinguishable from other assets and liabilities of the Company. Assets are valued at fair value and liabilities are equal to the amount due to the policy owner without a reduction for surrender charges. The investment income, gains and losses of these accounts generally accrue to the policy owners, and, therefore, are not included in the Company's net income.

**p. Adoption of New Accounting Guidance**

*Disclosures about Offsetting Assets and Liabilities*

In December 2011 and January 2013, the FASB issued guidance regarding the offsetting of specific assets and liabilities on the statement of financial position. The guidance applies to derivatives that are subject to a master netting arrangement. Under certain conditions, offsetting of the assets and liabilities will continue to be permissible, provided that the Company includes required disclosures to facilitate the reconciliation of the financial statements between U.S. GAAP and IFRSs. The Company adopted the guidance for its year ended December 31, 2013. The new guidance affects disclosures only and, therefore, the adoption had no impact on the Company's results of operations or financial position.

*Testing Indefinite-Lived Intangible Assets for Impairment*

In July 2012, the FASB issued guidance providing the option to perform a qualitative, rather than quantitative, assessment to determine whether it is more likely than not that indefinite-lived intangible assets are impaired, which would indicate that further quantitative analysis would need to be performed to determine whether an impairment has occurred. The Company adopted this guidance on January 1, 2013 and has elected the option of performing a qualitative assessment. The new guidance did not impact the Company's results of operations or financial position.

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#### *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*

In February 2013, the FASB issued guidance requiring entities to present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. If the component is not required to be reclassified to net income in its entirety, entities would instead cross reference to the related footnote for additional information. The Company adopted this guidance on January 1, 2014. The new guidance affects presentation of accumulated other comprehensive income only; therefore, the adoption of this guidance had no impact on the Company's results of operations or financial position.

#### **r. Subsequent Events**

The Company has evaluated events subsequent to December 31, 2014 through February 27, 2015, the date these financial statements were available to be issued. Based on this evaluation, no events have occurred subsequent to December 31, 2014 that require disclosure or adjustment to the financial statements at that date or for the year then ended.

## **2. Acquisitions**

On December 31, 2013, AmFam Inc. acquired 100% of the ownership interest in Homesite for \$658,600,000 in cash. The purpose of this acquisition was to broaden distribution channels and to spread the concentration of risk. Homesite's wholly-owned subsidiary, Homesite Indemnity Corporation, is a property and casualty writer domiciled in Kansas. Homesite's other subsidiary, Homesite Securities Company, LLC, owns Homesite Insurance Agency and has seven wholly-owned insurance subsidiaries: Homesite Insurance Company of Georgia, Homesite Insurance Company of New York, Homesite Insurance Company of California, Homesite Insurance Company of the Midwest, Homesite Insurance Company of Illinois, Homesite Insurance Company of Florida, and Homesite Insurance Company. Homesite Securities Company, LLC, also owns and controls Texas-South of Homesite, Inc., which is the attorney-in-fact for Homesite Lloyd's of Texas. Homesite specializes in direct-to-consumer homeowners, renters and condominium insurance. Homesite sells its products primarily through alliances with other insurers, mortgage companies, and real estate companies. As of December 31, 2014, Homesite had policies in force in 47 states and the District of Columbia.

The transaction was accounted for under the acquisition method using Homesite's historical financial information and applying fair value estimates to the acquired assets and liabilities as of the acquisition date. The excess of the purchase price over the fair value of the assets acquired and liabilities assumed at the acquisition date have been allocated to goodwill and intangible assets. The Company recognized \$135,025,000 of goodwill, which is primarily attributable to future growth potential, an assembled workforce with industry-wide technical expertise and synergies that will bring more value to customers through better operating efficiencies.

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The following is a summary of the fair values of the tangible and intangible assets acquired and liabilities assumed of Homesite at the date of acquisition:

<i>(in thousands of dollars)</i>	<b>December 31, 2013</b>
<b>Assets</b>	
Cash and investments	\$ 693,954
Reinsurance recoverable	38,496
Premiums receivable	66,362
Accrued investment income	3,659
Prepaid reinsurance premium	85,456
Intangible assets	228,900
Property and equipment	4,551
Other assets	47,948
Total assets	<u>\$ 1,169,326</u>
<b>Liabilities</b>	
Losses and loss adjustment expenses	\$ 159,346
Unearned premiums	359,913
Deferred income tax liability	56,619
Accrued expenses	57,183
Other liabilities	12,690
Total liabilities	<u>\$ 645,751</u>
Total identified net assets acquired	<u>\$ 523,575</u>
Goodwill	<u>\$ 135,025</u>

The acquired intangible assets of \$228,900,000 are comprised of partner relationships, referral relationships, software, state insurance licenses, value of business acquired, and renewal rights. Useful lives for finite-lived intangible assets range from one to twelve years. The goodwill will not be deductible for tax purposes. In 2014 measurement period adjustments resulting from the following were recorded: the final valuation of the business acquired (VOBA) intangible asset resulted in a decrease to intangible assets of \$3,450,000; various deferred tax adjustments, primarily for the decrease to VOBA, recognition of future windfall tax benefits, and establishment of a valuation allowance against state net operating loss carryforwards, netting to an asset of \$1,681,000; and an increase to goodwill of \$2,419,000.

Acquisition related expenses of \$7,898,000 were incurred during 2013 and are included in other expenses in the consolidated statements of comprehensive income.

**3. Establishment of Control**

On January 14, 2013, AFMIC obtained control of BID by making an initial \$1,500,000 cash contribution in exchange for 100% of the Class A units of BID and majority membership on the BID Board of Managers.

On August 31, 2013, AFMIC exchanged its existing investment in BID and contributed \$4,000,000 of additional capital for 100% of the 8,000 Class A units of AIA. The transaction was accounted for

# American Family Mutual Insurance Company and Subsidiaries

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as a transfer of assets between entities under common control. On November 26, 2014, AFMIC purchased 100% of the Class B units of AIA for \$4,692,000 cash. The Class A units and Class B units of AIA entitle AFMIC to 100% voting capital interest and 100% nonvoting profits interest. As of December 31, 2014, AIA had a carrying value of \$19,452,000.

#### 4. Financial Instruments

##### a. Fair Value of Financial Instruments

The fair value guidance establishes a hierarchy for inputs used in determining fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available.

Fair value is a market-based measure considered from the perspective of a market participant who owns an asset or owes a liability. Accordingly, when market observable data is not readily available, the Company's own assumptions are set to reflect those that market participants would be presumed to use in pricing the asset or liability at the measurement date. The Company uses prices and inputs that are current as of the measurement date, including during periods of market disruption. In periods of market disruption, the ability to observe prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from one level of the hierarchy to another.

When available, the Company uses the market approach to estimate the fair value of its financial instruments, which is based on quoted prices that are readily and regularly available in active markets. Generally, these are the most liquid of the Company's holdings and valuation of these securities does not involve management judgment. Matrix pricing and other similar techniques are other examples of the market approach. Matrix pricing values a particular security by utilizing the prices of securities with similar ratings, maturities, industry classifications, and/or coupons and interpolating among known values of these similar instruments to derive a price.

When quoted prices in active markets are not available, the Company uses the income approach, or a combination of the market and income approaches, to estimate the fair value of its financial instruments. The income approach involves using discounted cash flow and other standard valuation methodologies. The inputs in applying these market standard valuation methodologies include, but are not limited to, interest rates, benchmark yields, bid/ask spreads, dealer quotes, liquidity, term to maturity, estimated future cash flows, credit risk and default projections, collateral performance, deal and tranche attributes, and general market data.

The following valuation techniques and inputs were used to estimate the fair value of each class of significant financial instruments:

##### **Level 1 Measurements**

**Bonds:** *U.S. Government:* Comprised of U.S. Treasuries valued based on unadjusted quoted prices for identical assets in markets that are generally active.

**Common Stocks:** Comprised of actively traded, exchange listed U.S. and international equity securities. Valuation is based on unadjusted quoted prices for identical assets in active markets that the Company can access.

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Cash Equivalents: Comprised of actively traded money market funds that have daily quoted net asset values for identical assets that the Company can access and U.S. Treasuries with valuations based on unadjusted quoted prices for identical assets in markets that are generally active.

Short-term Investments: Comprised of U.S. Treasuries with valuations based on unadjusted quoted prices for identical assets in markets that are generally active.

#### **Level 2 Measurements**

Bonds: The Company uses leading, nationally recognized providers of market data and analytics to price a vast majority of the Company's Level 2 fair value measurements for fixed income securities. These securities are principally valued using the market and income approaches. When available, recent trades of identical or similar assets are used to price these securities. However, because many fixed income securities do not actively trade on a daily basis, pricing models are often used to determine security prices. The pricing models discount future cash flows at estimated market interest rates. These rates are derived by calculating the appropriate spreads over comparable U.S. Treasury securities based on credit quality, industry, and structure of the asset. Observable inputs used by the models include benchmark yields, bid/ask spreads, dealer quotes, liquidity, term to maturity, credit risk and default projections, collateral performance, deal and tranche attributes, and general market data. Inputs may vary depending on type of security.

A small segment of Level 2 and Level 3 securities are priced internally using matrix pricing, broker quotes, and benchmark and spread analysis, or through third party vendors that specialize in difficult-to-price securities. Pricing for specific security types is as follows:

*Corporates, including privately placed:* These securities are principally valued using the market and income approaches. Valued based on inputs including quoted prices for identical or similar assets in markets that are not active, or using matrix pricing or other similar techniques that use standard market observable inputs such as benchmark yield curves, bid/ask spreads, and credit quality. Also includes privately placed securities that are valued using internal matrix pricing and discounted cash flow methodologies using standard market observable inputs including taxable and tax-exempt yield curves and market observable ratings from external parties. Due to the relative illiquidity of private placements, illiquidity premiums of 25 and 100 basis points are factored into the yield curve inputs for investment grade and below investment grade securities, respectively.

*Municipals:* Valued using the market and income approaches based on inputs including quoted prices for identical or similar assets in markets that are not active, benchmark yield curves, bid/ask spreads, and credit quality.

*U.S. Government and Obligations of Foreign Governments:* Valued using the market and income approaches based on inputs including quoted prices for identical or similar assets in markets that are not active, benchmark yield curves, and bid/ask spreads.

*Asset Backed Securities (ABS), Residential Mortgage-backed Securities (RMBS), and Commercial Mortgage-backed Securities (CMBS):* Valued using the market and income approaches based on inputs including quoted prices for identical or similar assets in markets that are not active, benchmark yield curves, bid/ask spreads, default assumptions, projected cash flows, collateral performance, deal structure, and tranche characteristics.

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Common Stocks: Comprised of shares in Federal Home Loan Bank of Chicago (FHLBC) stock as discussed in Note 12.

Cash Equivalents: Cash equivalents are valued based on inputs including quoted prices for identical or similar assets in markets that are not active, benchmark yield curves, bid/ask spreads, and credit quality.

Short-term Investments: Short-term investments are valued based on quoted prices for identical or similar assets in markets that are not active, benchmark yield curves, bid/ask spreads, and credit quality.

Derivative Instruments: Over-the-counter (OTC) derivatives, including interest rate swaps, are valued using models that rely on inputs such as interest rate yield curves that are observable for substantially the full term of the contract. These models discount cash flows at each coupon date and the valuation of interest rate swaps is the difference between the values of the discounted cash flows of the fixed and floating legs of the swap. Fair value is the estimated amount that the Company would receive (pay) to terminate the derivative contracts at the reporting date. Derivative assets (liabilities) are reported gross of collateral payable (receivable) for purposes of fair value disclosures in Note 4(a).

Separate Account Assets: Comprised of mutual funds traded in non-active markets that have daily quoted net asset values for identical assets that the Company can access. Net asset values for the actively traded mutual funds in which the separate account assets are invested are obtained daily from the fund managers.

Long-term debt: Comprised of an FHLBC fixed-rate advance, for which daily published interest rates are available. See Note 4(h) for additional valuation methodology.

#### **Level 3 Measurements**

##### Bonds:

*Corporates:* Valued using cash flow modeling and the mid-point of actual bid and ask market quotes from global and regional banks, broker/dealers, and exchanges.

*Municipals:* Includes a bond issued to reimburse costs incurred by the developer (which is the Company) at the Mitchell Avenue Corridor Project 1 TIF location in St. Joseph, Missouri. This is the location of the Company's Missouri regional office building, and the Company is the sole property owner within the TIF boundary. The City of St. Joseph collects TIF property taxes from the Company and is obligated to request that the city council appropriate these tax payments to pay debt service on the bonds. The bond is priced at 100 as the Company is essentially backing this bond through property tax payments. Also includes a bond valued internally using a discounted cash flow model and a bond valued externally using broker quotes.

*ABS, RMBS and CMBS:* Valued using cash flow modeling and non-binding broker quotes received from brokers who are familiar with these generally illiquid investments. The cash flow model uses prepayment, default and severity assumptions, benchmark yields and weighted average lives as inputs.

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#### Other Valuations

Includes private equity investments presented using equity and cost methods of accounting, policy loans carried at their outstanding principal balance, mortgage loans carried at their outstanding principal amount and cash. Also includes trust preferred debentures carried at their outstanding principal balance.

The following summarizes the Company's financial assets and liabilities measured at fair value on a recurring basis as of December 31:

2014					
(in thousands of dollars)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Other Valuations	Balance as of December 31, 2014
<b>Financial assets</b>					
Bonds, available-for-sale and trading:					
U.S. Government	\$ 411,995	\$ 135,094	\$ -	\$ -	\$ 547,089
Municipals	-	4,950,905	19,191	-	4,970,096
Corporates	-	4,413,476	9,748	-	4,423,224
RMBS	-	1,100,366	2	-	1,100,368
CMBS	-	546,978	287	-	547,265
ABS	-	753,151	73,083	-	826,234
Common stocks, available-for-sale	2,179,397	13,326	-	16,225	2,208,948
Cash equivalents	280,262	3,732	-	-	283,994
Short-term investments	121,065	45,006	-	-	166,071
Derivative assets	-	3,041	-	-	3,041
Separate account assets	-	318,096	-	-	318,096
<b>Total recurring basis assets</b>	<u>2,992,719</u>	<u>12,283,171</u>	<u>102,311</u>	<u>16,225</u>	<u>15,394,426</u>
Valued at cost, amortized cost or using the equity method	-	-	-	1,611,153	1,611,153
<b>Total financial assets</b>	<u>\$ 2,992,719</u>	<u>\$ 12,283,171</u>	<u>\$ 102,311</u>	<u>\$ 1,627,378</u>	<u>\$ 17,005,579</u>
Long-term debt	-	624,021	-	36,083	660,104
Derivative liabilities	-	18,795	-	-	18,795
<b>Total financial liabilities</b>	<u>\$ -</u>	<u>\$ 642,816</u>	<u>\$ -</u>	<u>\$ 36,083</u>	<u>\$ 678,899</u>
2013					
(in thousands of dollars)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Other Valuations	Balance as of December 31, 2013
<b>Financial assets</b>					
Bonds, available-for-sale and trading:					
U.S. Government	\$ 376,305	\$ 142,128	\$ -	\$ -	\$ 518,433
Obligations of Foreign Governments	-	3,788	-	-	3,788
Municipals	-	4,604,671	17,880	-	4,622,551
Corporates	-	4,247,240	5,365	-	4,252,605
RMBS	-	1,186,964	3	-	1,186,967
CMBS	-	507,430	-	-	507,430
ABS	-	611,249	30,926	-	642,175
Common stocks, available-for-sale	1,841,715	97,426	-	11,507	1,950,648
Cash equivalents	329,167	1,376	-	-	330,543
Short-term investments	88,846	25,438	-	-	114,284
Derivative assets	-	37,406	-	-	37,406
Separate account assets	-	319,028	-	-	319,028
<b>Total recurring basis assets</b>	<u>2,636,033</u>	<u>11,784,144</u>	<u>54,174</u>	<u>11,507</u>	<u>14,485,858</u>
Valued at cost, amortized cost or using the equity method	-	-	-	1,457,530	1,457,530
<b>Total financial assets</b>	<u>\$ 2,636,033</u>	<u>\$ 11,784,144</u>	<u>\$ 54,174</u>	<u>\$ 1,469,037</u>	<u>\$ 15,943,388</u>
Long-term debt	-	496,176	-	36,083	532,259
Derivative liabilities	-	505	-	-	505
<b>Total financial liabilities</b>	<u>\$ -</u>	<u>\$ 496,681</u>	<u>\$ -</u>	<u>\$ 36,083</u>	<u>\$ 532,764</u>

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As part of its pricing procedures, the Company obtains quotes from a leading provider of pricing data, and the Company's internal pricing policy is to use a consistent source for individual securities in order to maintain the integrity of its valuation process. These primary quotes are validated on a quarterly basis via comparison to a secondary pricing source, which may include quotes received from a different third party pricing data provider or recent trade activity obtained from reputable online trading sites. Investment managers may be consulted to corroborate prices received from outside sources based on their knowledge of market trends and activity. As necessary, the Company utilizes a pricing service that specializes in difficult-to-value securities to price esoteric or illiquid securities. Material discrepancies between the primary and secondary sources are investigated, reconciled and updated as warranted. This may involve challenging a price from the primary source if the Company determines the price provided does not meet expectations based on observed market, sector, or security trends and activity.

On an annual basis the Company reviews quality control measures and data assumptions from its pricing sources to determine if any significant changes have occurred that may indicate issues or concerns regarding their evaluation or market coverage. In addition, an annual analysis is performed on a sample of securities to further validate the inputs, assumptions, and methodologies used by the primary source to price those securities.

During the course of the valuation process, if it is determined the material inputs used to price a security are unobservable, the Company will transfer that security to Level 3. Level 3 securities have historically represented a nominal percentage of the total investment portfolio and have generally consisted of illiquid or thinly traded CDO and private placement deals, bonds of issuers in the process of restructuring or bankruptcy, or other esoteric or difficult-to-price securities with little liquidity.

All transfers into or out of a particular level are recognized as of the beginning of the reporting period. In 2014, the Company transferred \$7,871,000 of ABS securities from Level 2 to Level 3. These securities were purchased near the end of 2013 and the purchase prices were used to determine year-end prices, resulting in a Level 2 designation. In 2014 a third party pricing service began pricing these securities using unobservable inputs, resulting in a change to Level 3. The Company also transferred \$1,574,000 of CMBS securities from Level 2 to Level 3 during 2014. This bond was previously priced by a third party pricing service using observable inputs but is now priced manually through a different third party pricing service using unobservable inputs. In 2014, the Company also transferred \$3,900,000 of other invested assets from Other Valuations to Level 3. These partnerships were previously valued using capital account valuations as reported by the various limited partnerships. In the second quarter of 2014 they were valued using agreed-upon purchase prices from a sale planned to occur later in the year, which resulted in their transfer to Level 3. These partnerships were all subsequently sold during 2014. There were no other material transfers between levels in 2014.

In 2013, the Company transferred a \$14,000,000 municipal bond from Level 2 to Level 3. This bond was initially valued based on its December 2012 purchase price but has subsequently been valued internally using a discounted cash flow model utilizing unobservable inputs. The Company transferred \$4,328,000 of corporate bonds from Level 2 to Level 3 in 2013. These bonds were previously priced by a third party pricing service using observable inputs but pricing for these securities was discontinued in 2013. The bonds are now priced manually using unobservable inputs. The Company transferred a \$17,152,000 corporate bond from Level 3 to Level 2 during 2013. This bond was previously priced manually using unobservable inputs but is now priced by a third party pricing service using observable inputs. In 2013, the Company transferred \$2,333,000 and \$7,748,000 of CMBS and ABS securities from Level 3 to

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

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Level 2, respectively. These securities were previously priced using unobservable inputs, but are currently either priced manually using observable trade data or by the Company's primary pricing vendor using observable inputs. There were no other material transfers between levels in 2013.

The following provides a summary of changes in fair value during the year ended December 31, of Level 3 financial assets held at fair value on a recurring basis at December 31:

2014								
Total Realized and Unrealized Gains (Losses) included in								
(in thousands of dollars)	Balance as of January 1, 2014	Net Income	OCI on Balance Sheet	Purchases	Sales	Settlements	Net Transfers In and/or (Out) of Level 3	Balance as of December 31, 2014
<b>Financial assets</b>								
Bonds, available-for-sale & trading:								
Municipals	\$ 17,880	\$ -	\$ 320	\$ 1,702	\$ -	\$ (711)	\$ -	\$ 19,191
Corporates	5,365	(20)	148	5,913	-	(1,658)	-	9,748
RMBS	3	-	-	-	-	(1)	-	2
CMBS	-	-	(9)	-	-	(1,278)	1,574	287
ABS	30,926	(68)	(284)	58,033	-	(23,395)	7,871	73,083
<b>Total recurring Level 3 financial assets</b>	<b>54,174</b>	<b>(88)</b>	<b>175</b>	<b>65,648</b>	<b>-</b>	<b>(27,043)</b>	<b>9,445</b>	<b>102,311</b>
Other invested assets	-	(862)	-	478	(3,141)	(375)	3,900	-
<b>Total Level 3 financial assets</b>	<b>\$ 54,174</b>	<b>\$ (950)</b>	<b>\$ 175</b>	<b>\$ 66,126</b>	<b>\$ (3,141)</b>	<b>\$ (27,418)</b>	<b>\$ 13,345</b>	<b>\$ 102,311</b>

  

2013								
Total Realized and Unrealized Gains (Losses) included in								
(in thousands of dollars)	Balance as of January 1, 2013	Net Income	OCI on Balance Sheet	Purchases	Sales	Settlements	Net Transfers In and/or (Out) of Level 3	Balance as of December 31, 2013
<b>Financial assets</b>								
Bonds, available-for-sale & trading:								
Municipals	\$ 4,500	\$ -	\$ (455)	\$ -	\$ -	\$ (165)	\$ 14,000	\$ 17,880
Corporates	17,152	-	(210)	1,432	-	(185)	(12,824)	5,365
RMBS	-	-	-	-	-	(5)	8	3
CMBS	2,950	243	-	-	(860)	-	(2,333)	-
ABS	31,665	588	(452)	16,765	-	(9,892)	(7,748)	30,926
<b>Total recurring Level 3 financial assets</b>	<b>56,267</b>	<b>831</b>	<b>(1,117)</b>	<b>18,197</b>	<b>(860)</b>	<b>(10,247)</b>	<b>(8,897)</b>	<b>54,174</b>

There were no gains or losses included in net income for Level 3 instruments still held at December 31, 2014 or 2013.

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The following table summarizes quantitative information about significant unobservable inputs used to value Level 3 securities as of December 31:

<i>(in thousands of dollars)</i>	Fair Value at 12/31/2014	Valuation Technique	Unobservable Input	Range
Municipals	\$ 13,874	Cash flow modeling	Spread (Discount margin)	581 bps (added to UST with similar maturity)
	3,620	Par value	Backed by property tax payments made by the Company	Priced at par
	1,697	Broker quotes	Bid quotes	70.988
Corporates	4,862	Broker quotes	Bid quotes	97.25
	983	Cash flow modeling	Discount margin	135
	3,903	Cash flow modeling	Spread (Discount margin)	380 bps (added to UST with similar maturity)
CMBS	287	Cash flow modeling	Weighted average life Spread (Discount margin)	<1 year 60 bps
ABS	73,083	Cash flow modeling	Spread (Discount margin) Conditional prepayment rate Severity Bid quotes Ask quotes	20 - 300 0 - 20 30 - 70 99.86 - 100.76 100.17
Significant unobservable inputs not available	2			
Total Level 3 Securities	<u>\$ 102,311</u>			
<i>(in thousands of dollars)</i>	Fair Value at 12/31/2013	Valuation Technique	Unobservable Input	Range
Municipals	\$ 4,335	Par value	Backed by property tax payments made by the Company	Priced at par
	13,545	Cash flow modeling	Spread (Discount Margin)	581 bps (added to UST with similar maturity)
Corporates	2,397	Broker quotes	Bid and ask quotes	99.349 - 107.250
	2,968	Cash flow modeling	Spread (Discount Margin)	120 bps (added to 5 year UST)
ABS	30,926	Cash flow modeling	Weighted Average Life Yield Ask quotes Discount Margin Conditional Prepayment Rate Conditional Prepayment Rate Severity	0.5 yr 3.00% 99 - 101 30 - 240 0 - 20 2 - 15% 30 - 70
Significant unobservable inputs not available	3			
Total Level 3 Securities	<u>\$ 54,174</u>			

The tables do not include quantitative information for \$2,000 and \$3,000 of securities whose Level 3 fair values are obtained from non-binding external sources where unobservable inputs are not reasonably available to the Company as of December 31, 2014 and 2013, respectively. Due to the relative size of these securities' fair values compared to the total portfolio's fair value, any changes in pricing methodology would not have a significant change in valuation that would materially impact other comprehensive income.

**American Family Mutual Insurance Company and Subsidiaries**  
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***Mortgage Loans on Real Estate***

The fair value of mortgage loans on real estate is based upon discounted future cash flows using the current rates at which similar loans with comparable maturities would be made to borrowers with similar credit ratings.

***Policy Loans***

Policy loans represent amounts borrowed from the Company by life insurance policyholders, secured by the cash value of the related policies, and are reported at unpaid principal balance. Policy loans have no stated maturity dates and are an integral part of the related insurance contract. The carrying value of policy loans approximates the fair value. The interest rate for policy loans on current issues was 8% in both 2014 and 2013.

***Deferred Annuities and Structured Settlements***

Fair values for deferred annuities are based on the cash surrender value of the policies. Fair values for structured settlements are based on the present value of expected payments using current crediting interest rates.

***Fair Value***

The fair values of the Companies' significant financial instruments that are carried on the consolidated balance sheets at a value other than fair value or are not disclosed on the face of the consolidated balance sheets or elsewhere in the notes at December 31 are as follows:

	2014		2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<i>(in thousands of dollars)</i>				
<b>Financial assets</b>				
Mortgage loans on real estate	\$ 483,404	\$ 520,756	\$ 424,217	\$ 453,863
Policy loans	218,498	218,498	224,696	224,696
<b>Financial liabilities</b>				
Deferred annuities	263,225	260,974	256,389	254,080
Structured settlements	62,189	74,719	65,290	79,063

**b. Common Stocks**

The aggregate cost of common stocks at December 31, 2014 and 2013 was \$1,333,147,000 and \$865,805,000, respectively. Net unrealized appreciation of common stocks stated at fair value includes gross unrealized gains of \$899,599,000 and \$1,089,648,000 and gross unrealized losses of \$23,798,000 and \$4,805,000 at December 31, 2014 and 2013, respectively.

# American Family Mutual Insurance Company and Subsidiaries

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The fair value and unrealized losses, categorized by stocks in loss positions for less than 12 months and stocks in loss positions for more than 12 months at December 31 are as follows:

	2014							
	Less than 12 Months			12 Months or More			Total	
	Number of Issues	Fair Value	Unrealized Losses	Number of Issues	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>(in thousands of dollars, except number of issues)</i>								
<b>Description of Securities:</b>								
Common stocks	521	\$ 143,370	\$ (17,174)	3	\$ 1,990	\$ (6,624)	\$ 145,360	\$ (23,798)
Total	521	\$ 143,370	\$ (17,174)	3	\$ 1,990	\$ (6,624)	\$ 145,360	\$ (23,798)
	2013							
	Less than 12 Months			12 Months or More			Total	
	Number of Issues	Fair Value	Unrealized Losses	Number of Issues	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>(in thousands of dollars, except number of issues)</i>								
<b>Description of Securities:</b>								
Common stocks	18	\$ 5,843	\$ (452)	1	\$ 2,549	\$ (4,353)	\$ 8,392	\$ (4,805)
Total	18	\$ 5,843	\$ (452)	1	\$ 2,549	\$ (4,353)	\$ 8,392	\$ (4,805)

The Company believes that unrealized losses related to these stocks are temporary. In determining whether these unrealized losses are temporary, the Company considers severity of impairment, duration of impairment, forecasted market price recovery, and the intent and ability of the Company to hold the investment until the market price has recovered.

During 2014 and 2013, the Company recorded other-than-temporary impairments (OTTI) relating to its common stock portfolio of \$7,932,000 and \$1,686,000, respectively.

Proceeds from sales of stock during 2014 and 2013 were \$1,002,790,000 and \$300,934,000, respectively. These amounts exclude spin-offs, tax-free exchanges, taxable exchanges and returns of capital. Gross gains of \$409,030,000 and \$65,518,000 and gross losses of \$10,592,000 and \$5,318,000 were realized on those sales during 2014 and 2013, respectively. The basis of the securities sold was determined using specific identification.

The Company's common stock portfolios were primarily invested in and managed to large, mid, and small cap indices. A portion of the large cap portfolio is weighted toward dividend paying stocks within the Russell 3000 Index. In addition the Company maintained a small portfolio managed to a master limited partnership index. Further separation of equity securities by geography or industry concentration is not deemed relevant.

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**c. Bonds and Short-Term Investments**

The amortized cost and fair value of bonds and short-term investments at December 31 are as follows:

2014				
<i>(in thousands of dollars)</i>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Description of Securities:</b>				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 660,268	\$ 8,267	\$ (382)	\$ 668,153
Obligations of foreign governments	-	-	-	-
Obligations of states and political subdivisions	4,809,572	209,909	(6,197)	5,013,284
Corporate	4,247,814	214,162	(38,753)	4,423,223
Residential mortgage-backed securities	1,073,867	31,180	(4,679)	1,100,368
Commercial mortgage-backed securities	528,110	19,468	(313)	547,265
Asset-backed securities	816,306	13,437	(1,689)	828,054
Total	<u>\$ 12,135,937</u>	<u>\$ 496,423</u>	<u>\$ (52,013)</u>	<u>\$ 12,580,347</u>
2013				
<i>(in thousands of dollars)</i>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Description of Securities:</b>				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 613,280	\$ 2,322	\$ (8,323)	\$ 607,279
Obligations of foreign governments	3,788	-	-	3,788
Obligations of states and political subdivisions	4,586,613	107,326	(64,345)	4,629,594
Corporate	4,155,257	174,808	(63,795)	4,266,270
Residential mortgage-backed securities	1,183,814	24,244	(21,091)	1,186,967
Commercial mortgage-backed securities	483,749	26,675	(2,994)	507,430
Asset-backed securities	629,747	18,965	(1,807)	646,905
Total	<u>\$ 11,656,248</u>	<u>\$ 354,340</u>	<u>\$ (162,355)</u>	<u>\$ 11,848,233</u>

# American Family Mutual Insurance Company and Subsidiaries

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The fair value and unrealized losses, categorized by bonds in loss positions for less than 12 months and bonds in loss positions for more than 12 months at December 31 are as follows:

<i>(in thousands of dollars, except number of issues)</i>	2014							
	Less than 12 Months			12 Months or More			Total	
	Number of Issues	Fair Value	Unrealized Losses	Number of Issues	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>Description of Securities:</b>								
U.S. Treasury securities and obligations of U.S. government corporations and agencies	24	\$ 277,344	\$ (298)	10	\$ 6,327	\$ (84)	\$ 283,671	\$ (382)
Obligations of states and political subdivisions	239	863,084	(4,340)	51	149,917	(1,857)	1,013,001	(6,197)
Corporate	250	616,254	(22,322)	125	345,897	(16,431)	962,151	(38,753)
Residential mortgage-backed securities	13	15,526	(57)	67	217,274	(4,622)	232,800	(4,679)
Commercial mortgage-backed securities	14	55,647	(207)	11	12,030	(106)	67,677	(313)
Asset-backed securities	109	325,234	(1,248)	17	32,358	(441)	357,592	(1,689)
<b>Total</b>	<b>649</b>	<b>\$ 2,153,089</b>	<b>\$ (28,472)</b>	<b>281</b>	<b>\$ 763,803</b>	<b>\$ (23,541)</b>	<b>\$ 2,916,892</b>	<b>\$ (52,013)</b>

  

<i>(in thousands of dollars, except number of issues)</i>	2013							
	Less than 12 Months			12 Months or More			Total	
	Number of Issues	Fair Value	Unrealized Losses	Number of Issues	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>Description of Securities:</b>								
U.S. Treasury securities and obligations of U.S. government corporations and agencies	51	\$ 257,143	\$ (7,549)	5	\$ 13,127	\$ (774)	\$ 270,270	\$ (8,323)
Obligations of states and political subdivisions	502	1,664,293	(59,681)	30	69,910	(4,664)	1,734,203	(64,345)
Corporate	525	1,282,939	(54,718)	40	109,640	(9,077)	1,392,579	(63,795)
Residential mortgage-backed securities	151	486,022	(18,839)	12	31,903	(2,252)	517,925	(21,091)
Commercial mortgage-backed securities	44	136,659	(2,786)	1	4,196	(208)	140,855	(2,994)
Asset-backed securities	67	204,546	(1,669)	6	11,165	(138)	215,711	(1,807)
<b>Total</b>	<b>1,340</b>	<b>\$ 4,031,602</b>	<b>\$ (145,242)</b>	<b>94</b>	<b>\$ 239,941</b>	<b>\$ (17,113)</b>	<b>\$ 4,271,543</b>	<b>\$ (162,355)</b>

The Company classifies its convertible bond investments as trading securities, and unrealized gains and losses related to these securities are included in investment income. The fair value of these securities was \$0 and \$251,232,000 as of December 31, 2014 and 2013, respectively. The portion of the change in unrealized gains (losses) recorded in income relating to trading securities still held at December 31, 2014 and 2013 is \$0 and \$11,038,000, respectively.

If the Company has the intent to sell or will more likely-than-not be required to sell a fixed income security prior to full recovery, the Company writes down the security to its current fair value with the entire write-down recorded as a realized loss in the consolidated statements of comprehensive income. If the Company does not have the intent to sell but the fixed income security is in an unrealized loss position, the Company determines if any of the decline in value is due to a credit-related loss (the present value of the expected future cash flows (PVCF) is less than amortized cost). Other-than-temporary credit-related impairments are recorded in earnings when the PVCF is less than the amortized cost. Any non-credit-related impairments, such as those related to movement in interest rates, are included with unrealized gains and losses in other comprehensive income. The Company believes that all other unrealized losses related to bonds are temporary.

In 2014 and 2013, there was no credit-related OTTI recorded on bonds. No portion of the OTTI loss was included in other comprehensive income. In determining OTTI, the Company

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considers severity of impairment, duration of impairment, forecasted market price recovery, and the intent and ability of the Company to hold the investment until the market price recovers or the investment matures to assist in determining if a potential credit loss exists. There were no other credit-related impairments recorded in 2014 or 2013, and the Company does not hold any impaired fixed income securities where part of the impairment was considered credit-related (recorded through the consolidated statements of comprehensive income) and part of the impairment was non-credit-related (recorded through other comprehensive income).

During 2014 and 2013, the Company recorded total OTTI relating to its bond portfolio of \$0 and \$6,926,000, respectively. These amounts include both credit-related impairments as well as impairments taken due to the intent to sell securities.

Subprime mortgages are residential loans to borrowers with weak credit profiles. Alt A mortgages are residential loans to borrowers who have credit profiles above subprime but do not conform to traditional (“prime”) mortgage underwriting guidelines. The Company had insignificant exposure to subprime and Alt A mortgages at December 31, 2014 and 2013.

The amortized cost and fair value of bonds and short-term investments at December 31, 2014 by contractual maturity are shown as follows. Expected maturities may differ from contractual maturities because borrowers may exercise the right to call or prepay obligations with or without penalties. Because most mortgage-backed and asset-backed securities provide for periodic payments throughout their lives, they are listed in a separate category as follows:

	<b>December 31, 2014</b>	
	<b>Amortized Cost</b>	<b>Fair Value</b>
<i>(in thousands of dollars)</i>		
Due in one year or less	\$ 848,420	\$ 857,812
Due after one year through five years	3,398,701	3,511,870
Due after five years through ten years	3,946,863	4,053,660
Due after ten years	<u>1,523,670</u>	<u>1,681,318</u>
Subtotal	9,717,654	10,104,660
Mortgage-backed securities	1,601,977	1,647,633
Asset-backed securities	<u>816,306</u>	<u>828,054</u>
Total	<u>\$ 12,135,937</u>	<u>\$ 12,580,347</u>

Proceeds from sales of bonds during 2014 and 2013 were \$4,401,009,000 and \$3,755,187,000, respectively. Gross gains of \$163,698,000 and \$140,700,000 and gross losses of \$16,607,000 and \$62,665,000 were realized on those sales during 2014 and 2013, respectively. The basis of the securities sold was determined using specific identification.

At December 31, 2014 and 2013, bonds with a fair value of \$65,302,000 and \$61,459,000, respectively, were on deposit with various regulatory authorities to comply with insurance laws.

# American Family Mutual Insurance Company and Subsidiaries

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#### **d. Other Invested Assets**

The Company held \$276,483,000 and \$268,715,000 in limited partnerships accounted for under the cost method and \$387,042,000 and \$350,262,000 in limited partnerships accounted for under the equity method at December 31, 2014 and 2013, respectively. See Note 1(b) for a description of specific accounting practices regarding the cost and equity methods.

During 2014 and 2013, the Company recorded OTTI in the other invested assets portfolio, resulting in a total realized loss of \$8,671,000 and \$2,424,000, respectively. The other-than-temporarily impaired investments were generally mature partnerships that had completed their initial investment period. Some were in the process of liquidating investment holdings. These partnerships may have experienced losses due to poor performance of a specific investment, poor performance of a particular sector, or unfavorable market conditions in general. As there was no clear indication of full recovery of value of these investments, OTTI losses were realized.

The Company believes that no additional other invested assets in the portfolio are other-than-temporarily impaired. In making this determination, the Company considers severity of impairment, age of the partnership, percent of the total commitment funded, performance of the underlying investments, sector of the underlying investments, and the intent and ability of the Company to hold the investment until the value has fully recovered.

#### **e. Derivative Instruments**

Interest rate risk is the risk that the Company will incur a market value loss due to adverse changes in interest rates relative to the interest rate characteristics of its interest-bearing assets and liabilities. The Company is subject to interest rate risk with respect to both its investment portfolio and its general operations.

In order to mitigate interest rate risk with respect to the Company's investment portfolio and general operations, the Company has entered into certain interest rate derivatives. The interest rate derivatives are used to hedge interest rate risk. The Company does not use derivatives for speculative purposes, and did not use derivatives for replication or other income generation purposes during 2014 or 2013.

Derivative instruments are accounted for on a fair value basis on the consolidated balance sheets, and unrealized and realized gains and losses on derivative positions are recognized as net investment income in the consolidated statements of comprehensive income. All derivative instruments are subject to enforceable master netting agreements and the Company elects to net derivative asset and derivative liability positions with the same counterparty on the consolidated balance sheets. Cash collateral payable (receivable) is netted with derivative assets (liabilities) and the net amount is recorded in other assets (liabilities) on the consolidated balance sheets. These derivative instruments are not separately presented on the consolidated balance sheets and consolidated statements of comprehensive income due to their immaterial effect on the Company's financial condition, cash flows, and results of operations.

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Derivative instruments as of December 31, 2014 and 2013 are as follows:

2014						
<i>(in thousands of dollars)</i>						
Derivatives designated as:	Notional Value	Purpose	Balance Sheet		Statement of Comprehensive Income	
			Classification	Fair Value	Classification	Amount Realized
<b><u>Non-hedging instruments</u></b>						
<u>Assets:</u>						
Interest rate sw aps	\$ 130,000	Manage interest rate risk	Other assets	\$ 3,041	Net investment income	\$ (34,479)
<u>Liabilities:</u>						
Interest rate sw aps	1,005,000	Manage interest rate risk	Other liabilities	(18,794)	Net investment income	(17,493)
Total open positions	<u>\$1,135,000</u>			<u>\$ (15,753)</u>		<u>\$ (51,972)</u>
<u>Closed:</u>						
Interest rate sw aps	\$ 265,000	Manage interest rate risk	N/A		Net investment income	\$ (4,142)
Total closed positions						<u>\$ (4,142)</u>
Total						<u>\$ (56,114)</u>
2013						
<i>(in thousands of dollars)</i>						
Derivatives designated as:	Notional Value	Purpose	Balance Sheet		Statement of Comprehensive Income	
			Classification	Fair Value	Classification	Amount Realized
<b><u>Non-hedging instruments</u></b>						
<u>Assets:</u>						
Interest rate sw aps	\$ 1,150,000	Manage interest rate risk	Other assets	\$ 37,406	Net investment income	\$ 36,565
<u>Liabilities:</u>						
Interest rate sw aps	50,000	Manage interest rate risk	Other liabilities	(505)	Net investment income	10,326
Total open positions	<u>\$1,200,000</u>			<u>\$ 36,901</u>		<u>\$ 46,891</u>
<u>Closed:</u>						
Interest rate sw aps	\$ 535,000	Manage interest rate risk	N/A		Net investment income	\$ 4,778
Total closed positions						<u>\$ 4,778</u>
Total						<u>\$ 51,669</u>

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The following table provides gross and net amounts for the Company's derivative instruments:

2014						
<i>(in thousands of dollars)</i>						
Derivatives Designated as:	Gross Amount	Counterparty Netting	Cash Collateral (Received) Pledged	Net Amount on Balance Sheet	Amounts Not Offset on Balance Sheet	
					Securities Collateral (Received) Pledged	Net Amount
Assets	\$ 4,147	\$ (1,106)	\$ (2,610)	\$ 431	\$ -	\$ 431
Liabilities	(19,900)	1,106	20,436	1,642	14,291	15,933
<b>Total</b>	<b>\$ (15,753)</b>	<b>\$ -</b>	<b>\$ 17,826</b>	<b>\$ 2,073</b>	<b>\$ 14,291</b>	<b>\$ 16,364</b>

2013						
<i>(in thousands of dollars)</i>						
Derivatives Designated as:	Gross Amount	Counterparty Netting	Cash Collateral (Received) Pledged	Net Amount on Balance Sheet	Amounts Not Offset on Balance Sheet	
					Securities Collateral (Received) Pledged	Net Amount
Assets	\$ 38,542	\$ (1,136)	\$ (22,084)	\$ 15,322	\$ (6,115)	\$ 9,207
Liabilities	(1,641)	1,136	220	(285)	523	238
<b>Total</b>	<b>\$ 36,901</b>	<b>\$ -</b>	<b>\$ (21,864)</b>	<b>\$ 15,037</b>	<b>\$ (5,592)</b>	<b>\$ 9,445</b>

Collateral pledged as initial margin to the Chicago Mercantile Exchange (CME) is not subject to a master netting agreement and is therefore excluded from collateral (received) pledged in the previous table.

Counterparty credit risk is evaluated closely to ensure that the party, or collateral, backing the derivative transaction will meet the financial obligations of the contract. For bilateral over-the-counter transactions the amount of counterparty exposure depends on the creditworthiness of and collateral provided by the counterparty. The Company actively monitors and evaluates the financial qualifications of counterparties and requires counterparties to provide sufficient collateral security through the execution of a legally enforceable Credit Support Annex (CSA). The CSA requires collateral to be exchanged when predetermined exposure limits are exceeded and permits either party to net collateral transfers due for transactions covered under the agreements. As of December 31, 2014 and 2013, the Company pledged bonds with a fair value of \$14,291,000 and \$523,000, respectively, as collateral to counterparties. Bonds pledged by the Company as collateral are included in bonds, available-for-sale, on the consolidated balance sheets. As of December 31, 2014 and 2013, counterparties pledged bonds with a fair value of \$0 and \$6,115,000, respectively, to the Company. Bonds pledged by counterparties as collateral are not included on the Company's consolidated balance sheets. The Company pledged cash of \$656,000 and \$220,000 as collateral to counterparties and counterparties pledged \$2,610,000 and \$16,740,000 in cash collateral to the Company as of December 31, 2014 and 2013, respectively. Cash collateral pledged to (by) the Company is netted with derivative assets (liabilities) on the consolidated balance sheets as previously described.

Certain OTC swap contracts were transacted and cleared through the central clearinghouse at the CME, where the CME serves as the counterparty for both parties to the swap contract. Rather than directly posting collateral to/from a traditional counterparty as in a bilateral agreement, the Company posts initial and variation margin per the CME's requirements. Initial margin, which may consist of cash and/or securities, protects against "shock" events and is not used to settle market value variation movements. After initial execution of the swap contract, the CME uses a market-standard model to price (mark to market) accepted trades, and that price serves as the basis for variation margin requirements. Similar to the movement

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of collateral between counterparties in a bilateral agreement, centrally cleared swap contracts require variation margin to be posted (received) by the Company as the market value of the swap contract moves further out of (into) the money. As of December 31, 2014 and 2013, the Company pledged initial margin of \$50,000 and \$12,276,000 in cash to the CME. In addition, the Company pledged \$19,781,000 and \$0 in cash as variation margin to the CME as of December 31, 2014 and 2013, respectively. In return, the CME posted \$0 and \$5,344,000 in cash as variation margin to the Company as of December 31, 2014 and 2013, respectively. Cash pledged as variation margin by (to) the Company is netted with derivative assets (liabilities) on the consolidated balance sheets as previously described. Bonds pledged by the Company as margin are included in bonds, available-for-sale, on the consolidated balance sheets.

Counterparty credit exposure by counterparty credit rating as it relates to open interest rate derivative contracts as of December 31, 2014 and 2013, is as follows:

<b>2014</b>				
<i>(in thousands of dollars)</i>				
<b>Rating</b>	<b>Number of Counterparties</b>	<b>Notional Value</b>	<b>Credit Exposure</b>	<b>Exposure, Net of Collateral</b>
Centrally Cleared	1	\$ 670,000	\$ -	\$ -
A+	2	330,000	3,041	431
A	1	85,000	-	-
A-	1	50,000	-	-
<b>Total</b>	<b>5</b>	<b>\$ 1,135,000</b>	<b>\$ 3,041</b>	<b>\$ 431</b>

<b>2013</b>				
<i>(in thousands of dollars)</i>				
<b>Rating</b>	<b>Number of Counterparties</b>	<b>Notional Value</b>	<b>Credit Exposure</b>	<b>Exposure, Net of Collateral</b>
Centrally Cleared	1	\$ 575,000	\$ 11,885	\$ 6,541
A+	2	450,000	18,761	2,021
A	1	125,000	6,760	645
A-	1	50,000	-	-
<b>Total</b>	<b>5</b>	<b>\$ 1,200,000</b>	<b>\$ 37,406</b>	<b>\$ 9,207</b>

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**f. Net Investment Income**

Net investment income for the years ended December 31 is summarized as follows:

<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>
Bonds	\$ 426,331	\$ 414,824
Common stocks	45,287	38,960
Real estate	44,289	48,039
Mortgage loans	24,631	23,907
Policy loans	15,958	16,586
Other	<u>103,129</u>	<u>61,282</u>
Total gross investment income	659,625	603,598
Change in value of convertible bonds	(14,339)	(17,091)
Change in value of derivatives	(56,114)	51,669
Change in fair value of long term debt	(127,845)	(3,824)
Investment expenses	<u>(84,498)</u>	<u>(76,346)</u>
Net investment income	<u>\$ 376,829</u>	<u>\$ 558,006</u>

**g. Mortgage Loans on Real Estate**

The minimum and maximum lending rates for commercial mortgage loans issued during 2014 and 2013 ranged from 3.42% to 6.10% and 4.10 % to 5.52%, respectively. During 2014 and 2013, the Company did not reduce interest rates on any outstanding mortgage loans.

Mortgage loans of the Company are invested primarily in office, retail and industrial properties and are reported and measured at their outstanding principal amount. Fire and extended coverage insurance is required on all properties. The maximum percentage of any one loan to the value of security at the time of the loan, exclusive of insured or guaranteed or purchase money mortgages, did not exceed 70%.

Significant concentrations of mortgage loans amounting to \$196,470,000 and \$183,794,000 exist for properties located in the Midwest region at December 31, 2014 and 2013, respectively. In addition significant concentrations by state include the following:

<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>
Texas	\$ 112,336	\$ 96,434
Ohio	71,328	52,345
Minnesota	*	39,389

\* - Not a significant concentration in the current year

The Company considers any loan that is one or more days delinquent to be past due. At December 31, 2014 and 2013, the Company had no past due commercial mortgage loans, and the average recorded investment in impaired loans was \$0 during both 2014 and 2013. As of December 31, 2014 and 2013, all loans in the portfolio were in good standing, and no loans had been modified or restructured.

A loan is considered to be in good standing if all payments are current. When reviewing loans for impairment and making the determination to increase the valuation allowance or to charge off a loan, the Company individually monitors and analyzes loans and does not utilize portfolio

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

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segments or classes for monitoring purposes. The Company considers delinquency or default of payments, the mortgage loan unpaid principal balance as a percent of the fair value of the mortgage loan collateral, present value of expected payments compared to the current carrying value of the mortgage, current rent rolls of the property, financial condition of major tenants, and local economic conditions that would impact individual loans when reviewing potential loan impairment.

If analysis of any of these factors suggests the ability of the borrower to make future payments may be compromised or if the loan is delinquent in its payments by fewer than 90 days, the loan is added to the Company's watchlist. A watchlist loan has developed negative characteristics or trends in the impairment indicators discussed above, but has not yet met the criteria of a non-performing loan. Specific examples of such watchlist indicators may include loss of a major tenant or delinquency of property tax payments. Watchlist loans are monitored closely by the Company for indications of possible default, and an allowance may be established if ultimate collectability of the full principal amount becomes uncertain. If a loan is 90 days or more past due or is in the process of foreclosure, the loan is reclassified as non-performing. Non-performing loans are reserved to an amount equal to the expected potential principal loss and are reviewed in detail to determine whether an impairment or charge-off is necessary. Charge-offs are recorded when principal loss is imminent and the amount is readily determinable.

The Company had \$435,499,000 and \$366,296,000 of loans in good standing and \$47,905,000 and \$57,921,000 of loans on the watchlist as of December 31, 2014 and 2013, respectively. There were no non-performing loans held as of December 31, 2014 and 2013. There were no charge-offs recorded in the mortgage loan portfolio in 2014 and 2013.

The Company did not carry a valuation allowance for credit losses on mortgage loans as of December 31, 2014 and 2013.

Commercial mortgage loans are placed on nonaccrual status after a default notice has been issued and the borrower has failed to cure the defect in a reasonable amount of time. Once a loan reaches nonaccrual status any accrued interest income is derecognized and future accrual of interest is suspended until the loan is made current. If the ultimate collectability of principal, either in whole or in part, is in doubt, any payment received on a nonaccrual loan shall first be applied to reduce principal to the extent necessary to eliminate such doubt. There were no loans in nonaccrual status at December 31, 2014 and 2013 and no loans were restructured during 2014 or 2013.

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**h. Fair Value Option (FVO) of Long-Term Debt**

The following table presents information for certain liabilities, which are accounted for under the FVO at December 31, 2014 and 2013. These liabilities were initially measured at fair value.

*(in thousands of dollars)*

<b>Liabilities:</b>	<b>2014</b>	<b>2013</b>
Contractual principal balance	\$ 500,000	\$ 500,000
Difference between estimated fair value and contractual principal balance	124,021	(3,824)
Carrying value at estimated fair value	<u>\$ 624,021</u>	<u>\$ 496,176</u>

These liabilities are comprised of long-term debt. Changes in estimated value of these liabilities are recognized in net investment income of \$(127,845,000) and \$3,824,000 for the year ended December 31, 2014 and 2013, respectively. Interest expense of \$25,956,000 and \$782,000 is recognized in other expenses for the year ended December 31, 2014 and 2013, respectively.

The long-term debt measured at fair value includes the FHLBC advance (see Note 12). As of December 31, 2014 and 2013, the entire long-term debt balance is eligible for the fair value option. The portion of the long-term debt not elected for the FVO includes the long-term debt associated with PGC.

Fair value for the FHLBC advance is based upon a discounted cash flow analysis using a combination of observable and insignificant unobservable market inputs. Electing the fair value option of long-term debt better reflects the economic position of the liability due to the prepayment option of the FHLBC advance.

**5. Deferred Policy Acquisition Costs**

DAC and the related amortization charged to income were as follows:

*(in thousands of dollars)*

	<b>2014</b>	<b>2013</b>
<b>Property and Casualty</b>		
Balance, beginning of year	\$ 328,951	\$ 309,748
Costs deferred during year	962,822	829,740
Amortization related to operations during year	<u>(932,998)</u>	<u>(810,537)</u>
Balance, end of year	<u>\$ 358,775</u>	<u>\$ 328,951</u>

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<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>
<b>Life</b>		
Balance, beginning of year	\$ 289,860	\$ 260,502
Costs deferred during year	23,013	19,245
Amortization related to operations during year	(14,696)	(14,099)
Net adjustment due to assumption revisions	3,207	(3,644)
Amounts related to change in fair value adjustment of available-for-sale bonds	(15,497)	55,242
DAC adjustment for KCL transaction (see note 1(i))	<u>-</u>	<u>(27,386)</u>
Balance, end of year	<u>\$ 285,887</u>	<u>\$ 289,860</u>
<b>AFFS</b>		
Balance, end of year	<u>\$ 9</u>	<u>\$ 10</u>
<b>Total DAC</b>	<u>\$ 644,671</u>	<u>\$ 618,821</u>

**6. Commitments and Contingencies**

The Companies have various leases for property and equipment used in the normal course of business. These lease commitments are summarized in Note 1(n).

The Companies are contingently liable for cessions to reinsurers to the extent that any reinsurer might be unable to meet its obligations assumed under the various reinsurance contracts.

AFMIC has purchased annuities for which the claimant is the payee, but for which AFMIC is contingently liable. The carrying values of all such annuities purchased from nonaffiliated life insurers at December 31, 2014 and 2013 were \$58,723,000 and \$54,964,000, respectively.

AFMIC enters into contractual agreements that require capital contributions to limited partnerships. These contributions are recorded on the consolidated balance sheets as other invested assets. Capital is typically contributed to the partnerships over multiple years. At any time, AFMIC will have commitments to the partnerships that have not yet been funded. As of December 31, 2014 and 2013, AFMIC was obligated to contribute \$352,947,000 and \$410,756,000, respectively, in additional capital to various limited partnerships. These contributions are callable under the commitments to the partnerships over the lives of the partnerships.

The Companies are at times involved in lawsuits which are related to their operations. In most cases, such lawsuits involve claims under insurance policies and other contracts of the Companies. Such lawsuits, either individually or in the aggregate, are not expected to have a material effect on the Companies' financial statements.

The Companies are liable for mandatory assessments that are levied by the property and casualty and life and health guaranty fund associations of states in which the Companies are licensed. These assessments are to cover losses to policyholders of insolvent or rehabilitated insurance companies. Guaranty fund assessment liabilities, as of December 31, 2014 and 2013, were \$29,848,000 and \$26,684,000, respectively. Corresponding assets related to future premium tax credits have also been recorded and were \$16,093,000 and \$16,439,000 as of December 31, 2014 and 2013, respectively. Such estimates are subject to change as the associations determine more

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precisely the losses that have occurred and how such losses will be assessed to insurance companies.

**7. Federal Income Taxes**

The components of the net deferred tax assets (liabilities) at December 31 are as follows:

<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>
<b>Deferred tax assets</b>		
Life reserves	\$ 113,070	\$ 118,701
Unearned premium	82,565	69,011
Reserve discounting, net of salvage and subrogation	57,969	70,301
Deferred compensation	327,958	274,299
Pension accrual	77,613	17,682
Policyholder dividends	4,136	5,325
Fair Value Option of Long Term Debt	45,063	-
AMT credit carryover	38,765	143,127
Net operating loss carryforward	1,920	4,576
Other	7,532	11,118
Total deferred tax assets	<u>756,591</u>	<u>714,140</u>
<b>Deferred tax liabilities</b>		
Investments	(498,359)	(502,178)
Deferred policy acquisition costs	(62,810)	(59,586)
Depreciation basis differences	(99,271)	(90,891)
Fair Value Option of Long Term Debt	-	(1,394)
Intangibles	(74,157)	(93,552)
Total deferred tax liabilities	<u>(734,597)</u>	<u>(747,601)</u>
Net deferred tax assets (liabilities)	<u>\$ 21,994</u>	<u>\$ (33,461)</u>

As of December 31, 2014, the Company has net operating loss carryforwards of \$5,119,000 which will expire at various times through 2034.

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The effective tax rate used to determine the provision for current and deferred tax expense differs from the expected statutory rate as the result of permanent and other differences between pre-tax income and taxable income determined under existing tax regulations. The more significant differences, their effect on the statutory tax rate, and the resulting effective tax rates are summarized as follows:

	<b>2014</b>	<b>2013</b>
Federal statutory tax rate	35 %	35 %
Tax-exempt income, net of proration	(4)	(7)
Dividend received deduction	(2)	(2)
State tax expense (net of federal tax)	1	1
Other	<u>1</u>	<u>1</u>
Effective tax rate	<u>31 %</u>	<u>28 %</u>

Under pre-1984 life insurance company income tax laws, a portion of a company's "gain from operations" was not subject to current income taxation but was accumulated for tax purposes in a memorandum account designated as the "Policyholders' Surplus Account." A stock life insurance company is subject to tax on any direct or indirect distributions to shareholders from the existing Policyholders' Surplus Account at the corporate rate in the tax year of the distribution. Any distributions are deemed to be first made from another tax memorandum account known as the "Shareholder's Surplus Account." The Company's undistributed taxable Shareholder's Surplus Account was \$1,323,885,000 and \$1,252,687,000 at December 31, 2014 and 2013, respectively. The Company's Policyholders' Surplus Account was \$5,149,000 at December 31, 2014 and 2013. At current corporate income tax rates, the associated tax is \$1,802,000. The Company has not recorded this DTL because it does not expect to make any taxable distributions.

The guidance for accounting for uncertainty in income taxes prescribes a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Interest and penalties on tax uncertainties are classified as a separate operating expense. The total amount of interest accrued was \$536,000 and \$1,396,000 as of December 31, 2014 and 2013, respectively. The Company does not expect to have a significant change in unrecognized tax benefits in the next twelve months.

The examinations of the Company's consolidated federal income tax returns for the years 2011 and prior are closed, and the years 2012 through 2013 remain open under the IRS statute of limitations. The examinations of PGC Holdings Corp. and Subsidiaries' federal income tax return (filed separately until 2013) for the years 2009 and prior are closed, and the years 2010 through 2012 remain open under the IRS statute of limitations. The examinations of Homesite Group Inc. and Subsidiaries' federal income tax return (filed separately until 2014) for the years 2009 and prior are closed, and the years 2010 through 2013 remain open under the IRS statute of limitations.

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**8. Goodwill and Intangible Assets**

The Company's business acquisitions of Homesite, PGC and MIC (formerly LCIC) resulted in the identification of certain intangible assets and goodwill. Intangible assets with finite lives are amortized over their estimated useful lives of one to twelve years. Finite-lived intangible assets have a weighted average remaining useful life of approximately eight and seven years at December 31, 2014 and 2013, respectively. Intangible assets with indefinite lives are considered to have an infinite life and will not be amortized, but are evaluated at least annually for impairment. The Company completes an annual test for goodwill impairment during the fourth quarter based on the results of operations through October 31. There were no indications of goodwill or intangible asset impairment. The following presents a summary of the Company's goodwill and intangible assets at December 31:

<i>(in thousands of dollars)</i>	2014		2013	
	Gross Balance	Accumulated Amortization	Gross Balance	Accumulated Amortization
Total goodwill	\$ 221,627	\$ -	\$ 219,208	\$ -
Trade name and trademarks	25,900	5,180	25,900	2,590
Partner relationships	97,100	1,634	97,100	300
Referral relationships	11,100	5,842	11,100	2,700
Software	23,000	12,388	23,000	2,381
Renewal rights	56,500	7,532	56,500	-
Value of business acquired	52,350	52,350	55,800	7,600
Total finite life intangible assets	265,950	84,926	269,400	15,571
State insurance licenses	28,310	-	28,310	-
Total indefinite life intangible assets	28,310	-	28,310	-
Total goodwill and intangible assets	<u>\$ 515,887</u>	<u>\$ 84,926</u>	<u>\$ 516,918</u>	<u>\$ 15,571</u>

Refer to Note 2 for measurement period adjustments recorded in 2014 to goodwill and value of business acquired. There was \$69,355,000 and \$15,571,000 of amortization expense related to intangible assets during the years ended December 31, 2014 and 2013, respectively.

The estimated amortization expense related to intangible assets with a finite life for each of the next five years is as follows:

*(in thousands of dollars)*

2015	\$ 33,258
2016	24,418
2017	22,761
2018	19,594
2019	18,800
Total	<u>\$ 118,831</u>

# American Family Mutual Insurance Company and Subsidiaries

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#### 9. Employee Benefit Plans

The Companies, excluding PGC, Homesite and AIA, have non-contributory pension plans (herein referred to as the "Plans") covering substantially all employees. Employees providing services to the Companies are employees of AFMIC, with the exception of employees providing services to PGC, Homesite, and AIA who are employees of PGC, Homesite, and AIA, respectively. For AFMIC employees hired before January 1, 2009, and Agency Sales Managers hired before January 1, 2010, benefits are based on years of credited service and highest average compensation (as defined in the Plans). For employees hired on or after January 1, 2009, and Agency Sales Managers hired on or after January 1, 2010, benefits are determined under a cash balance formula (as defined in the Plans). The asset valuation method used in 2014 for the funding calculation was the Two-Year Smoothed Value method. The new benefit restrictions, required under the Pension Protection Act of 2006, do not apply in 2014 given the funded status of the Plans.

The Companies provide certain health care benefits to certain grandfathered agents and substantially all employees. In addition, the Companies provide most employees with a life insurance benefit. Upon retirement, agents and employees are eligible to continue certain of these benefits. For the life insurance program, the Companies absorb substantially all of the cost. The Company also contributes toward eligible employees' postretirement health care using a fixed amount for each year of eligible service. The Companies' portions of the costs of these programs are unfunded. The Companies sponsor no other significant postretirement benefit plans. The Companies use a measurement date of December 31 for pension and other postretirement benefit plans.

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The following table reflects the Plans' funded status, the Companies' accrued postretirement benefits liability, and amounts recognized in the Companies' consolidated balance sheets at December 31:

<i>(in thousands of dollars)</i>	<b>Pension Benefits</b>		<b>Other Benefits</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>Change in benefits obligation</b>				
Projected benefit obligation,				
beginning of year	\$ 869,609	\$ 977,011	\$ 50,061	\$ 46,404
Service cost	40,043	42,008	3,059	3,252
Interest cost	38,653	36,014	2,248	1,923
Plan participant contributions	-	-	-	-
Amendments	-	-	-	-
Actuarial (gain)/loss	176,920	(79,147)	1,675	(299)
Benefits paid	(54,690)	(106,277)	(1,336)	(1,219)
Liability (gain)/loss due to curtailment/settlement	-	-	-	-
Projected benefit obligation, end of year	<u>\$ 1,070,535</u>	<u>\$ 869,609</u>	<u>\$ 55,707</u>	<u>\$ 50,061</u>
<b>Change in plan assets</b>				
Fair value of plan assets,				
beginning of year	\$ 731,927	\$ 670,302	\$ -	\$ -
Actual return on plan assets	68,205	84,542	-	-
Employer contribution	3,899	83,360	1,336	1,219
Plan participant contributions	-	-	-	-
Benefits paid	(54,690)	(106,277)	(1,336)	(1,219)
Fair value of plan assets, end of year	<u>\$ 749,341</u>	<u>\$ 731,927</u>	<u>\$ -</u>	<u>\$ -</u>
Net amount recognized	<u>\$ (321,194)</u>	<u>\$ (137,682)</u>	<u>\$ (55,707)</u>	<u>\$ (50,061)</u>
<b>Net periodic cost</b>				
Service cost	\$ 40,043	\$ 42,008	\$ 3,059	\$ 3,253
Interest cost	38,653	36,014	2,248	1,923
Expected return on plan assets	(51,854)	(50,663)	-	-
Amortization of				
Prior service cost	(6,787)	(6,766)	(1,331)	(1,331)
Actuarial (gain)/loss	8,263	16,939	105	321
Curtailement/settlement expense/(income)	1,376	21,976	-	-
Net periodic cost	<u>\$ 29,694</u>	<u>\$ 59,508</u>	<u>\$ 4,081</u>	<u>\$ 4,166</u>
Accumulated other comprehensive income (loss)	<u>\$ (259,760)</u>	<u>\$ (102,043)</u>	<u>\$ 12,820</u>	<u>\$ 15,721</u>

The Company recognized additional pension expenses in connection with settlement accounting, which resulted from lump sum distributions exceeding service and interest cost during the year, of \$1,376,000 and \$21,976,000 for 2014 and 2013, respectively.

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**Incremental Effect of Applying Pension and Other Postretirement Guidance  
On Individual Line Items in the Balance Sheets**

	<b>Pension Benefits</b>		<b>Other Benefits</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<i>(in thousands of dollars)</i>				
Liability for benefits	\$ 321,194	\$ 137,682	\$ 55,707	\$ 50,061
Deferred income taxes	116,706	50,192	20,241	18,250
Liabilities (net of tax)	<u>\$ 204,488</u>	<u>\$ 87,490</u>	<u>\$ 35,466</u>	<u>\$ 31,811</u>
Other comprehensive income (loss) (net of tax)	\$ (100,410)	\$ 92,251	\$ (1,847)	\$ (451)

**Components of Periodic Benefit Cost  
That Make up Other Comprehensive Income  
December 31, 2014**

	<b>Pension Benefits</b>			<b>Postretirement Benefits</b>		
	<b>Before Tax Amount</b>	<b>Tax (Expense) or Benefit</b>	<b>Net-of-tax Amount</b>	<b>Before Tax Amount</b>	<b>Tax (Expense) or Benefit</b>	<b>Net-of-tax Amount</b>
<i>(in thousands of dollars)</i>						
Actuarial gain (loss)	\$ (160,569)	\$ 58,343	(102,226)	\$ (1,675)	\$ 609	(1,066)
Less: Amortization of actuarial gain (loss)	8,263	(3,002)	5,261	105	(38)	67
Prior service cost	-	-	-	-	-	-
Less: Amortization of prior service cost	(6,787)	2,466	(4,321)	(1,331)	484	(847)
Actuarial gain (loss) recognized due to settlement	-	-	-	-	-	-
Less: Amortization of actuarial gain (loss) due to settlement	1,376	(500)	876	-	-	-
Prior service cost recognized due to settlement	-	-	-	-	-	-
Less: Amortization of prior service cost due to settlement	-	-	-	-	-	-
Net recognized in OCI	<u>\$ (157,717)</u>	<u>\$ 57,307</u>	<u>\$ (100,410)</u>	<u>\$ (2,901)</u>	<u>\$ 1,054</u>	<u>\$ (1,847)</u>

**Estimated items to be amortized in next year's  
periodic pension cost from accumulated other  
comprehensive income**

Amortization of net actuarial loss (gain)	\$ 21,971	\$ 119
Amortization of prior service cost (credit)	(6,789)	(1,331)
Amortization of transition obligation (asset)	-	-
Total	<u>\$ 15,182</u>	<u>\$ (1,212)</u>

The pension accumulated benefit obligation at December 31, 2014 and 2013 was \$927,580,000 and \$697,536,000, respectively.

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	Pension Benefits		Postretirement Benefits	
	2014	2013	2014	2013
<b>Assumptions used to determine projected benefit obligations as of December 31:</b>				
<b>Discount rate</b>				
Qualified plans				
Employee Plan	3.85 %	4.65 %	N/A	N/A
District Manager Plan	3.55	4.15	N/A	N/A
Nonqualified plans				
District Manager Supplementary Plan	3.10	3.50	N/A	N/A
District Manager Expense Reimbursement Plan	3.60	4.20	N/A	N/A
Employee Excess Plan	3.30	4.00	N/A	N/A
District Manager Excess Plan	3.80	4.95	N/A	N/A
Combined Benefit Service Plan	3.75	4.60	N/A	N/A
Prior Service Plan	3.20	3.65	N/A	N/A
Other benefit plans	N/A	N/A	4.10 %	4.90 %
<b>Expected return on plan assets</b>				
Qualified plans (all plans)	6.75 %	7.50 %	N/A	N/A
<b>Rate of compensation increase</b>				
Qualified plans				
Employee Plan	3.25 %	3.75 %	N/A	N/A
District Manager Plan	N/A	N/A	N/A	N/A
Nonqualified plans				
District Manager Supplementary Plan	N/A	N/A	N/A	N/A
District Manager Expense Reimbursement Plan	N/A	N/A	N/A	N/A
Employee Excess Plan	3.25	3.75	N/A	N/A
District Manager Excess Plan	N/A	N/A	N/A	N/A
Combined Benefit Service Plan	3.25	3.75	N/A	N/A
Prior Service Plan	N/A	N/A	N/A	N/A
Other benefit plans	N/A	N/A	3.25 %	3.75 %
<b>Assumptions used to determine net periodic benefit cost as of December 31:</b>				
<b>Discount rate:</b>				
Qualified plans				
Employee Plan	4.65 %	3.80 %	N/A	N/A
District Manager Plan	4.15	3.35	N/A	N/A
Nonqualified plans				
District Manager Supplementary Plan	3.50	2.70	N/A	N/A
District Manager Expense Reimbursement Plan	4.20	3.35	N/A	N/A
Employee Excess Plan	4.00	3.20	N/A	N/A
District Manager Excess Plan	4.40	3.50	N/A	N/A
Combined Benefit Service Plan	4.60	3.70	N/A	N/A
Prior Service Plan	3.65	2.80	N/A	N/A
Other benefit plans	N/A	N/A	4.90 %	4.00 %
<b>Expected return on plan assets:</b>				
Qualified plans (all plans):	7.50 %	7.75 %	N/A	N/A
<b>Rate of compensation increase:</b>				
Qualified plans				
Employee Plan	3.75 %	3.75 %	N/A	N/A
District Manager Plan	N/A	N/A	N/A	N/A
Nonqualified plans				
District Manager Supplementary Plan	N/A	N/A	N/A	N/A
District Manager Expense Reimbursement Plan	N/A	N/A	N/A	N/A
Employee Excess Plan	3.75	3.75	N/A	N/A
District Manager Excess Plan	N/A	N/A	N/A	N/A
Combined Benefit Service Plan	3.75	3.75	N/A	N/A
Prior Service Plan	N/A	N/A	N/A	N/A
Other benefit plans	N/A	N/A	3.75 %	3.75 %

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

### December 31, 2014 and 2013

Assumed health care cost trend rates do not have a significant effect on the amounts reported for the health care plans.

Annual rates of increase in the per capita costs of 7.50% and 7.75% (Pre-65) and 7.00% and 7.25% (Post-65) of covered health care benefits were assumed for 2014 and 2013, respectively. Rates will gradually decrease to 5.00% by 2022.

The expected long-term rate of return on these plan assets was 7.50% and 7.75% in 2014 and 2013, respectively. The expected rate of return on plan assets is based upon an analysis of historical returns for each asset class. The expected returns by asset class contemplate a risk free interest rate environment as of the measurement date and then add a risk premium. The risk premium is a range of percentages and is based upon information and other factors such as expected reinvestment returns and asset manager performance. Finally, an underlying inflation assumption is incorporated to determine the overall expected long-term rate of return assumption. The target allocation, asset allocation, and fair value of plan assets for the Companies' pension plans at the end of 2014 and 2013, by asset category, follow.

(in thousands of dollars)

Asset Category	Target Allocation		Percentage of Plan Assets, Year End		Fair Value of Plan Assets, Year End	
	2014	2013	2014	2013	2014	2013
Equity	54 %	54 %	55 %	56 %	\$ 401,467	\$ 410,747
Debt	40	40	37	33	276,147	238,608
Private equity	5	5	7	10	49,090	71,554
Commodities	1	1	-	1	-	5,225
Other (cash and cash equivalents)	-	-	1	-	9,686	1,157
Total	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>\$ 736,390</u>	<u>\$ 727,291</u>

The overall investment objective of the Plan is to maximize the risk adjusted return on assets over a long-term period, while ensuring the Plan is able to meet current and future obligations to plan participants. The primary considerations in developing target asset allocations are the Plan's overall investment objective, the investment objectives for the various assets, the necessary level of diversification, and maintaining an acceptable level of risk. In 2013 the Company modified its target asset allocations to improve the risk adjusted return of the plan assets. The existing allocations are within the Company's tolerance for variation from target allocation.

The Plan's equity allocation seeks to provide a solid long-term return with a diversified basket of domestic and international equity securities and mutual funds. The Plan invests in actively managed domestic and international mutual funds and equity portfolios that seek to diversify equity risk, generate long-term growth of capital, and outperform benchmark indices. Actively managed equity allocations represent 35% and 36% of Plan assets at December 31, 2014 and 2013, respectively. The Plan also invests in a passively managed domestic large cap equity index portfolio that seeks to mirror the risk characteristics and return performance of the Russell 200 Index. This portfolio comprised approximately 20% of Plan assets at both December 31, 2014 and 2013.

The pension bond fund seeks to maximize total return by investing in fixed income securities. The fund offers diverse exposure to the fixed income market by investing in a combination of investment grade bonds including corporate debt securities, U.S. Treasury and agency securities, mortgage-backed securities and asset-backed securities, and cash equivalents. The objective is to outperform Barclays' U.S. Aggregate Index. This fund comprised 37% and 33% of Plan assets at year end 2014 and 2013, respectively.

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

### December 31, 2014 and 2013

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The alternative investments objective is to add diversification and produce superior long-term returns when compared to more traditional investment opportunities. These assets comprised 7% and 10% of Plan assets at year end 2014 and 2013, respectively.

The Companies have no significant concentrations of risk within Plan assets.

Plan assets at fair value are categorized in the same manner as Company assets, based on the reliability of inputs to the valuation techniques as described in Note 1(c).

Below is a summary of significant valuation techniques specific to Plan assets:

#### **Level 1 Measurements**

**Bonds:** *U.S. Government Securities:* Comprised of U.S. Treasuries valued based on unadjusted quoted prices for identical assets in markets that are generally active.

#### **Equity Securities:**

*Common Stocks & Foreign Stocks:* Comprised of actively traded, exchange listed U.S. and international equity securities. Valuation is based on unadjusted quoted prices for identical assets in active markets that the Plan can access.

*Mutual Funds:* Comprised of actively traded U.S. and international mutual funds comprised of equity securities that have daily quoted net asset values for identical assets that the Plan can access.

**Short-term Investments:** Comprised of actively traded money market funds that have daily quoted net asset values for identical assets that the Company can access.

#### **Level 2 Measurements**

**Equity Securities:** *Mutual Funds:* Comprised of non-actively traded U.S. and international funds priced by the fund manager using observable inputs primarily consisting of quoted prices of the underlying stocks.

**Bonds:** *Corporate Bonds and Notes, Foreign Bonds, and Municipal Bonds:* Valued using the market and income approaches based on inputs including quoted prices for identical or similar assets in markets that are not active, benchmark yield curves, bid/ask spreads, credit quality, and projected cash flows.

**Short-term Investments:** Valued based on inputs, including amortized cost, which approximates fair value, and quoted prices for identical or similar assets in markets that are not active.

**Commodity Funds:** Comprised of an investment in an actively managed limited partnership investment fund traded in non-active markets with underlying investments in commodity-linked exchange traded funds, common stocks, future contracts, and swaps. Valued using the market approach based on capital account valuations, which are quoted monthly by the fund manager.

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

### December 31, 2014 and 2013

#### Level 3 Measurements

*Limited Partnerships:* Valued using capital account valuations as reported by the various limited partnerships, which approximates fair value.

The following table summarizes the Plan's financial assets measured at fair value on a recurring basis as of December 31, 2014 and 2013:

<b>Assets at fair value as of December 31, 2014</b>				
<i>(in thousands of dollars)</i>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Financial assets</b>				
Bonds				
U.S Government securities	\$ 14,588	\$ -	\$ -	\$ 14,588
Corporate bonds and notes	-	217,200	-	217,200
Municipal bonds	-	1,312	-	1,312
Foreign bonds	-	43,047	-	43,047
Equity securities				
Common stocks	178,963	-	-	178,963
Mutual funds	-	219,715	-	219,715
Foreign stocks	2,789	-	-	2,789
Short-term investments	9,686	-	-	9,686
Limited partnerships*	-	-	49,090	49,090
<b>Total financial assets at fair value</b>	<b>\$ 206,026</b>	<b>\$ 481,274</b>	<b>\$ 49,090</b>	<b>\$ 736,390</b>

<b>Assets at fair value as of December 31, 2013</b>				
<i>(in thousands of dollars)</i>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Financial assets</b>				
Bonds				
U.S Government securities	\$ 2,111	\$ -	\$ -	\$ 2,111
Corporate bonds and notes	-	197,986	-	197,986
Municipal bonds	-	765	-	765
Foreign bonds	-	37,746	-	37,746
Equity securities				
Common stocks	29,159	-	-	29,159
Mutual funds	143,813	235,781	-	379,594
Foreign stocks	1,994	-	-	1,994
Short-term investments	-	1,157	-	1,157
Commodities	-	5,225	-	5,225
Limited partnerships*	-	-	71,554	71,554
<b>Total financial assets at fair value</b>	<b>\$ 177,077</b>	<b>\$ 478,660</b>	<b>\$ 71,554</b>	<b>\$ 727,291</b>

\* Limited partnerships were valued using 9/30 capital account valuations provided by the various limited partnerships, adjusted for any capital calls made and distributions received between 9/30 and 12/31.

All transfers into or out of a particular level are recognized as of the beginning of the reporting period. The Plan transferred \$9,686,000 of short-term investments from Level 2 to Level 1 in 2014 as a result of a review of current pricing methodologies. The transferred money market funds are valued based on unadjusted quoted prices in markets that are considered to be generally active and therefore meet the characteristics of Level 1 financial asset.

**American Family Mutual Insurance Company and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
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The table below sets forth a summary of changes in the fair value of the Plan's Level 3 assets for the year ended December 31, 2014 and 2013:

<i>(in thousands of dollars)</i>	<b>Limited Partnerships</b>	
	<b>2014</b>	<b>2013</b>
Balance, beginning of year*	\$ 71,554	\$ 72,965
Purchases, sales, issuance and settlements, net	(22,464)	(1,411)
Balance, end of year*	<u>\$ 49,090</u>	<u>\$ 71,554</u>

\* Limited partnerships were valued using 9/30 capital account valuations provided by the various limited partnerships, adjusted for any capital calls made and distributions received between 9/30 and 12/31.

**Expected Cash Flows**

Information about the expected cash flows for the pension and other postretirement benefits plans follows:

<i>(in thousands of dollars)</i>	<b>Pension Benefits</b>	<b>Postretirement Benefits</b>
<b>Employer contributions</b>		
2015 (expected)	\$4,000- \$702,000	\$ 2,803
<b>Expected benefit payments</b>		
2015	64,720	2,803
2016	72,391	2,763
2017	77,509	2,761
2018	81,876	2,958
2019	85,252	3,156
2020 - 2024	464,701	17,911

The above table reflects vested benefits expected to be paid from the Plans.

Expected contributions include qualified pension benefits contributions within the range of \$0 (minimum contribution) and \$679,000,000 (maximum contribution) and postretirement contribution of \$2,803,000 expected to be paid from the Companies' assets in 2015.

Other Plans

The Companies, excluding PGC, Homesite and AIA, also participate in a qualified contributory 401(k) plan (herein referred to as the "Plan"). Substantially all employees are eligible to enter into the Plan. Employee participation in the Plan is optional; participants contribute at least 1%, but no more than 30% of base compensation, subject to Internal Revenue Service limitations. The Companies (excluding PGC, Homesite and AIA) are required to make contributions each payroll period, as defined, to a trust fund. These contributions are based on a formula with a 100% match on the first 3% of eligible contributions plus 50% on the next 2% of eligible contributions. The maximum annual contribution of the Companies (excluding PGC, Homesite and AIA) is 4% of eligible contributions. The Company recognized expense of \$18,427,000 and \$17,568,000 related to the Plan in 2014 and 2013, respectively.

PGC sponsors a defined contribution 401(k) plan for which substantially all employees of PGC are eligible to participate. Under the PGC plan, PGC's matching contribution is equal to 50% to 100%

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

### December 31, 2014 and 2013

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of each participant's contribution (depending upon years of service) to a maximum of 5% of the participant's eligible compensation. Plan expenses for PGC during 2014 and 2013 amounted to \$1,256,000 and \$1,344,000, respectively.

Homesite sponsors a defined contribution 401(k) plan for which substantially all Homesite employees are eligible to participate. Under the Homesite plan, Homesite's matching contribution is equal to 50% of each participant's contribution, subject to a maximum of 5% of the participant's eligible compensation. Expenses related to this plan of \$3,620,000 were incurred during 2014.

Effective May 5, 2014, AIA participates in a defined contribution 401(k) Plan. Substantially all employees of AIA who are 21 years of age and have completed two consecutive months of employment are eligible to enter into the AIA Plan. Employee participation in the AIA Plan is optional and employee contributions are subject to Internal Revenue Service limitations. Under the Plan, AssureStart's matching contribution is equal to a maximum of 4% of the participant's eligible compensation. Employer profit sharing contributions are discretionary; participants vest in profit sharing contributions from 25% to 100% depending upon one to four years of service. There were no profit sharing contributions in 2014. AssureStart recorded expenses of \$107,000 related to the Plan in 2014.

A liability of \$48,976,000 and \$44,611,000 was accrued for earned but untaken vacation as of December 31, 2014 and 2013, respectively. A liability of \$17,458,000 and \$17,291,000 was accrued for unused sick leave as of December 31, 2014 and 2013, respectively.

#### **10. Agent Termination Benefits**

Exclusive agents of American Family are eligible to receive payments upon termination after a period of covered service. Years of service exclude time under an advance compensation plan, not to exceed two years. For agents appointed prior to January 1, 2009 that have more than 10 years of covered service, benefits are based on a percentage of service fees during the period of up to 12 months prior to termination (as defined in the agreement). For agents appointed on or after January 1, 2009 that have eight or more years of covered service, benefits are based on a cash balance formula that utilizes sales and service fees (as defined in the agreement).

The Companies use a measurement date of December 31 for their agent termination benefits plan.

**American Family Mutual Insurance Company and Subsidiaries**  
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The following sets forth the status of the agent termination benefits plan's obligation reconciled with amounts reported in the Companies' consolidated balance sheets at December 31:

<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>
<b>Change in benefits obligation</b>		
Projected benefit obligation, beginning of year	\$ 575,156	\$ 684,705
Service cost	24,501	33,722
Interest cost	26,526	26,233
Plan participant contributions	-	-
Amendments	-	-
Actuarial (gain) loss	82,588	(140,632)
Benefits paid	<u>(33,607)</u>	<u>(28,872)</u>
Projected benefit obligation, end of year	<u>\$ 675,164</u>	<u>\$ 575,156</u>
<b>Change in plan assets</b>		
Fair value of plan assets, beginning of year	\$ -	\$ -
Actual return on plan assets	-	-
Employer contribution	33,607	28,872
Plan participant contributions	-	-
Benefits paid	<u>(33,607)</u>	<u>(28,872)</u>
Fair value of plan assets, end of year	<u>\$ -</u>	<u>\$ -</u>
Net Amount Recognized	<u>\$ (675,164)</u>	<u>\$ (575,156)</u>
<b>Net periodic cost</b>		
Service cost	\$ 24,501	\$ 33,722
Interest cost	26,525	26,233
Expected return on plan assets	-	-
Amortization of		
Transition (asset) obligation	-	-
Prior service cost	-	-
Actuarial (gain) loss	<u>(3,990)</u>	<u>(236)</u>
Net periodic cost	<u>\$ 47,036</u>	<u>\$ 59,719</u>
Accumulated other comprehensive income (loss)	<u>\$ 16,783</u>	<u>\$ 103,361</u>

**Incremental Effect of Applying Pension and Other Postretirement Guidance  
On Agent Contract Termination Payment Program Individual Line Items  
in the Consolidated Balance Sheets**

<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>
Liability for benefits	\$ 675,164	\$ 575,156
Deferred income taxes	246,132	209,674
Liabilities (net of tax)	<u>\$ 429,032</u>	<u>\$ 365,482</u>
Other comprehensive income/(loss) net of tax	\$ (55,016)	\$ 89,214

**American Family Mutual Insurance Company and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
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**Components of Periodic Benefit Cost  
That Make up Other Comprehensive Income  
December 31, 2014**

	<b>Agent Contract Termination Payment Program</b>		
	<b>Before Tax Amount</b>	<b>Tax (Expense) or Benefit</b>	<b>Net-of-tax Amount</b>
<i>(in thousands of dollars)</i>			
Actuarial gain (loss)	\$ (82,588)	\$ 30,108	\$ (52,480)
Less: Amortization of actuarial gain (loss)	(3,990)	1,455	(2,535)
Prior service cost	-	-	-
Less: Amortization of prior service cost	-	-	-
Net transition obligation	-	-	-
Less: Amortization of net transition obligation	-	-	-
Net recognized in OCI	\$ (86,578)	\$ 31,562	\$ (55,016)
<b>Estimated items to be amortized in next year's periodic pension cost from accumulated other comprehensive income</b>			
Amortization of net actuarial loss (gain)	\$ (166)		
Amortization of prior service cost (credit)	-		
Amortization of transition obligation (asset)	-		
Total	<u>\$ (166)</u>		

The accumulated benefit obligation at December 31, 2014 and 2013 was \$579,689,000 and \$495,703,000, respectively.

**American Family Mutual Insurance Company and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
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	2014	2013
<b>Assumptions used to determine projected benefit obligation as of December 31:</b>		
<b>Discount rate</b>	3.95 %	4.75 %
<b>Service fees increase</b>		
AFMIC		
First 8 years after appointment	21.00	21.00
After first 8 years of appointment	3.25	3.25
ASIC		
First 6 years after appointment	8.00	8.00
After first 6 years of appointment	(4.00)	(4.00)
<b>Expected return on plan assets</b>	N/A	N/A
<b>Assumptions used to determine net periodic benefit cost as of December 31:</b>		
<b>Discount rate</b>	4.75 %	3.95 %
<b>Service fees increase</b>		
AFMIC		
First 8 years after appointment	21.00	21.00
After first 8 years of appointment	3.25	4.75
ASIC		
First 6 years after appointment	8.00	8.00
After first 6 years of appointment	(4.00)	(3.00)
<b>Expected return on plan assets</b>	N/A	N/A

**Expected Cash Flows**

Information about the expected cash flows for the agent termination benefits plan follows:

*(in thousands of dollars)*

<b>Expected contract termination payments</b>	
2015	\$ 33,536
2016	33,918
2017	37,198
2018	39,940
2019	40,123
2020-2024	226,191

The above table reflects vested benefits expected to be paid from the Companies' assets.

**American Family Mutual Insurance Company and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**December 31, 2014 and 2013**

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**11. Property and Casualty Loss and Loss Adjustment Expense Reserve**

Activity in the loss and loss adjustment expense reserve for property and casualty insurance, including health insurance, is summarized as follows:

<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>
<b>Direct and assumed balances as of January 1</b>	\$ 3,692,509	\$ 3,553,469
Less reinsurance recoverables on unpaid losses and loss adjustment expenses	<u>53,621</u>	<u>36,241</u>
Net balance as of January 1	3,638,888	3,517,228
<b>Incurred losses and loss adjustment expenses related to</b>		
Current year	4,761,926	4,395,097
Prior years	<u>(150,961)</u>	<u>(197,627)</u>
Total incurred	4,610,965	4,197,470
<b>Paid losses and loss adjustment expenses related to</b>		
Current year	3,087,377	2,706,340
Prior year	<u>1,536,973</u>	<u>1,501,450</u>
Total paid	4,624,350	4,207,790
<b>Liability for losses and loss adjustment expenses acquired</b>	<u>-</u>	<u>131,980</u>
Net balance as of December 31	3,625,503	3,638,888
<b>Plus reinsurance recoverables on unpaid losses and loss adjustment expenses</b>	<u>92,982</u>	<u>53,621</u>
Direct and assumed balance as of December 31	<u>\$ 3,718,485</u>	<u>\$ 3,692,509</u>

The estimated cost of loss and loss adjustment expenses attributable to insured events of prior years decreased by \$150,961,000 and \$197,627,000 during 2014 and 2013, respectively. The current year decrease is the result of re-estimation of unpaid losses and loss adjustment expenses. The lines of business primarily affected were Private Passenger Auto Liability, Auto Physical Damage and Other Liability. Increases or decreases of this nature occur as the result of claim settlements during the current year, and as additional information is received regarding individual claims, causing changes from their original estimates. The prior year decrease is the result of the reserve releases that was primarily seen in the homeowners and commercial lines of insurance, as underwriting changes have led to better-than-expected loss and LAE experience. Recent development trends in legal expense payments are also taken into account in evaluating the overall adequacy of unpaid losses and loss adjustment expenses.

Management has reviewed the Companies' exposure to toxic tort and environmental pollution claims. Reported claim activity levels to date have not been material. The Companies are predominantly a personal lines writer and are not subject to significant exposure from toxic tort and environmental pollution claims.

# American Family Mutual Insurance Company and Subsidiaries

## Notes to Consolidated Financial Statements

### December 31, 2014 and 2013

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#### 12. Long-Term Debt

In December 2004, PGC invested in two separate trust subsidiaries by purchasing common stock totaling \$1,083,000 from the trusts. On December 15, 2004, PGC completed two private placements of trust-preferred securities through its newly formed trust subsidiaries. Both placements have a stated term of 30 years redeemable after five years and have a floating interest rate adjusted quarterly based on the 90-day London Interbank Offered Rate (LIBOR), which was 0.246% at December 31, 2014. The trust subsidiaries used the proceeds to acquire \$36,083,000 of long-term subordinated debentures from PGC. The terms of the debentures issued by PGC are identical to the terms of the trust preferred securities issued by the trust subsidiaries. Two supplemental indentures were executed in connection with the acquisition of PGC that resulted in the assumption of the debenture obligations by AmFam, Inc.

Fair value for the Company's debentures is estimated at \$36,083,000, equal to the carrying value of \$36,083,000 as of December 31, 2014 and 2013. Since publicly quoted market prices are not available, fair value for the debentures is based upon a discounted cash flow analysis using a combination of observable and unobservable market inputs.

The Company is a member of the FHLBC. Through its membership the Company executed a 30-year fixed rate advance of \$500,000,000 from the FHLBC on November 20, 2013, which was used to partially finance the acquisition of Homesite on December 31, 2013. See Note 2 for further details of this acquisition. The Company pays monthly interest to FHLBC at a fixed annual interest rate of 5.12%, and principal is due in a balloon payment at the end of the advance's 30-year term. The Company paid \$25,956,000 and \$782,000 in interest on the advance during 2014 and 2013, respectively, and accrued interest of \$2,204,000 at both December 31, 2014 and 2013. The advance is fully collateralized with stock and qualified securities with a book value of \$668,437,000 and \$626,153,000 and market value of \$693,721,000 and \$620,899,000 as of December 31, 2014 and 2013, respectively.

The Company held 133,261 and 161,702 shares of FHLBC stock and \$13,326,100 and \$16,170,200 in carrying value at December 31, 2014 and 2013, respectively. The Company has determined the actual maximum borrowing capacity as \$566,522,000 and \$623,404,000 as of December 31, 2014 and 2013, respectively, based on the value of the FHLBC activity stock times the borrowing capacity of the stock held. The Company held 100,000 shares of 50-1 stock as of December 31, 2014 and 2013, and 33,261 and 61,702 shares of 20-1 stock as of December 31, 2014 and 2013, respectively. The Company's borrowing capacity net of outstanding advances was \$66,522,000 and \$123,404,000 as of December 31, 2014 and 2013, respectively. The shares in FHLBC stock are considered Class B shares and are recorded in common stocks, available-for-sale in the consolidated balance sheets. Fair value for the Company's FHLBC advance is disclosed in Note 4.

**American Family Mutual Insurance Company and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
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**13. Accumulated Other Comprehensive Income (Loss)**

Accumulated other comprehensive income (loss) at December 31 was comprised of the following components:

<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>
Unrealized gains (losses) on common stocks	\$ 881,443	\$ 1,089,243
Unrealized gains (losses) on bonds	444,408	177,653
Unrealized gains (losses) on other assets	1,007	997
Adjustment of DAC relating to fair value adjustment	(43,854)	(28,357)
Employee/agent deferred compensation plan adjustment	(230,157)	17,039
Deferred income taxes	<u>(381,782)</u>	<u>(457,465)</u>
Accumulated other comprehensive income (loss)	<u>\$ 671,065</u>	<u>\$ 799,110</u>

**14. Separate Accounts**

Separate account assets include segregated funds invested by the Company for the benefit of variable universal life insurance and variable annuity policy owners. Policy owners' premium payments, net of applicable loads, are invested by the Company in accordance with selections made by the policy owner into the Variable Accounts. The Company records these payments as assets in the separate accounts. Separate account liabilities represent reserves held related to the separate account business.

The Variable Accounts are unit investment trusts registered under the Investment Company Act of 1940. Each Variable Account has nine subaccounts, each of which invests in a non-proprietary mutual fund (the "Fund"). The shares of the Funds are carried at the net asset value of the Funds, which approximates fair value.

A fixed account is also included as an investment option for variable policy owners. Premiums, net of applicable loads, allocated to the fixed account are invested in the general assets of the Company.

The assets and liabilities of the Variable Accounts are clearly identified and distinguished from the other assets and liabilities of the Company. The assets of the Variable Accounts will not be applied to the liabilities arising out of any other business conducted by the Company.

The Company assumes the mortality and expense risk associated with these contracts and therefore deducts a daily mortality and expense charge from the assets of the separate accounts. Income from these charges is included in premium revenues in the consolidated statements of comprehensive income, and is 100% ceded to KCL (see Note 1(i)). The charges to the separate accounts, shown as follows for the years ended December 31, are based on the average daily net assets at specified annual rates:

<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>
American Family Variable Account I	\$ 1,129	\$ 1,097
American Family Variable Account II	<u>2,016</u>	<u>1,943</u>
	<u>\$ 3,145</u>	<u>\$ 3,040</u>

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In addition, the Company deducts certain amounts from the cash value of the accounts invested in the separate accounts for surrender charges, annual administrative charges and cost of insurance charges. Income from these charges is included in premium revenues in the consolidated statements of comprehensive income, and is 100% ceded to KCL (see Note 1(i)). For the years ended December 31 amounts are as follows:

<i>(in thousands of dollars)</i>	<b>2014</b>	<b>2013</b>
American Family Variable Account I	\$ 12,180	\$ 12,476
American Family Variable Account II	<u>488</u>	<u>422</u>
	<u>\$ 12,668</u>	<u>\$ 12,898</u>

**15. Statutory Financial Data**

The Company's insurance subsidiaries also prepare financial statements in accordance with statutory accounting (STAT) practices prescribed or permitted by the Office of the Commissioner of Insurance of the State of Wisconsin, the Ohio Department of Insurance, the Illinois Department of Insurance, the Kansas Insurance Department, the Connecticut Insurance Department, the California Department of Insurance, the Office of Insurance and Safety Fire Commissioner of the State of Georgia, the Department of Financial Services of the State of New York, the North Dakota Insurance Department, and the Texas Department of Insurance (collectively the Companies operating NAIC states). Prescribed STAT practices include the National Association of Insurance Commissioners' (NAIC) "Accounting Practices and Procedures Manual," state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in a particular state. In addition, the Companies operating NAIC states have a right to permit other specific practices that may deviate from prescribed practices. No permitted differences in STAT practices between the Companies operating NAIC states and the NAIC are used in the preparation of the statutory financial statements. The principal differences between financial statements prepared in accordance with STAT and financial statements prepared in accordance with GAAP are disclosed in the reconciliation that follows.

The Company's insurance subsidiaries are subject to regulation and supervision by the various state insurance regulatory authorities in the states in which they conduct business. Such regulation is generally designed to protect policyholders and includes such matters as maintenance of minimum statutory capital and surplus, risk-based capital ratios, and restrictions on the payment of policyholder dividends. Generally, a portion of the Company's insurance subsidiaries' statutory surplus may be available for distribution to their policyholders. However, such distributions as dividends may be subject to prior regulatory approval. The Company accrued \$434,000 and \$851,000 in dividends related to workers compensation in 2014 and 2013, respectively.

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Consolidated statutory capital and surplus and consolidated net income for AFMIC and its subsidiaries as of and for the years ended December 31, 2014 and 2013 were as follows:

<i>(in thousands of dollars)</i>	<u>Surplus/Equity</u>		<u>Net Income</u>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Per statutory annual statements	\$ 6,030,083	\$ 5,791,697	\$ 741,369	\$ 343,726
<b>GAAP adjustments</b>				
Unrealized gains (losses) on bonds	460,379	195,692	(16,122)	(17,099)
P&C deferred policy acquisition costs	358,775	328,951	7,848	19,038
Life deferred policy acquisition costs	285,887	289,860	11,524	(25,884)
Life and deposit contract liabilities	(59,576)	(74,779)	15,202	35,264
Partnership accounting	(73,963)	(73,285)	10,453	25,279
Termination benefits	6,387	82,183	10,782	12,302
Pension/post-retirement benefits	497	(75,918)	(3,716)	16,405
Deferred taxes	(415,912)	(359,100)	(23,233)	(80,921)
Nonadmitted assets	445,040	412,495	-	-
Unrealized gains (losses) on derivatives	-	-	(51,972)	46,891
Long-term debt fair value adjustment	(124,021)	(3,525)	(127,845)	(3,525)
Amortization of intangible assets	49,185	13,661	43,371	13,445
Other	2,347	53,014	(102,467)	(6,086)
Per GAAP financial statements	<u>\$ 6,965,108</u>	<u>\$ 6,580,946</u>	<u>\$ 515,194</u>	<u>\$ 378,835</u>