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United States  
Securities and Exchange Commission  
Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2014

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period From \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: **000-52613****FIRST TRINITY FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

**Oklahoma**

(State or other jurisdiction of incorporation or organization)

**34-1991436**

(I.R.S. Employer Identification Number)

**7633 East 63rd Place, Suite 230****Tulsa, Oklahoma 74133-1246**

(Address of principal executive offices)

**(918) 249-2438**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer: ☐ Accelerated filer: ☐ Non-accelerated filer: ☒ Smaller reporting company: ☐

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: Common stock .01 par value as of August 11, 2014: 7,831,934 shares

**FIRST TRINITY FINANCIAL CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR QUARTERLY PERIOD ENDED JUNE 30, 2014**

**TABLE OF CONTENTS**

**PART I. FINANCIAL INFORMATION**

**Page**  
**Number**

Item 1. Consolidated Financial Statements

Consolidated Statements of Financial Position as of June 30, 2014 (Unaudited) and December 31, 2013 3

Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2014 and 2013 (Unaudited) 4

Consolidated Statements of Comprehensive Income (Loss) for the Three and Six Months Ended June 30, 2014 and 2013 (Unaudited) 5

Consolidated Statements of Changes in Shareholders' Equity for the Six Months Ended June 30, 2014 and 2013 (Unaudited) 6

Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2014 and 2013 (Unaudited) 7

Notes to Consolidated Financial Statements (Unaudited) 8

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 29

Item 4. Controls and Procedures 54

**Part II. OTHER INFORMATION**

Item 1. Legal Proceedings 55

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 55

Item 3. Defaults upon Senior Securities 55

Item 4. Mine Safety Disclosures 55

Item 5. Other Information 56

Item 6. Exhibits 56

Signatures 56

Exhibit No. 31.1

Exhibit No. 31.2

Exhibit No. 32.1

Exhibit No. 32.2

Exhibit No 101.INS

Exhibit No. 101.SCH

Exhibit No. 101.CAL

Exhibit No. 101.DEF

Exhibit No. 101.LAB

Exhibit No. 101.PRE

**PART I-FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements**

First Trinity Financial Corporation and Subsidiaries  
Consolidated Statements of Financial Position

|   | June30, 2014<br>(Unaudited) | December31,<br>2013   |
|---|-----------------------------|-----------------------|
| <b>Assets</b>   |                             |                       |
| Investments   |                             |                       |
| Available-for-sale fixed maturity securities at fair value ( amortized cost:<br>\$105,305,377 as of June30, 2014 and \$98,218,823 as of December31, 2013)   | \$ 110,590,195              | \$ 100,429,711        |
| Available-for-sale equity securities at fair value ( cost: \$593,558 as of June30,<br>2014 and \$567,697 as of December31, 2013)  | 746,081                     | 717,433               |
| Mortgage loans on real estate   | 28,662,291                  | 19,124,869            |
| Investment real estate  | 9,237,834                   | 6,531,971             |
| Policy loans  | 1,517,997                   | 1,488,646             |
| Other long-term investments   | 22,487,895                  | 21,763,648            |
| Total investments   | <u>173,242,293</u>          | <u>150,056,278</u>    |
| Cash and cash equivalents   | 8,881,179                   | 10,608,438            |
| Short-term investments  | 1,392,649                   | -                     |
| Accrued investment income   | 1,680,209                   | 1,558,153             |
| Recoverable from reinsurers   | 1,181,055                   | 1,200,807             |
| Agents' balances and due premiums   | 271,568                     | 285,033               |
| Deferred policy acquisition costs   | 8,644,979                   | 8,172,627             |
| Value of insurance business acquired  | 6,884,192                   | 7,086,790             |
| Property and equipment, net   | 104,460                     | 130,287               |
| Other assets  | 4,847,600                   | 4,074,746             |
| <b>Total assets</b>   | <u>\$ 207,130,184</u>       | <u>\$ 183,173,159</u> |
| <b>Liabilities and Shareholders'Equity</b>  |                             |                       |
| Policy liabilities  |                             |                       |
| Policy holders' account balances  | \$ 128,271,756              | \$ 113,750,681        |
| Future policy benefits  | 34,586,650                  | 33,354,454            |
| Policy claims   | 630,030                     | 611,417               |
| Other policy liabilities  | 93,749                      | 89,504                |
| Total policy liabilities  | 163,582,185                 | 147,806,056           |
| Notes pay able  | 4,076,473                   | -                     |
| Deferred federal income taxes   | 3,115,239                   | 2,543,825             |
| Other liabilities   | 2,676,217                   | 2,182,264             |
| <b>Total liabilities</b>  | <u>173,450,114</u>          | <u>152,532,145</u>    |
| <b>Shareholders'equity</b>  |                             |                       |
| Common stock, par value \$.01 per share (20,000,000 shares authorized, and<br>8,050,193 issued as of June30, 2014 and December31, 2013 and 7,831,934 and<br>7,851,984 outstanding as of June30, 2014 and December31, 2013,<br>respectively) | 80,502                      | 80,502                |
| Additional paid-in capital  | 28,684,748                  | 28,684,748            |
| Treasury stock, at cost (218,259 and 198,209 shares as of June30, 2014 and<br>December31, 2013, respectively)   | (773,731)                   | (693,731)             |
| Accumulated other comprehensive income  | 4,319,879                   | 1,878,157             |
| Accumulated earnings  | <u>1,368,672</u>            | <u>691,338</u>        |

**Total shareholders' equity**33,680,07030,641,014**Total liabilities and shareholders' equity****\$ 207,130,184****\$ 183,173,159**

*See notes to consolidated financial statements (unaudited).*

First Trinity Financial Corporation and Subsidiaries  
Consolidated Statements of Operations  
(Unaudited)

|   | Three Months Ended June<br>30, |                  | Six Months Ended June<br>30, |                   |
|---|--------------------------------|------------------|------------------------------|-------------------|
|   | 2014                           | 2013             | 2014                         | 2013              |
| <b>Revenues</b>   |                                |                  |                              |                   |
| Premiums  | \$ 1,932,055                   | \$ 1,921,494     | \$ 3,942,038                 | \$ 3,849,044      |
| Net investment income   | 2,261,603                      | 1,764,367        | 4,232,411                    | 3,415,990         |
| Net realized investment gains                                   | 465,151                        | 126,932          | 761,716                      | 276,201           |
| Other income  | 6,763                          | 4,739            | 20,075                       | 7,758             |
| <b>Total revenues</b>   | <u>4,665,572</u>               | <u>3,817,532</u> | <u>8,956,240</u>             | <u>7,548,993</u>  |
| <b>Benefits, Claims and Expenses</b>                            |                                |                  |                              |                   |
| Benefits and claims   |                                |                  |                              |                   |
| Increase in future policy benefits                              | 594,832                        | 575,056          | 1,214,804                    | 1,165,747         |
| Death benefits  | 750,013                        | 601,828          | 1,472,462                    | 1,095,694         |
| Surrenders  | 152,492                        | 179,940          | 243,938                      | 308,976           |
| Interest credited to policyholders                              | 1,079,517                      | 892,263          | 2,101,727                    | 1,795,303         |
| Dividend, endowment and supplementary life contract benefits    | 71,390                         | 69,108           | 137,600                      | 121,938           |
| Total benefits and claims                                       | <u>2,648,244</u>               | <u>2,318,195</u> | <u>5,170,531</u>             | <u>4,487,658</u>  |
| Policy acquisition costs deferred                               | (558,309)                      | (511,059)        | (1,086,471)                  | (1,152,594)       |
| Amortization of deferred policy acquisition costs               | 308,272                        | 126,171          | 589,554                      | 383,709           |
| Amortization of value of insurance business acquired            | 96,744                         | 120,956          | 202,598                      | 215,800           |
| Commissions   | 529,531                        | 533,795          | 1,039,981                    | 1,052,437         |
| Other underwriting, insurance and acquisition expenses          | 1,189,823                      | 1,137,657        | 2,323,282                    | 2,120,038         |
| Total expenses  | <u>1,566,061</u>               | <u>1,407,520</u> | <u>3,068,944</u>             | <u>2,619,390</u>  |
| <b>Total benefits, claims and expenses</b>                      | <u>4,214,305</u>               | <u>3,725,715</u> | <u>8,239,475</u>             | <u>7,107,048</u>  |
| <b>Income before total federal income tax expense (benefit)</b> | <u>451,267</u>                 | <u>91,817</u>    | <u>716,765</u>               | <u>441,945</u>    |
| Current federal income tax expense                              | 28,191                         | 55,724           | 78,450                       | 103,248           |
| Deferred federal income tax benefit                             | (11,104)                       | (36,457)         | (39,019)                     | (114,845)         |
| <b>Total federal income tax expense (benefit)</b>               | <u>17,087</u>                  | <u>19,267</u>    | <u>39,431</u>                | <u>(11,597)</u>   |
| <b>Net income</b>   | <u>\$ 434,180</u>              | <u>\$ 72,550</u> | <u>\$ 677,334</u>            | <u>\$ 453,542</u> |
| <b>Net income per common share basic and diluted</b>            | <u>\$ 0.06</u>                 | <u>\$ 0.01</u>   | <u>\$ 0.09</u>               | <u>\$ 0.06</u>    |

See notes to consolidated financial statements (unaudited).

First Trinity Financial Corporation and Subsidiaries  
Consolidated Statements of Comprehensive Income (Loss)  
(Unaudited)

|   | Three Months Ended June<br>30, |                       | Six Months Ended June<br>30, |                       |
|---|--------------------------------|-----------------------|------------------------------|-----------------------|
|   | 2014                           | 2013                  | 2014                         | 2013                  |
| <b>Net income</b>   | \$ 434,180                     | \$ 72,550             | \$ 677,334                   | \$ 453,542            |
| <b>Other comprehensive income (loss)</b>                      |                                |                       |                              |                       |
| Total net unrealized gains (losses) arising during the period | 2,183,448                      | (2,349,888)           | 3,838,433                    | (2,008,477)           |
| Less net realized investment gains                            | 465,151                        | 126,932               | 761,716                      | 276,201               |
| Net unrealized gains (losses)                                 | 1,718,297                      | (2,476,820)           | 3,076,717                    | (2,284,678)           |
| Adjustment to deferred acquisition costs                      | (15,055)                       | 12,197                | (24,565)                     | 11,681                |
| Other comprehensive income (loss) before income tax expense   | 1,703,242                      | (2,464,623)           | 3,052,152                    | (2,272,997)           |
| Income tax (expense) benefit                                  | (340,648)                      | 492,927               | (610,430)                    | 454,602               |
| <b>Total other comprehensive income (loss)</b>                | 1,362,594                      | (1,971,696)           | 2,441,722                    | (1,818,395)           |
| <b>Total comprehensive income (loss)</b>                      | <u>\$ 1,796,774</u>            | <u>\$ (1,899,146)</u> | <u>\$ 3,119,056</u>          | <u>\$ (1,364,853)</u> |

See notes to consolidated financial statements (unaudited).

First Trinity Financial Corporation and Subsidiaries  
Consolidated Statements of Changes in Shareholders' Equity  
Six Months Ended June 30, 2014 and 2013  
(Unaudited)

|                                      | Common<br>Stock<br>\$.01 Par<br>Value | Additional<br>Paid-in<br>Capital | Treasury<br>Stock   | Accumulated<br>Other<br>Comprehensive<br>Income | Accumulated<br>Earnings<br>(Deficit) | Total<br>Shareholders'<br>Equity |
|--------------------------------------|---------------------------------------|----------------------------------|---------------------|---|--------------------------------------|----------------------------------|
| <b>Balance as of January 1, 2013</b> | \$ 80,374                             | \$28,707,648                     | \$ (648,595)        | \$ 5,780,670                                    | \$ (197,985)                         | \$ 33,722,112                    |
| Subscriptions of common stock        | 128                                   | (33,360)                         | -                   | -   | -                                    | (33,232)                         |
| Repurchase of common stock           | -                                     | -                                | (45,136)            | -   | -                                    | (45,136)                         |
| Comprehensive income:                |                                       |                                  |                     |   |                                      |                                  |
| Net income                           | -                                     | -                                | -                   | -   | 453,542                              | 453,542                          |
| Other comprehensive loss             | -                                     | -                                | -                   | (1,818,395)                                     | -                                    | (1,818,395)                      |
| <b>Balance as of June 30, 2013</b>   | <u>\$ 80,502</u>                      | <u>\$28,674,288</u>              | <u>\$ (693,731)</u> | <u>\$ 3,962,275</u>                             | <u>\$ 255,557</u>                    | <u>\$ 32,278,891</u>             |
| <b>Balance as of January 1, 2014</b> | \$ 80,502                             | \$28,684,748                     | \$ (693,731)        | \$ 1,878,157                                    | \$ 691,338                           | \$ 30,641,014                    |
| Repurchase of common stock           | -                                     | -                                | (80,000)            | -   | -                                    | (80,000)                         |
| Comprehensive income:                |                                       |                                  |                     |   |                                      |                                  |
| Net income                           | -                                     | -                                | -                   | -   | 677,334                              | 677,334                          |
| Other comprehensive income           | -                                     | -                                | -                   | 2,441,722                                       | -                                    | 2,441,722                        |
| <b>Balance as of June 30, 2014</b>   | <u>\$ 80,502</u>                      | <u>\$28,684,748</u>              | <u>\$ (773,731)</u> | <u>\$ 4,319,879</u>                             | <u>\$ 1,368,672</u>                  | <u>\$ 33,680,070</u>             |

See notes to consolidated financial statements (unaudited).



First Trinity Financial Corporation and Subsidiaries  
Consolidated Statements of Cash Flows  
(Unaudited)

|   | Six Months Ended June 30, |                    |
|---|---------------------------|--------------------|
|   | 2014                      | 2013               |
| <b>Operating activities</b>   |                           |                    |
| Net income  | \$ 677,334                | \$ 453,542         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                           |                    |
| Provision for depreciation  | 101,821                   | 104,045            |
| Accretion of discount on investments  | (459,252)                 | (436,232)          |
| Net realized investment gains   | (761,716)                 | (276,201)          |
| Loss on sale of real estate   | -                         | 833                |
| Amortization of policy acquisition cost   | 589,554                   | 383,709            |
| Policy acquisition cost deferred  | (1,086,471)               | (1,152,594)        |
| Mortgage loan origination fees deferred   | (49,500)                  | (88,458)           |
| Amortization of loan origination fees   | 47,937                    | 23,974             |
| Amortization of value of insurance business acquired                              | 202,598                   | 215,800            |
| Provision for deferred federal income tax benefit                                 | (39,019)                  | (114,845)          |
| Interest credited to policyholders  | 2,101,727                 | 1,795,303          |
| Change in assets and liabilities:   |                           |                    |
| Allowance for mortgage and premium finance loan losses                            | 36,904                    | 40,787             |
| Policy loans  | (29,351)                  | (31,251)           |
| Short-term investments  | (1,392,649)               | -                  |
| Accrued investment income   | (122,056)                 | (84,972)           |
| Recoverable from reinsurers   | 19,752                    | (232,944)          |
| Agents' balances and due premiums   | 13,465                    | 15,544             |
| Other assets (excluding \$9,500 net changes in 2014 premium financing loans)      | (782,354)                 | (508,817)          |
| Future policy benefits  | 1,232,196                 | 1,195,268          |
| Policy claims   | 18,613                    | (41,891)           |
| Other policy liabilities  | 4,245                     | (54,220)           |
| Other liabilities   | 493,953                   | (390,217)          |
| <b>Net cash provided by operating activities</b>                                  | <b>817,731</b>            | <b>816,163</b>     |
| <b>Investing activities</b>   |                           |                    |
| Purchases of fixed maturity securities  | (15,551,685)              | (7,200,433)        |
| Maturities of fixed maturity securities   | 3,309,000                 | 1,592,000          |
| Sales of fixed maturity securities  | 5,271,058                 | 1,451,743          |
| Purchases of equity securities  | (105,542)                 | (4,291)            |
| Sales of equity security securities   | 101,080                   | -                  |
| Purchases and originations of mortgage loans                                      | (12,342,197)              | (4,340,626)        |
| Payments on mortgage loans  | 3,010,790                 | 1,440,236          |
| Purchases of other long-term investments  | (1,837,619)               | (3,831,065)        |
| Payments on other long-term investments   | 1,947,162                 | 2,104,326          |
| Loans repaid for premiums financed  | 19,000                    | 116,714            |
| Sale of real estate   | 36,000                    | 40,000             |
| Purchases of real estate  | (2,817,857)               | (10,656)           |
| Purchases of furniture and equipment  | -                         | (46,158)           |
| <b>Net cash used in investing activities</b>                                      | <b>(18,960,810)</b>       | <b>(8,688,210)</b> |
| <b>Financing activities</b>   |                           |                    |
| Policyholders' account deposits   | 15,658,605                | 11,310,286         |
| Policyholders' account withdrawals  | (3,239,258)               | (3,213,166)        |
| Purchases of treasury stock   | (80,000)                  | (45,136)           |

|   |                     |                      |
|---|---------------------|----------------------|
| Proceeds from issuance of notes payable                 | 4,076,473           | -                    |
| Proceeds from stock offerings                           | -                   | (33,232)             |
| <b>Net cash provided by financing activities</b>        | <u>16,415,820</u>   | <u>8,018,752</u>     |
| <b>Increase (decrease) in cash and cash equivalents</b> | (1,727,259)         | 146,705              |
| Cash and cash equivalents, beginning of period          | 10,608,438          | 10,947,474           |
| Cash and cash equivalents, end of period                | <u>\$ 8,881,179</u> | <u>\$ 11,094,179</u> |

See notes to consolidated financial statements (unaudited).

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

## **1. Organization and Significant Accounting Policies**

### ***Nature of Operations***

First Trinity Financial Corporation (the "Company") is the parent holding company of Trinity Life Insurance Company ("TLIC"), Family Benefit Life Insurance Company ("FBLIC"), First Trinity Capital Corporation ("FTCC") and Southern Insurance Services, LLC ("SIS"). The Company was incorporated in Oklahoma on April 19, 2004, for the primary purpose of organizing a life insurance subsidiary.

The Company owns 100% of TLIC. TLIC owns 100% of FBLIC. TLIC and FBLIC are primarily engaged in the business of marketing, underwriting and distributing a broad range of individual life and annuity insurance products to individuals. TLIC's and FBLIC's current product portfolio consists of a modified premium whole life insurance policy with a flexible premium deferred annuity rider, whole life, term, final expense, accidental death and dismemberment and annuity products. The term products are both renewable and convertible and issued for 10, 15, 20 and 30 years. They can be issued with premiums fully guaranteed for the entire term period or with a limited premium guarantee. The final expense is issued as either a simplified issue or as a graded benefit, determined by underwriting. The TLIC and FBLIC products are sold through independent agents. TLIC is licensed in the states of Illinois, Kansas, Kentucky, Nebraska, North Dakota, Ohio, Oklahoma and Texas. FBLIC is licensed in the states of Arizona, Arkansas, Colorado, Illinois, Indiana, Kansas, Kentucky, Louisiana, Missouri, Nebraska, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Tennessee, Texas, Virginia and West Virginia. FBLIC also has certificate of authority applications pending in Alabama, Georgia, Michigan and Mississippi.

The Company owns 100% of FTCC that was incorporated in 2006, and began operations in January 2007. FTCC provided financing for casualty insurance premiums for individuals and companies and was licensed to conduct premium financing business in the states of Alabama, Arkansas, Louisiana, Mississippi and Oklahoma. FTCC currently has no operations other than minor premium refunds and collections of past due accounts and accounts involved in litigation. The Company also owns 100% of SIS, a limited liability company acquired in 2009 that operated as a property and casualty insurance agency but currently has no operations.

### ***Company Capitalization***

The Company raised \$1,450,000 from two private placement stock offerings during 2004 and \$25,669,480 from three public stock offerings from June 22, 2005 through February 23, 2007; June 29, 2010 through April 30, 2012; and August 15, 2012 through March 8, 2013. The Company issued 7,347,488 shares of its common stock and incurred \$3,624,518 of offering costs during these private placements and public stock offerings.

The Company also issued 702,705 shares of its common stock in connection with two stock dividends paid to shareholders in 2011 and 2012 that resulted in accumulated earnings being charged \$5,270,288 with an offsetting credit of \$5,270,288 to common stock and additional paid-in capital. The impact of these two stock dividend charges of \$5,270,288 to accumulated earnings decreased the balance of accumulated earnings as of June 30, 2014 to \$1,368,672, as shown in the accumulated earnings caption in the June 30, 2014 consolidated statement of financial position.

The Company has also purchased 218,259 shares of treasury stock at a cost of \$773,731 from former members of the Board of Directors, a former agent and a charitable organization where a former member of the Board of Directors had donated shares of the Company's common stock.

### ***Acquisition of Other Companies***

On December 23, 2008, FTFC acquired 100% of the outstanding common stock of First Life America Corporation ("FLAC") from an unaffiliated company. The acquisition of FLAC was accounted for as a purchase. The aggregate purchase price for

FLAC was approximately \$2,695,000 (including direct cost associated with the acquisition of approximately \$195,000). The acquisition of FLAC was financed with the working capital of FTFC. On December 31, 2008, FTFC made FLAC a 15 year loan in the form of a surplus note in the amount of \$250,000 with an interest rate of 6% payable quarterly, that was approved by the Oklahoma Insurance Department ("OID"). This surplus note is eliminated in consolidation.

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**1. Organization and Significant Accounting Policies** (continued)

On August 31, 2009, two of the Company's subsidiaries, Trinity Life Insurance Company ("Old TLIC") and FLAC, were merged, with FLAC being the surviving company. Immediately following the merger, FLAC changed its name to TLIC.

On December 28, 2011, TLIC acquired 100% of the outstanding common stock of FBLIC from FBLIC's shareholders. The acquisition of FBLIC was accounted for as a purchase. The aggregate purchase price for the acquisition of FBLIC was \$13,855,129. The acquisition of FBLIC was financed with the working capital of TLIC.

***Basis of Presentation***

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting primarily of normal recurring accruals) considered necessary for a fair presentation of the results for the interim periods have been included. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results to be expected for the year ended December 31, 2014 or for any other interim period or for any other future year. Certain financial information which is normally included in notes to consolidated financial statements prepared in accordance with U.S. GAAP, but which is not required for interim reporting purposes, has been condensed or omitted. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto included in the Company's report on Form 10-K for the year ended December 31, 2013.

***Principles of Consolidation***

The consolidated financial statements include the accounts and operations of the Company and its subsidiaries. All intercompany accounts and transactions are eliminated in consolidation.

***Reclassifications***

Certain reclassifications have been made in the prior year and prior quarter financial statements to conform to current year and current quarter classifications. These reclassifications had no effect on previously reported net income or shareholders' equity.

***Use of Estimates***

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Although these estimates are based on management's knowledge of current events and actions it may undertake in the future, they may ultimately differ from actual results.

***Common Stock***

Common stock is fully paid, non-assessable and has a par value of \$.01 per share.

***Subsequent Events***

Management has evaluated all events subsequent to June 30, 2014 through the date that these financial statements have been issued and no disclosures are required.



**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**1. Organization and Significant Accounting Policies (continued)**

***Recent Accounting Pronouncements***

*Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*

In April 2014, the Financial Accounting Standards Board ("FASB") issued revised guidance to reduce diversity in practice for reporting discontinued operations. Under the previous guidance, any component of an entity that was a reportable segment, an operating segment, a reporting unit, a subsidiary, or an asset group was eligible for discontinued operations presentation. The revised guidance only allows disposals of components of an entity that represent a strategic shift (e.g., disposal of a major geographical area, a major line of business, a major equity method investment, or other major parts of an entity) and that have a major effect on a reporting entity's operations and financial results to be reported as discontinued operations. The revised guidance also requires expanded disclosure in the financial statements for discontinued operations as well as for disposals of significant components of an entity that do not qualify for discontinued operations presentation. The updated guidance is effective for the quarter ending March 31, 2015. The adoption of this guidance is not expected to have a material effect on the Company's results of operations, financial position or liquidity.

*Revenue from Contracts with Customers*

In May 2014, the FASB issued updated guidance to clarify the principles for recognizing revenue. While insurance contracts are not within the scope of this updated guidance, the Company's fee income related to providing limited services will be subject to this updated guidance.

The updated guidance requires an entity to recognize revenue as performance obligations are met, in order to reflect the transfer of promised goods or services to customers in an amount that reflects the consideration the entity is entitled to receive for those goods or services. The following steps are applied in the updated guidance: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation.

The updated guidance is effective for the quarter ending March 31, 2017. The adoption of this guidance is not expected to have a material effect on the Company's results of operations, financial position, or liquidity.

*Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*

In June 2014, the FASB issued updated guidance to resolve diversity in practice concerning employee share-based payments that contain performance targets that could be achieved after the requisite service period. Many reporting entities account for performance targets that could be achieved after the requisite service period as performance conditions that affect the vesting of the award and, therefore, do not reflect the performance targets in the estimate of the grant-date fair value of the award. Other reporting entities treat those performance targets as nonvesting conditions that affect the grant-date fair value of the award.

The updated guidance requires that a performance target that affects vesting and that can be achieved after the requisite service period be treated as a performance condition. As such, the performance target that affects vesting should not be reflected in estimating that fair value of the award at the grant date. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which service has been rendered. If the performance target becomes probable of being achieved before the end of the service period, the remaining unrecognized compensation cost for which requisite service has not yet been rendered is recognized prospectively over the remaining service period. The total amount of compensation cost

recognized during and after the service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest.



**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**1. Organization and Significant Accounting Policies (continued)**

The updated guidance is effective for annual and interim periods beginning after December 15, 2015, with early adoption permitted. The adoption of this guidance is not expected to have a material effect on the Company's results of operations, financial position or liquidity.

***Future Application of Accounting Standards***

The Company is currently required to prepare its financial statements in accordance with U.S. GAAP, as promulgated by the FASB. During the last several years, the Securities and Exchange Commission ("SEC") has been evaluating whether, when and how International Financial Reporting Standards ("IFRS") should be incorporated into the U.S. financial reporting system. Before making a decision, the SEC set forth a work plan to evaluate the remaining differences between GAAP and IFRS, determine whether IFRS represent high quality standards, consider how the International Accounting Standards Board ("IASB") is funded and its governance structure and examine the variations in the way IFRS was applied by various foreign companies that file financial statements with the SEC. In July 2012, the SEC staff issued a final report on the SEC work plan which concluded that IFRS provided high quality accounting standards, but also indicated concerns with funding, consistency of application and enforcement of IFRS globally. The report did not give a recommendation to the SEC on whether, when and how IFRS should be incorporated into the U.S. financial reporting system. In addition, the SEC has not indicated a timeline for further consideration of incorporating IFRS.

The FASB and the IASB have a convergence program with the intent of developing global standards for several significant areas of accounting, including the accounting for insurance contracts. In June 2012, the FASB issued a statement that indicated that based on the nature and totality of differences between the FASB's and IASB's views, it is not likely that the two boards will achieve convergence on this project. The FASB further noted that the FASB and IASB have very different perspectives on the project, given that the U.S. has existing guidance on insurance contracts whereas there is currently no comprehensive IFRS accounting standard for insurance contracts.

In June 2013, each board issued for comment an exposure draft of the accounting for insurance contracts that has significant differences from the other board's draft as well as from current GAAP. Both exposure drafts proposed changes that, if ultimately adopted, could significantly impact the accounting by insurers, including the Company, for premiums, policyholders' account balances, future policy benefits, policy claims and claims adjustment expenses, reinsurance and deferred acquisition costs. In February 2014, due to the evaluation of responses received from its 2013 exposure draft, the FASB announced that it has decided to consider targeted improvements to GAAP related to insurance contracts rather than a comprehensive overhaul of GAAP related to insurance contracts.

The FASB and the IASB also continue to deliberate the two remaining projects intended to bring convergence between GAAP and IFRS for accounting for financial instruments and leasing. The Boards currently have different positions on certain key aspects of the financial instrument project (the classification and measurement and impairment) but both Boards intend to complete their financial instrument project during the first half of 2014. The timing of the leasing project is not known at this time.

The Company is not able to predict whether it will be required to adopt IFRS or how the adoption of IFRS (or the potential convergence of GAAP and IFRS, including the joint project for valuing insurance contract liabilities) may impact the Company's financial statements in the future.

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**2. Investments**

***Fixed Maturity and Equity Securities Available-For-Sale***

Investments in fixed maturity and equity securities available-for-sale as of June 30, 2014 and December 31, 2013 are summarized as follows:

| <u>June 30, 2014 (J. J. Na audited)</u>      | <u>Amortized<br/>Cost</u> | <u>Gross<br/>Unrealized<br/>Gains</u> | <u>Gross<br/>Unrealized<br/>Losses</u> | <u>Fair<br/>Value</u> |
|--|---------------------------|---------------------------------------|--|-----------------------|
| Fixed maturity securities                    |                           |                                       |  |                       |
| U.S. government and U.S. government agencies | \$ 2,631,575              | \$ 180,966                            | \$ 143,874                             | \$ 2,668,667          |
| States and political subdivisions            | 658,225                   | 4,242                                 | 3,590                                  | 658,877               |
| Residential mortgage-backed securities       | 76,709                    | 68,661                                | -                                      | 145,370               |
| Corporate bonds                              | 89,986,345                | 4,629,603                             | 200,170                                | 94,415,778            |
| Foreign bonds                                | 11,952,523                | 749,275                               | 295                                    | 12,701,503            |
| Total fixed maturity securities              | 105,305,377               | 5,632,747                             | 347,929                                | 110,590,195           |
| Equity securities                            | <u>Cost</u>               | <u>Gross<br/>Unrealized<br/>Gains</u> | <u>Gross<br/>Unrealized<br/>Losses</u> | <u>Fair<br/>Value</u> |
| Mutual funds                                 | 73,070                    | 19,723                                | -                                      | 92,793                |
| Corporate preferred stock                    | 369,505                   | 4,042                                 | 19,256                                 | 354,291               |
| Corporate common stock                       | 150,983                   | 148,014                               | -                                      | 298,997               |
| Total equity securities                      | 593,558                   | 171,779                               | 19,256                                 | 746,081               |
| Total fixed maturity and equity securities   | <u>\$105,898,935</u>      | <u>\$ 5,804,526</u>                   | <u>\$ 367,185</u>                      | <u>\$111,336,276</u>  |
| <u>December 31, 2013</u>                     | <u>Amortized<br/>Cost</u> | <u>Gross<br/>Unrealized<br/>Gains</u> | <u>Gross<br/>Unrealized<br/>Losses</u> | <u>Fair<br/>Value</u> |
| Fixed maturity securities                    |                           |                                       |  |                       |
| U.S. government and U.S. government agencies | \$ 3,163,203              | \$ 177,700                            | \$ 285,282                             | \$ 3,055,621          |
| States and political subdivisions            | 209,495                   | 601                                   | 9,698                                  | 200,398               |
| Residential mortgage-backed securities       | 86,022                    | 62,588                                | -                                      | 148,610               |
| Corporate bonds                              | 89,683,844                | 3,332,305                             | 1,262,513                              | 91,753,636            |
| Foreign bonds                                | 5,076,259                 | 234,153                               | 38,966                                 | 5,271,446             |
| Total fixed maturity securities              | 98,218,823                | 3,807,347                             | 1,596,459                              | 100,429,711           |
| Equity securities                            | <u>Cost</u>               | <u>Gross<br/>Unrealized<br/>Gains</u> | <u>Gross<br/>Unrealized<br/>Losses</u> | <u>Fair<br/>Value</u> |
| Mutual funds                                 | 68,808                    | 15,759                                | -                                      | 84,567                |
| Corporate preferred stock                    | 347,905                   | 21,752                                | 32,605                                 | 337,052               |
| Corporate common stock                       | 150,984                   | 144,830                               | -                                      | 295,814               |
| Total equity securities                      | 567,697                   | 182,341                               | 32,605                                 | 717,433               |

Total fixed maturity and equity securities

\$98,786,520 \$3,989,688 \$1,629,064 \$101,147,144

12

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**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**2. Investments (continued)**

All securities in an unrealized loss position as of the financial statement dates, the estimated fair value, pre-tax gross unrealized loss and number of securities by length of time that those securities have been continuously in an unrealized loss position as of June 30, 2014 and December 31, 2013 are summarized as follows:

| <u>June 30, 2014 (Unaudited)</u>             | <u>Fair Value</u>     | <u>Unrealized Loss</u>     | <u>Number of Securities</u>     |
|--|-----------------------|----------------------------|---------------------------------|
| Fixed maturity securities                    |                       |                            |                                 |
| Less than 12 months                          |                       |                            |                                 |
| States and political subdivisions            | \$ 267,163            | \$ 2,690                   | 2                               |
| Corporate bonds                              | 5,112,998             | 45,211                     | 20                              |
| Foreign bonds                                | 101,386               | 295                        | 1                               |
| Total less than 12 months                    | 5,481,547             | 48,196                     | 23                              |
| More than 12 months                          |                       |                            |                                 |
| U.S. government and U.S. government agencies | 1,286,126             | 143,874                    | 2                               |
| States and political subdivisions            | 106,142               | 900                        | 1                               |
| Corporate bonds                              | 6,152,570             | 154,959                    | 22                              |
| Total more than 12 months                    | 7,544,838             | 299,733                    | 25                              |
| Total fixed maturity securities              | 13,026,385            | 347,929                    | 48                              |
| Equity securities                            |                       |                            |                                 |
| Less than 12 months                          |                       |                            |                                 |
| Corporate preferred stock                    | 199,190               | 19,256                     | 3                               |
| Total equity securities                      | 199,190               | 19,256                     | 3                               |
| Total fixed maturity and equity securities   | <u>\$ 13,225,575</u>  | <u>\$ 367,185</u>          | <u>51</u>                       |
| <br><u>December 31, 2013</u>                 | <br><u>Fair Value</u> | <br><u>Unrealized Loss</u> | <br><u>Number of Securities</u> |
| Fixed maturity securities                    |                       |                            |                                 |
| Less than 12 months                          |                       |                            |                                 |
| U.S. government and U.S. government agencies | \$ 1,144,718          | \$ 285,282                 | 3                               |
| States and political subdivisions            | 97,934                | 9,698                      | 1                               |
| Corporate bonds                              | 31,495,624            | 1,225,816                  | 141                             |
| Foreign bonds                                | 1,364,449             | 38,966                     | 5                               |
| Total less than 12 months                    | 34,102,725            | 1,559,762                  | 150                             |
| More than 12 months                          |                       |                            |                                 |
| Corporate bonds                              | 531,683               | 36,697                     | 4                               |
| Total more than 12 months                    | 531,683               | 36,697                     | 4                               |
| Total fixed maturity securities              | 34,634,408            | 1,596,459                  | 154                             |
| Equity securities                            |                       |                            |                                 |
| Less than 12 months                          |                       |                            |                                 |
| Corporate preferred stock                    | 185,840               | 32,605                     | 3                               |
| Total equity securities                      | 185,840               | 32,605                     | 3                               |
| Total fixed maturity and equity securities   | <u>\$ 34,820,248</u>  | <u>\$ 1,629,064</u>        | <u>157</u>                      |

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**2. Investments (continued)**

As of June 30, 2014, all of the above fixed maturity securities had a fair value to cost ratio equal to or greater than 88%. As of December 31, 2013, all of the above fixed maturity securities had a fair value to cost ratio equal to or greater than 77%. Fixed maturity securities were 97% and 96% investment grade as rated by Standard & Poor's as of June 30, 2014 and December 31, 2013, respectively. As of June 30, 2014, all of the above equity securities had a fair value to cost ratio equal to or greater than 86%. As of December 31, 2013, all of the above equity securities had a fair value to cost ratio equal to or greater than 78%.

The Company's decision to record an impairment loss is primarily based on whether the security's fair value is likely to remain significantly below its book value based on all of the factors considered. Factors that are considered include the length of time the security's fair value has been below its carrying amount, the severity of the decline in value, the credit worthiness of the issuer, and the coupon and/or dividend payment history of the issuer. The Company also assesses whether it intends to sell or whether it is more likely than not that it may be required to sell the security prior to its recovery in value.

For any fixed maturity securities that are other-than-temporarily impaired, the Company determines the portion of the other-than-temporary impairment that is credit-related and the portion that is related to other factors. The credit-related portion is the difference between the expected future cash flows and the amortized cost basis of the fixed maturity security, and that difference is charged to earnings. The non-credit-related portion representing the remaining difference to fair value is recognized in other comprehensive income (loss). Only in the case of a credit-related impairment where management has the intent to sell the security, or it is more likely than not that it will be required to sell the security before recovery of its cost basis, is a fixed maturity security adjusted to fair value and the resulting losses recognized in realized gains (losses) in the consolidated statements of operations. Any other-than-temporary impairments on equity securities are recorded in the consolidated statements of operations in the periods incurred as the difference between fair value and cost.

Based on management's review, the Company experienced no other-than-temporary impairments during the six months ended June 30, 2014 and the year ended December 31, 2013. Management believes that the Company will fully recover its cost basis in the securities held as of June 30, 2014, and management does not have the intent to sell nor is it more likely than not that the Company will be required to sell such securities until they recover or mature. The remaining temporary impairments shown herein are primarily the result of the current interest rate environment rather than credit factors that would imply other-than-temporary impairment.

Net unrealized gains included in other comprehensive income for investments classified as available-for-sale, net of the effect of deferred income taxes and deferred acquisition costs assuming that the appreciation had been realized as of June 30, 2014 and December 31, 2013, are summarized as follows:

|  | (Unaudited)<br>June 30, 2014 | December 31,<br>2013 |
|--|------------------------------|----------------------|
| Unrealized appreciation on available-for-sale securities     | \$ 5,437,341                 | \$ 2,360,624         |
| Adjustment to deferred acquisition costs                     | (37,492)                     | (12,927)             |
| Deferred income taxes  | (1,079,970)                  | (469,540)            |
| Net unrealized appreciation on available-for-sale securities | <u>\$ 4,319,879</u>          | <u>\$ 1,878,157</u>  |

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**2. Investments (continued)**

The amortized cost and fair value of fixed maturity available-for-sale securities and other long-term investments as of June 30, 2014, by contractual maturity, are summarized as follows:

|  | June 30, 2014 (Unaudited)                    |                       |                             |                      |
|--|--|-----------------------|-----------------------------|----------------------|
|  | Fixed Maturity Available-For-Sale Securities |                       | Other Long-Term Investments |                      |
|  | Amortized Cost                               | Fair Value            | Amortized Cost              | Fair Value           |
| Due in one year or less                | \$ 4,736,604                                 | \$ 4,812,154          | \$ 3,837,695                | \$ 3,916,696         |
| Due in one year through five years     | 37,169,207                                   | 39,605,904            | 9,617,236                   | 10,429,258           |
| Due after five years through ten years | 52,561,331                                   | 54,990,188            | 5,990,938                   | 7,446,929            |
| Due after ten years                    | 10,761,526                                   | 11,036,579            | 3,042,026                   | 4,425,582            |
| Due at multiple maturity dates         | 76,709                                       | 145,370               | -                           | -                    |
|  | <u>\$ 105,305,377</u>                        | <u>\$ 110,590,195</u> | <u>\$ 22,487,895</u>        | <u>\$ 26,218,465</u> |

Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds and gross realized gains (losses) from the sales, calls and maturities of fixed maturity securities available-for-sale and mortgage loans on real estate for the three and six months ended June 30, 2014 and 2013 are summarized as follows:

|                       | Three Months Ended June 30, (Unaudited) |             |                               |            | Six Months Ended June 30, (Unaudited) |             |                               |             |
|-----------------------|---|-------------|-------------------------------|------------|---------------------------------------|-------------|-------------------------------|-------------|
|                       | Fixed Maturity and Equity Securities    |             | Mortgage Loans on Real Estate |            | Fixed Maturity and Equity Securities  |             | Mortgage Loans on Real Estate |             |
|                       | 2014                                    | 2013        | 2014                          | 2013       | 2014                                  | 2013        | 2014                          | 2013        |
| Proceeds              | \$5,250,808                             | \$1,256,225 | \$2,300,954                   | \$ 749,432 | \$8,681,138                           | \$3,043,743 | \$3,010,790                   | \$1,440,236 |
| Gross realized gains  | 287,893                                 | 8,582       | 177,324                       | 120,754    | 567,463                               | 59,595      | 195,285                       | 223,269     |
| Gross realized losses | (66)                                    | (2,404)     | -                             | -          | (1,032)                               | (6,663)     | -                             | -           |

The accumulated change in net unrealized investment gains for fixed maturity and equity securities available-for-sale for the three and six months ended June 30, 2014 and 2013 and the amount of realized investment gains on fixed maturity and equity securities available-for-sale and mortgage loans on real estate for the three and six months ended June 30, 2014 and 2013 are summarized as follows:

| Three Months Ended June 30, (Unaudited) |      | Six Months Ended June 30, (Unaudited) |      |
|---|------|---------------------------------------|------|
| 2014                                    | 2013 | 2014                                  | 2013 |

Change in unrealized investment gains:  
Available-for-sale securities:

|                           |              |                |              |                |
|---------------------------|--------------|----------------|--------------|----------------|
| Fixed maturity securities | \$ 1,710,928 | \$ (2,483,725) | \$ 3,073,930 | \$ (2,303,881) |
| Equity securities         | 7,369        | 6,905          | 2,787        | 19,203         |

## Net realized investment gains:

## Available-for-sale securities:

|                               |         |         |         |         |
|-------------------------------|---------|---------|---------|---------|
| Fixed maturity securities     | 266,427 | 6,178   | 545,031 | 52,932  |
| Equity securities             | 21,400  | -       | 21,400  | -       |
| Mortgage loans on real estate | 177,324 | 120,754 | 195,285 | 223,269 |

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**2. Investments** (continued)

Major categories of net investment income for the three and six months ended June 30, 2014 and 2013 are summarized as follows:

|                                  | Three Months Ended June<br>30, (Unaudited) |                     | Six Months Ended June<br>30, (Unaudited) |                     |
|----------------------------------|--|---------------------|--|---------------------|
|                                  | 2014                                       | 2013                | 2014                                     | 2013                |
| Fixed maturity securities        | \$ 1,128,167                               | \$ 1,094,086        | \$ 2,248,063                             | \$ 2,192,919        |
| Equity securities                | 10,747                                     | 7,371               | 21,404                                   | 14,686              |
| Other long-term investments      | 418,379                                    | 419,843             | 833,790                                  | 815,478             |
| Mortgage loans                   | 581,733                                    | 266,145             | 1,035,705                                | 476,167             |
| Policy loans                     | 25,435                                     | 24,961              | 50,378                                   | 49,065              |
| Real estate                      | 204,799                                    | 90,710              | 377,994                                  | 181,420             |
| Short-term and other investments | 35,781                                     | 17,536              | 72,078                                   | 27,964              |
| Gross investment income          | 2,405,041                                  | 1,920,652           | 4,639,412                                | 3,757,699           |
| Investment expenses              | (143,438)                                  | (156,285)           | (407,001)                                | (341,709)           |
| Net investment income            | <u>\$ 2,261,603</u>                        | <u>\$ 1,764,367</u> | <u>\$ 4,232,411</u>                      | <u>\$ 3,415,990</u> |

TLIC and FBLIC are required to hold assets on deposit with various state insurance departments for the benefit of policyholders and other special deposits in accordance with statutory rules and regulations. As of June 30, 2014 and December 31, 2013, these required deposits, included in investment assets, had amortized costs that totaled \$3,245,734 and \$3,220,853, respectively. As of June 30, 2014 and December 31, 2013, these required deposits had fair values that totaled \$3,264,760 and \$3,097,372, respectively.

The Company's mortgage loans by property type as of June 30, 2014 and December 31, 2013 are summarized as follows:

|                                 | June 30, 2014       |                | December 31, 2013   |                |
|---------------------------------|---------------------|----------------|---------------------|----------------|
|                                 | Amount              | Percentage     | Amount              | Percentage     |
| Commercial mortgage loans       |                     |                |                     |                |
| Retail stores                   | \$ 1,698,527        | 5.93%          | \$ 1,801,443        | 9.42%          |
| Office buildings                | 335,893             | 1.17%          | 349,508             | 1.83%          |
| Total commercial mortgage loans | 2,034,420           | 7.10%          | 2,150,951           | 11.25%         |
| Residential mortgage loans      | 26,627,871          | 92.90%         | 16,973,918          | 88.75%         |
| Total mortgage loans            | <u>\$28,662,291</u> | <u>100.00%</u> | <u>\$19,124,869</u> | <u>100.00%</u> |

TLIC owns approximately six and one-half acres of land located in Topeka, Kansas that includes a 20,000 square foot office building on approximately one-half of this land. The Company also owns one acre of land in Greensburg, Indiana that includes a 3,975 square foot retail building on approximately 8% of this land, another acre of land in Norman, Oklahoma that includes a 9,100 square foot retail building on approximately 18% of this land, one acre of land in Houston, Texas that includes a 9,195 square foot building constructed on approximately 25% of this land and three-fourths of an acre of land in Harrisonville, Missouri that includes a 6,895 square foot building constructed on approximately 20% of this land.





**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**2. Investments (continued)**

The Company's investment real estate as of June 30, 2014 and December 31, 2013 is summarized as follows:

|   | June 30, 2014       | December 31,<br>2013 |
|---|---------------------|----------------------|
| Land  | \$ 2,247,638        | \$ 1,453,135         |
| Buildings   | 7,676,169           | 5,688,816            |
| Less - accumulated depreciation                         | (685,973)           | (609,980)            |
| Buildings net of accumulated depreciation               | <u>6,990,196</u>    | <u>5,078,836</u>     |
| Investment real estate, net of accumulated depreciation | <u>\$ 9,237,834</u> | <u>\$ 6,531,971</u>  |

**3. Fair Value Measurements**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) on the measurement date. The Company also considers the impact on fair value of a significant decrease in volume and level of activity for an asset or liability when compared with normal activity.

The Company holds fixed maturity and equity securities that are measured and reported at fair market value on the statement of financial position. The Company determines the fair market values of its financial instruments based on the fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value, as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities. The Company's Level 1 assets include equity securities that are traded in an active exchange market.

Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company's Level 2 assets and liabilities include fixed maturity securities with quoted prices that are traded less frequently than exchange-traded instruments or assets and liabilities whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes U.S. Government and agency mortgage-backed debt securities and corporate debt securities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. The Company's Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments where independent pricing information was not able to be obtained for a significant portion of the underlying assets.

The Company has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into the three-level fair value hierarchy. If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. A review of fair value hierarchy classifications is conducted on a quarterly basis. Changes in the valuation

inputs, or their ability to be observed, may result in a reclassification for certain financial assets or liabilities. Reclassifications impacting Level 3 of the fair value hierarchy are reported as transfers in and out of the Level 3 category as of the beginning of the period in which the reclassifications occur.

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**3. Fair Value Measurements (continued)**

The Company's fair value hierarchy for those financial instruments measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013 is summarized as follows:

| <u>June 30, 2014 (Unaudited)</u>              | <u>Level 1</u>    | <u>Level 2</u>        | <u>Level 3</u>   | <u>Total</u>          |
|---|-------------------|-----------------------|------------------|-----------------------|
| Fixed maturity securities, available-for-sale |                   |                       |                  |                       |
| U.S. government and U.S. government agencies  | \$ -              | \$ 2,668,667          | \$ -             | \$ 2,668,667          |
| States and political subdivisions             | -                 | 658,877               | -                | 658,877               |
| Residential mortgage-backed securities        | -                 | 145,370               | -                | 145,370               |
| Corporate bonds                               | -                 | 94,415,778            | -                | 94,415,778            |
| Foreign bonds                                 | -                 | 12,701,503            | -                | 12,701,503            |
| Total fixed maturity securities               | <u>\$ -</u>       | <u>\$ 110,590,195</u> | <u>\$ -</u>      | <u>\$ 110,590,195</u> |
| Equity securities, available-for-sale         |                   |                       |                  |                       |
| Mutual funds                                  | \$ -              | \$ 92,793             | \$ -             | \$ 92,793             |
| Corporate preferred stock                     | 199,420           | 154,871               | -                | 354,291               |
| Corporate common stock                        | 280,997           | -                     | 18,000           | 298,997               |
| Total equity securities                       | <u>\$ 480,417</u> | <u>\$ 247,664</u>     | <u>\$ 18,000</u> | <u>\$ 746,081</u>     |
| <u>December 31, 2013</u>                      | <u>Level 1</u>    | <u>Level 2</u>        | <u>Level 3</u>   | <u>Total</u>          |
| Fixed maturity securities, available-for-sale |                   |                       |                  |                       |
| U.S. government and U.S. government agencies  | \$ -              | \$ 3,055,621          | \$ -             | \$ 3,055,621          |
| States and political subdivisions             | -                 | 200,398               | -                | 200,398               |
| Residential mortgage-backed securities        | -                 | 148,610               | -                | 148,610               |
| Corporate bonds                               | -                 | 91,753,636            | -                | 91,753,636            |
| Foreign bonds                                 | -                 | 5,271,446             | -                | 5,271,446             |
| Total fixed maturity securities               | <u>\$ -</u>       | <u>\$ 100,429,711</u> | <u>\$ -</u>      | <u>\$ 100,429,711</u> |
| Equity securities, available-for-sale         |                   |                       |                  |                       |
| Mutual funds                                  | \$ -              | \$ 84,567             | \$ -             | \$ 84,567             |
| Corporate preferred stock                     | 81,540            | 255,512               | -                | 337,052               |
| Corporate common stock                        | 277,814           | -                     | 18,000           | 295,814               |
| Total equity securities                       | <u>\$ 359,354</u> | <u>\$ 340,079</u>     | <u>\$ 18,000</u> | <u>\$ 717,433</u>     |

As of both June 30, 2014 and December 31, 2013, Level 3 financial instruments consisted of two private placement common stocks that have no active trading. These private placement stocks represent investments in small development stage insurance holding companies. The fair value for these securities was determined through the use of unobservable assumptions about market participants. The Company has assumed a willing market participant would purchase the securities for the same price as the Company paid until such time as the development stage company commences operations.

Fair values for Level 1 and Level 2 assets for the Company's fixed maturity and equity securities available-for-sale are primarily based on prices supplied by a third party investment service. The third party investment service provides quoted prices in the market which use observable inputs in developing such rates.

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**3. Fair Value Measurements (continued)**

The Company analyzes market valuations received to verify reasonableness and to understand the key assumptions used and the sources. Since the fixed maturity securities owned by the Company do not trade on a daily basis, the third party investment service prepares estimates of fair value measurements using relevant market data, benchmark curves, sector groupings and matrix pricing. As the fair value estimates of the Company's fixed maturity securities are based on observable market information rather than market quotes, the estimates of fair value on these fixed maturity securities are included in Level 2 of the hierarchy. The Company's Level 2 investments include obligations of U.S. government, U.S. government agencies, state and political subdivisions, mortgage-backed securities, corporate bonds and foreign bonds.

The Company's equity securities are included in Level 1 and Level 2 and the private placement common stocks included in Level 3. Level 1 for those equity securities classified as such is appropriate since they trade on a daily basis, are based on quoted market prices in active markets and are based upon unadjusted prices. Level 2 for those equity securities classified as such is appropriate since they are not actively traded as of June 30, 2014.

The Company's fixed maturity and equity securities available-for-sale portfolio is highly liquid and allows for a high percentage of the portfolio to be priced through pricing services.

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**3. Fair Value Measurements (continued)**

***Fair Value of Financial Instruments***

The carrying amount and fair value of the Company's financial assets and financial liabilities disclosed, but not carried, at fair value as of June 30, 2014 and December 31, 2013, and the level within the fair value hierarchy at which such assets and liabilities are measured on a recurring basis are summarized as follows:

Financial Instruments Disclosed, But Not Carried, at Fair Value:

| June 30, 2014 (Unaudited)       |                      |                      |                     |             |                      |
|---------------------------------|----------------------|----------------------|---------------------|-------------|----------------------|
|                                 | Carrying Amount      | Fair Value           | Level 1             | Level 2     | Level 3              |
| <b>Financial assets</b>         |                      |                      |                     |             |                      |
| Mortgage loans on real estate   |                      |                      |                     |             |                      |
| Commercial                      | \$ 2,034,420         | \$ 2,080,498         | \$ -                | \$ -        | \$ 2,080,498         |
| Residential                     | 26,627,871           | 27,329,677           | -                   | -           | 27,329,677           |
| Policy loans                    | 1,517,997            | 1,517,997            | -                   | -           | 1,517,997            |
| Other long-term investments     | 22,487,895           | 26,218,465           | -                   | -           | 26,218,465           |
| Cash and cash equivalents       | 8,881,179            | 8,881,179            | 8,881,179           | -           | -                    |
| Short-term investments          | 1,392,649            | 1,392,649            | 1,392,649           | -           | -                    |
| Accrued investment income       | 1,680,209            | 1,680,209            | -                   | -           | 1,680,209            |
| Total financial assets          | <u>\$ 64,622,220</u> | <u>\$ 69,100,674</u> | <u>\$10,273,828</u> | <u>\$ -</u> | <u>\$ 58,826,846</u> |
| <b>Financial liabilities</b>    |                      |                      |                     |             |                      |
| Policyholders' account balances | \$128,271,756        | \$114,702,605        | \$ -                | \$ -        | \$114,702,605        |
| Notes payable                   | 4,076,473            | 4,076,473            | -                   | -           | 4,076,473            |
| Policy claims                   | 630,030              | 630,030              | -                   | -           | 630,030              |
| Total financial liabilities     | <u>\$132,978,259</u> | <u>\$119,409,108</u> | <u>\$ -</u>         | <u>\$ -</u> | <u>\$119,409,108</u> |

| December 31, 2013               |                      |                     |                     |             |                     |
|---------------------------------|----------------------|---------------------|---------------------|-------------|---------------------|
|                                 | Carrying Amount      | Fair Value          | Level 1             | Level 2     | Level 3             |
| <b>Financial assets</b>         |                      |                     |                     |             |                     |
| Mortgage loans on real estate   |                      |                     |                     |             |                     |
| Commercial                      | \$ 2,150,951         | \$ 2,169,618        | \$ -                | \$ -        | \$ 2,169,618        |
| Residential                     | 16,973,918           | 17,758,414          | -                   | -           | 17,758,414          |
| Policy loans                    | 1,488,646            | 1,488,646           | -                   | -           | 1,488,646           |
| Other long-term investments     | 21,763,648           | 24,728,710          | -                   | -           | 24,728,710          |
| Cash and cash equivalents       | 10,608,438           | 10,608,438          | 10,608,438          | -           | -                   |
| Accrued investment income       | 1,558,153            | 1,558,153           | -                   | -           | 1,558,153           |
| Total financial assets          | <u>\$ 54,543,754</u> | <u>\$58,311,979</u> | <u>\$10,608,438</u> | <u>\$ -</u> | <u>\$47,703,541</u> |
| <b>Financial liabilities</b>    |                      |                     |                     |             |                     |
| Policyholders' account balances | \$113,750,681        | \$96,709,910        | \$ -                | \$ -        | \$96,709,910        |
| Policy claims                   | 611,417              | 611,417             | -                   | -           | 611,417             |
| Total financial liabilities     | <u>\$114,362,098</u> | <u>\$97,321,327</u> | <u>\$ -</u>         | <u>\$ -</u> | <u>\$97,321,327</u> |

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**3. Fair Value Measurements** (continued)

The estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment was required to interpret market data to develop these estimates. Accordingly, the estimates are not necessarily indicative of the amounts which could be realized in a current market exchange. The use of different market assumptions or estimation methodologies may have a material effect on the fair value amounts.

The following methods and assumptions were used in estimating the fair value disclosures for financial instruments in the accompanying financial statements and notes thereto:

***Fixed Maturity and Equity Securities***

The fair value of fixed maturity and equity securities are based on the principles previously discussed as Level 1, Level 2 and Level 3.

***Mortgage Loans on Real Estate***

The fair values for mortgage loans are estimated using discounted cash flow analyses. For residential mortgage loans, the discount rate used was indexed to the LIBOR yield curve adjusted for an appropriate credit spread. For commercial mortgage loans, the discount rate used was assumed to be the interest rate on the last commercial mortgage acquired by the Company.

***Cash and Cash Equivalents, Short-Term Investments, Accrued Investment Income and Policy Loans***

The carrying value of these financial instruments approximates their fair values. Cash and cash equivalents are included in Level 1 of the fair value hierarchy due to their highly liquid nature.

***Other Long-Term Investments***

Other long-term investments are comprised of lottery prize receivables and fair value is derived by using a discounted cash flow approach. Projected cash flows are discounted using the average Citigroup Pension Liability Index in effect at the end of each period.

***Investment Contracts - Policyholders' Account Balances***

The fair value for liabilities under investment-type insurance contracts (accumulation annuities) is calculated using a discounted cash flow approach. Cash flows are projected using actuarial assumptions and discounted to the valuation date using risk-free rates adjusted for credit risk and the nonperformance risk of the liabilities.

The fair values for insurance contracts other than investment-type contracts are not required to be disclosed.

***Policy Claims***

The carrying amounts reported for these liabilities approximate their fair value.

***Notes Payable***

The carrying amounts reported for these liabilities approximate their fair value. These notes payable were just issued on March 26, 2014 and current refinancing of these liabilities would result in notes payable yielding approximately the

carrying amount as shown in the June 30, 2014 consolidated statement of financial position.



**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

#### 4. Segment Data

The Company has a life insurance segment, consisting of the life insurance operations of TLIC and FBLIC, an annuity segment, consisting of the annuity operations of TLIC and FBLIC and a corporate segment. Results for the parent company and the operations of FTCC and SIS, after elimination of intercompany amounts, are allocated to the corporate segment. Prior to January 1, 2014, the Company's quarterly and annual segment data was reported based upon a life insurance segment, consisting of the operations of TLIC and FBLIC, a premium financing segment, consisting of the operations of FTCC and SIS and a corporate segment. Prior to January 1, 2014, the results for the parent company, after elimination of intercompany amounts, were included in the corporate segment.

The segment data as of December 31, 2013 and for the three and six months ended June 30, 2013 have been restated from what was previously reported and now follows the new segmentation methodology established on January 1, 2014.

These segments as of June 30, 2014 and December 31, 2013 and for the three and six months ended June 30, 2014 and 2013 are summarized as follows:

|  | Three Months Ended June<br>30, (Unaudited) |                       | Six Months Ended June<br>30, (Unaudited) |                     |
|--|--|-----------------------|--|---------------------|
|  | 2014                                       | 2013                  | 2014                                     | 2013                |
| Revenues:                              |  |                       |  |                     |
| Life insurance operations              | \$ 2,501,936                               | \$ 2,352,794          | \$ 5,015,313                             | \$ 4,717,945        |
| Annuity operations                     | 2,091,196                                  | 1,405,019             | 3,752,434                                | 2,726,142           |
| Corporate operations                   | <u>72,440</u>                              | <u>59,719</u>         | <u>188,493</u>                           | <u>104,906</u>      |
| Total                                  | <u>\$ 4,665,572</u>                        | <u>\$ 3,817,532</u>   | <u>\$ 8,956,240</u>                      | <u>\$ 7,548,993</u> |
| Income (loss) before income taxes:     |  |                       |  |                     |
| Life insurance operations              | \$ (110,708)                               | \$ (102,239)          | \$ (121,275)                             | \$ 224,476          |
| Annuity operations                     | 502,614                                    | 333,806               | 726,655                                  | 573,694             |
| Corporate operations                   | <u>59,361</u>                              | <u>(139,750)</u>      | <u>111,385</u>                           | <u>(356,225)</u>    |
| Total                                  | <u>\$ 451,267</u>                          | <u>\$ 91,817</u>      | <u>\$ 716,765</u>                        | <u>\$ 441,945</u>   |
| Depreciation and amortization expense: |  |                       |  |                     |
| Life insurance operations              | \$ 304,173                                 | \$ 262,884            | \$ 659,460                               | \$ 623,072          |
| Annuity operations                     | 126,927                                    | 42,479                | 276,880                                  | 92,437              |
| Corporate operations                   | <u>2,227</u>                               | <u>6,371</u>          | <u>5,570</u>                             | <u>12,019</u>       |
| Total                                  | <u>\$ 433,327</u>                          | <u>\$ 311,734</u>     | <u>\$ 941,910</u>                        | <u>\$ 727,528</u>   |
|  | (Unaudited)<br>June 30, 2014               | December 31,<br>2013  |  |                     |
| Assets:                                |  |                       |  |                     |
| Life insurance operations              | \$ 44,065,886                              | \$ 41,720,508         |  |                     |
| Annuity operations                     | 156,722,340                                | 134,934,891           |  |                     |
| Corporate operations                   | <u>6,341,958</u>                           | <u>6,517,760</u>      |  |                     |
| Total                                  | <u>\$ 207,130,184</u>                      | <u>\$ 183,173,159</u> |  |                     |



**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

## 5. Notes Payable

Notes payable as of June 30, 2014 are summarized as follows:

|  | (Unaudited)<br>June 30, 2014 |
|--|------------------------------|
| Promissory note payable to Grand Bank, secured by real estate and tenant leases located in Indiana, Oklahoma and Texas, 35 monthly payments of interest at 4.50% with a final payment in the 36th month of \$3,009,265 of principal plus unpaid accrued interest at 4.50%, maturity date is March 26, 2017 | \$ 3,009,265                 |
| Promissory note payable to Grand Bank, secured by real estate and tenant leases located in Missouri, 35 monthly payments of interest at 4.50% with a final payment on the 36th month of \$1,067,208 of principal plus unpaid accrued interest at 4.50%, maturity date is March 26, 2017                    | 1,067,208                    |
| Total promissory notes payable   | <u>\$ 4,076,473</u>          |

The \$3,009,265 promissory note is collateralized by three properties, located in Indiana, Oklahoma and Texas, purchased for \$4,940,647 in December 2013 and February 2014 including assignment of the tenant leases.

In December 2013, TLIC purchased one acre of land in Greensburg, Indiana that included a 3,975 square foot building constructed on approximately 8% of this land at a cost of \$2,444,203 (including closing costs of \$50,516). The building is leased through October 31, 2027 plus four future five year extensions effective on November 1, 2027, November 1, 2032, November 1, 2037 and November 1, 2042. The terms of the lease have the lessee responsible for paying real estate taxes, building insurance and building and ground maintenance. The monthly lease payments are as follows: \$14,661 in 2014; \$14,881 in 2015; \$15,104 in 2016 and \$15,331 in 2017, \$15,561 in 2018 and \$15,794 in 2019.

In December 2013, TLIC also purchased one acre of land in Norman, Oklahoma that included a 9,100 square foot building constructed on approximately 18% of this land at a cost of \$1,519,431 (including closing costs of \$37,931). The building is leased through August 31, 2028 plus three future five year extensions on September 1, 2028, September 1, 2033 and September 1, 2038. The terms of the lease have the lessee responsible for paying real estate taxes, building insurance and building and ground maintenance. The monthly lease payments are \$8,004 through August 31, 2028.

In February 2014, TLIC purchased one acre of land in Houston, Texas that included a 9,195 square foot building constructed on approximately 25% of this land at a cost of \$977,013 (including closing costs of \$31,063). The building is leased through December 31, 2023 plus four future five year extension effective on January 1, 2024, January 1, 2029, January 1, 2034 and January 1, 2039. The terms of the lease have the lessee responsible for paying real estate taxes and building insurance. TLIC is responsible for building and ground maintenance. The monthly lease payments are \$5,833 through December 31, 2018 and \$6,417 in 2019.

The \$1,067,208 promissory note is collateralized (including assignment of the tenant leases) by the February 2014 TLIC purchase of three-fourths of an acre of land in Harrisonville, Missouri that included a 6,895 square foot building constructed on approximately 20% of this land at a cost of \$1,752,397 (including closing costs of \$44,864). The building is leased through October 31, 2028 plus three future five year extensions on November 1, 2028, November 1, 2033 and November 1, 2038. The terms of the lease have the lessee responsible for paying real estate taxes, building insurance and building and ground maintenance. The monthly lease payments are \$9,463 through October 31, 2028.

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**6. Federal Income Taxes**

The provision for federal income taxes is based on the asset and liability method of accounting for income taxes. Deferred income taxes are provided for the cumulative temporary differences between balances of assets and liabilities determined under GAAP and the balances using tax bases. A valuation allowance has been established due to the uncertainty of certain loss carryforwards.

The Company has no known uncertain tax benefits within its provision for income taxes. In addition, the Company does not believe it would be subject to any penalties or interest relative to any open tax years and, therefore, has not accrued any such amounts. The Company files U.S. federal income tax returns and income tax returns in various state jurisdictions. The 2010 through 2013 U.S. federal tax years are subject to income tax examination by tax authorities. The Company classifies any interest and penalties (if applicable) as income tax expense in the financial statements.

**7. Legal Matters and Contingent Liabilities**

The Company and Chairman, President and Chief Executive Officer, Gregg E. Zahn, filed an action in the District Court of Tulsa County, Oklahoma in 2013, Case No. CJ-2013-03385, against former Company Board of Directors member, Wayne Pettigrew and Mr. Pettigrew's company, Group & Pension Planners, Inc. (the "Defendants"). The petition filed in the case alleges that Mr. Pettigrew, during and after the time he was a member of the Company's Board of Directors, made defamatory statements regarding the Company and Mr. Zahn. The defendants are alleged to have made defamatory statements to certain shareholders of the Company, to the press and to the OID and the Oklahoma Department of Securities. Mr. Pettigrew has denied the allegations.

The Board of Directors, represented by independent counsel, concluded that there was no action to be taken against Mr. Zahn and that the allegations by Mr. Pettigrew were without substance. The Company has been informed by the OID that it would take no action and was also informed that the Oklahoma Department of Securities, after its investigation of the allegations, concluded that no proceedings were needed with respect to the alleged matters. It is the Company's intention to vigorously prosecute this action against the Defendants for damages and for the correction of the defamatory statements. In the opinion of the Company's management, the ultimate resolution of any contingencies that may arise from this litigation is not considered material in relation to the financial position or results of operations of the Company.

Prior to its acquisition by TLIC, FBLIC developed, marketed, and sold life insurance products known as "Decreasing Term to 95" policies. On January 17, 2013, FBLIC's Board of Directors voted that, effective March 1, 2013, it was not approving, and therefore was not providing, a dividend for the Decreasing Term to 95 policies. On November 22, 2013, three individuals who owned Decreasing Term to 95 policies filed a Petition in the Circuit Court of Greene County, Missouri asserting claims against FBLIC relating to FBLIC's decision to not provide a dividend under the Decreasing Term to 95 policies.

The Petition asserts claims for breach of contract and anticipatory breach of contract and alleges that FBLIC breached, and will anticipatorily breach, the Decreasing Term to 95 policies of insurance by not providing a dividend sufficient to purchase a one year term life insurance policy which would keep the death benefit under the Decreasing Term to 95 policies the same as that provided during the first year of coverage under the policy. In addition to these claims, the Petition asserts claims for negligent misrepresentation, fraud, and violation of the Missouri Merchandising Practices Act. It alleges that during its sale of the Decreasing Term to 95 policies, FBLIC represented that the owners of these policies would always be entitled to dividends to purchase a one-year term life insurance policy and that the owners would have a level death benefit without an increase in premium.

The Petition also seeks to certify a class of individuals with similar claims but no class has been certified by the Court. FBLIC denies the allegations in the Petition and will continue to defend against them. It is the Company's intention to

vigorously defend the request for class certification, as well as to defend vigorously against the individual allegations. The Company is unable to determine the potential magnitude of the claims in the event of a final certification and the plaintiffs prevailing on the substantive action.

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**8. Other Comprehensive Income and Accumulated Other Comprehensive Income**

The changes in the components of the Company's accumulated other comprehensive income (loss) for the three and six months ended June 30, 2014 and 2013 are summarized as follows:

| Three Months Ended June 30, 2014 and 2013<br>(Unaudited)                          |   |   |   |
|---|---|---|---|
|   | Unrealized<br>Appreciation on<br>Available-For-<br>Sale<br>Securities | Adjustment to<br>Deferred<br>Acquisition<br>Costs | Accumulated<br>Other<br>Comprehensive<br>Income |
| Balance as of April 1, 2014   | \$ 2,975,234  | \$ (17,949)                                       | \$ 2,957,285                                    |
| Other comprehensive income before reclassifications, net of tax                   | 1,746,758   | (12,044)  | 1,734,714                                       |
| Less amounts reclassified from accumulated other comprehensive income, net of tax | 372,120   | -   | 372,120   |
| Other comprehensive income  | 1,374,638   | (12,044)  | 1,362,594                                       |
| Balance as of June 30, 2014   | <u>\$ 4,349,872</u>   | <u>\$ (29,993)</u>                                | <u>\$ 4,319,879</u>                             |
| Balance as of April 1, 2013   | \$ 5,965,023  | \$ (31,052)                                       | \$ 5,933,971                                    |
| Other comprehensive loss before reclassifications, net of tax                     | (1,879,909)   | 9,759   | (1,870,150)                                     |
| Less amounts reclassified from accumulated other comprehensive loss, net of tax   | 101,546   | -   | 101,546   |
| Other comprehensive loss  | (1,981,455)   | 9,759   | (1,971,696)                                     |
| Balance as of June 30, 2013   | <u>\$ 3,983,568</u>   | <u>\$ (21,293)</u>                                | <u>\$ 3,962,275</u>                             |

  

| Six Months Ended June 30, 2014 and 2013<br>(Unaudited)                            |   |   |   |
|---|---|---|---|
|   | Unrealized<br>Appreciation on<br>Available-For-<br>Sale<br>Securities | Adjustment to<br>Deferred<br>Acquisition<br>Costs | Accumulated<br>Other<br>Comprehensive<br>Income |
| Balance as of January 1, 2014   | \$ 1,888,498  | \$ (10,341)                                       | \$ 1,878,157                                    |
| Other comprehensive income before reclassifications, net of tax                   | 3,070,746   | (19,652)  | 3,051,094                                       |
| Less amounts reclassified from accumulated other comprehensive income, net of tax | 609,372   | -   | 609,372   |
| Other comprehensive income  | 2,461,374   | (19,652)  | 2,441,722                                       |
| Balance as of June 30, 2014   | <u>\$ 4,349,872</u>   | <u>\$ (29,993)</u>                                | <u>\$ 4,319,879</u>                             |
| Balance as of January 1, 2013   | \$ 5,811,309  | \$ (30,639)                                       | \$ 5,780,670                                    |
| Other comprehensive loss before reclassifications, net of tax                     | (1,606,781)   | 9,346   | (1,597,435)                                     |
| Less amounts reclassified from accumulated other comprehensive loss, net of tax   | 220,960   | -   | 220,960   |
| Other comprehensive loss  | (1,827,741)   | 9,346   | (1,818,395)                                     |
| Balance as of June 30, 2013   | <u>\$ 3,983,568</u>   | <u>\$ (21,293)</u>                                | <u>\$ 3,962,275</u>                             |



**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**8. Other Comprehensive Income and Accumulated Other Comprehensive Income (continued)**

The pretax components of the Company's other comprehensive income and the related income tax expense for each component for the three and six months ended June 30, 2014 and 2013 are summarized as follows:

| Three Months Ended June 30, 2014 (Unaudited)                     |                     |                                    |                     |
|--|---------------------|------------------------------------|---------------------|
|  | Pretax              | Income Tax<br>Expense<br>(Benefit) | Net of Tax          |
| Other comprehensive income:                                      |                     |                                    |                     |
| Change in net unrealized gains on available-for-sale securities: |                     |                                    |                     |
| Unrealized holding gains arising during the period               | \$ 2,183,448        | \$ 436,690                         | \$ 1,746,758        |
| Reclassification adjustment for gains included in income         | (465,151)           | (93,031)                           | (372,120)           |
| Net unrealized gains on investments                              | 1,718,297           | 343,659                            | 1,374,638           |
| Adjustment to deferred acquisition costs                         | (15,055)            | (3,011)                            | (12,044)            |
| Total other comprehensive income                                 | <u>\$ 1,703,242</u> | <u>\$ 340,648</u>                  | <u>\$ 1,362,594</u> |

| Three Months Ended June 30, 2013 (Unaudited)                     |                       |                                    |                       |
|--|-----------------------|------------------------------------|-----------------------|
|  | Pretax                | Income Tax<br>Expense<br>(Benefit) | Net of Tax            |
| Other comprehensive loss:  |                       |                                    |                       |
| Change in net unrealized gains on available-for-sale securities: |                       |                                    |                       |
| Unrealized holding losses arising during the period              | \$ (2,349,888)        | \$ (469,979)                       | \$ (1,879,909)        |
| Reclassification adjustment for gains included in income         | (126,932)             | (25,386)                           | (101,546)             |
| Net unrealized losses on investments                             | (2,476,820)           | (495,365)                          | (1,981,455)           |
| Adjustment to deferred acquisition costs                         | 12,197                | 2,438                              | 9,759                 |
| Total other comprehensive loss                                   | <u>\$ (2,464,623)</u> | <u>\$ (492,927)</u>                | <u>\$ (1,971,696)</u> |

| Six Months Ended June 30, 2014 (Unaudited)                       |                     |                                    |                     |
|--|---------------------|------------------------------------|---------------------|
|  | Pretax              | Income Tax<br>Expense<br>(Benefit) | Net of Tax          |
| Other comprehensive income:                                      |                     |                                    |                     |
| Change in net unrealized gains on available-for-sale securities: |                     |                                    |                     |
| Unrealized holding gains arising during the period               | \$ 3,838,433        | \$ 767,687                         | \$ 3,070,746        |
| Reclassification adjustment for gains included in income         | (761,716)           | (152,344)                          | (609,372)           |
| Net unrealized gains on investments                              | 3,076,717           | 615,343                            | 2,461,374           |
| Adjustment to deferred acquisition costs                         | (24,565)            | (4,913)                            | (19,652)            |
| Total other comprehensive income                                 | <u>\$ 3,052,152</u> | <u>\$ 610,430</u>                  | <u>\$ 2,441,722</u> |

| Six Months Ended June 30, 2013 (Unaudited)                       |        |                                    |            |
|--|--------|------------------------------------|------------|
|  | Pretax | Income Tax<br>Expense<br>(Benefit) | Net of Tax |
| Other comprehensive loss:  |        |                                    |            |
| Change in net unrealized gains on available-for-sale securities: |        |                                    |            |



|  |                       |                     |                       |
|--|-----------------------|---------------------|-----------------------|
| Unrealized holding losses arising during the period      | \$ (2,008,477)        | \$ (401,696)        | \$ (1,606,781)        |
| Reclassification adjustment for gains included in income | (276,201)             | (55,241)            | <del>(220,960)</del>  |
| Net unrealized losses on investments                     | (2,284,678)           | (456,937)           | (1,827,741)           |
| Adjustment to deferred acquisition costs                 | 11,681                | 2,335               | 9,346                 |
| Total other comprehensive loss                           | <u>\$ (2,272,997)</u> | <u>\$ (454,602)</u> | <u>\$ (1,818,395)</u> |

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**8. Other Comprehensive Income and Accumulated Other Comprehensive Income (continued)**

Realized gains and losses on the sales of investments are determined based upon the specific identification method and include provisions for other-than-temporary impairments where appropriate.

The pretax and the related income tax components of the amounts reclassified from the Company's accumulated other comprehensive income to the Company's consolidated statement of operations for the three and six months ended June 30, 2014 and 2013 are summarized as follows:

|  | Three Months Ended June<br>30, (Unaudited) |                   | Six Months Ended June<br>30, (Unaudited) |                   |
|--|--|-------------------|--|-------------------|
| Reclassification Adjustments                       | 2014                                       | 2013              | 2014                                     | 2013              |
| Unrealized gains on available-for-sale securities: |  |                   |  |                   |
| Realized gains on sales of securities (a)          | \$ 465,151                                 | \$ 126,932        | \$ 761,716                               | \$ 276,201        |
| Income tax expenses (b)                            | (93,031)                                   | (25,386)          | (152,344)                                | (55,241)          |
| Total reclassification adjustments                 | <u>\$ 372,120</u>                          | <u>\$ 101,546</u> | <u>\$ 609,372</u>                        | <u>\$ 220,960</u> |

(a) These items appear within net realized investment gains in the consolidated statement of operations.

(b) These items appear within federal income taxes in the consolidated statement of operations.

**9. Allowance for Loan Losses from Mortgage Loans on Real Estate and Loans from Premium Financing**

The allowance for possible loan losses from investments in mortgage loans on real estate and loans from premium financing is a reserve established through a provision for possible loan losses charged to expense which represents, in the Company's judgment, the known and inherent credit losses existing in the residential and commercial mortgage loan and premium financing loan portfolios. The allowance, in the judgment of the Company, is necessary to reserve for estimated loan losses inherent in the residential and commercial mortgage loan and premium finance loan portfolios and reduces the carrying value of investments in mortgage loans on real estate and premium finance loans to the estimated net realizable value on the statement of financial position.

While the Company utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including the performance of the residential and commercial mortgage loan and premium finance loan portfolios, the economy and changes in interest rates. The Company's allowance for possible mortgage loan and premium finance loan losses consists of specific valuation allowances established for probable losses on specific loans and a portfolio reserve for probable incurred but not specifically identified loans.

Mortgage loans and premium finance loans are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the mortgage loan or premium finance loan agreement. Factors considered by the Company in determining impairment include payment status, collateral value of the real estate subject to the mortgage loan, and the probability of collecting scheduled principal and interest payments when due. Mortgage loans and premium finance loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. The Company determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the mortgage loan or premium finance loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis.

**First Trinity Financial Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2014**  
**(Unaudited)**

**9. Allowance for Loan Losses from Mortgage Loans on Real Estate and Premium Financing Loans (continued)**

As of June 30, 2014, \$201,751 of cash and \$439,828 of independent mortgage loan balances totaling \$641,579 are held in escrow by a third party for the benefit of the Company related to its investment in \$7,120,469 of mortgage loans on real estate with one loan originator. In addition, the Company has an additional \$104,599 allowance for possible loan losses in the remaining \$21,541,822 of investments in mortgage loans on real estate as of June 30, 2014.

Through June 30, 2012, FTCC financed amounts up to 80% of the premium on property and casualty insurance policies after a 20% or greater down payment was made by the policy owner. The premiums financed were collateralized by the amount of the unearned premium of the insurance policy. Policies that became delinquent were submitted for cancellation and recovery of the unearned premium, up to the amount of the loan balance, 25 days after a payment became delinquent. Loans from premium financing of \$321,243 and \$340,243 as of June 30, 2014 and December 31, 2013, respectively, are carried net of unearned interest and any estimated loan losses.

There was no unearned interest as of June 30, 2014 and December 31, 2013. Allowances for loan losses on premium financing were \$197,358 and \$206,858 as of June 30, 2014 and December 31, 2013, respectively.

The balances of and changes in the company's credit losses related to mortgage loans on real estate and loans from premium financing as of and for the three and six months ended June 30, 2014 and 2013 are summarized as follows:

|                                  | Three Months Ended June<br>30, (Unaudited) |                   | Six Months Ended June<br>30, (Unaudited) |                   |
|----------------------------------|--|-------------------|--|-------------------|
|                                  | 2014                                       | 2013              | 2014                                     | 2013              |
| Allowance at beginning of period | \$ 282,656                                 | \$ 275,370        | \$ 265,053                               | \$ 228,999        |
| Charges (credits) to operations  | 19,301                                     | (5,584)           | 36,904                                   | 40,787            |
| Allowance at end of period       | <u>\$ 301,957</u>                          | <u>\$ 269,786</u> | <u>\$ 301,957</u>                        | <u>\$ 269,786</u> |

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

### Overview

First Trinity Financial Corporation ("we" "us", "our", "FTFC" or the "Company") conducts operations as an insurance holding company emphasizing ordinary life insurance products and annuities in niche markets.

As an insurance provider, we collect premiums in the current period to pay future benefits to our policy and contract holders. Our core TLIC and FBLIC operations include issuing modified premium whole life insurance with a flexible premium deferred annuity, ordinary whole life, final expense, term and annuity products to predominately middle income households through independent agents. TLIC is licensed in the states of Illinois, Kansas, Kentucky, Nebraska, North Dakota, Ohio, Oklahoma and Texas. FBLIC is licensed in the states of Arkansas, Arizona, Colorado, Illinois, Indiana, Kansas, Kentucky, Louisiana, Missouri, Nebraska, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Tennessee, Texas, Virginia and West Virginia and has certificate of authority applications pending in Alabama, Georgia, Michigan and Mississippi.

We also realize revenues from our investment portfolio, which is a key component of our operations. The revenues we collect as premiums from policyholders are invested to ensure future benefit payments under the policy contracts. Life insurance companies earn profits on the investment spread, which reflects the investment income earned on the premiums paid to the insurer between the time of receipt and the time benefits are paid out under policies. Changes in interest rates, changes in economic conditions and volatility in the capital markets can all impact the amount of earnings that we realize from our investment portfolio.

### Acquisitions

The Company also expects to facilitate growth through acquisitions of other life insurance companies and/or blocks of life insurance business. In late December 2008, the Company completed its acquisition of 100% of the outstanding stock of FLAC, included in the life insurance and annuity segments, for \$2,500,000 and had additional acquisition related expenses of \$195,000. In late December 2011, the Company completed its acquisition of 100% of the outstanding stock of FBLIC, also included in the life insurance and annuity segments, for \$13,855,129.

Our profitability in the life insurance and annuity segments is a function of our ability to accurately price the policies that we write, adequately value life insurance business acquired, administer life insurance company acquisitions at an expense level that validates the acquisition cost and invest the premiums and annuity considerations in assets that earn investment income with a positive spread.

### Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition, results of operations and liquidity and capital resources is based on our consolidated financial statements that have been prepared in accordance with U.S. GAAP. Preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. We evaluate our estimates and assumptions continually, including those related to investments, deferred acquisition costs, allowance for loan losses from mortgages and premium financing, value of insurance business acquired, policy liabilities, regulatory requirements, contingencies and litigation. We base our estimates on historical experience and on various other factors and assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

For a description of the Company's critical accounting policies and estimates, please refer to "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates" in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. The Company considers its most critical accounting estimates to be those applied to investments in fixed maturity and equity securities, deferred policy acquisition costs, value of insurance business acquired and future policy benefits. There have been no material changes to the Company's critical accounting policies and estimates since December 31, 2013.



## ***Recent Accounting Pronouncements***

### ***Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity***

In April 2014, the FASB issued revised guidance to reduce diversity in practice for reporting discontinued operations. Under the previous guidance, any component of an entity that was a reportable segment, an operating segment, a reporting unit, a subsidiary, or an asset group was eligible for discontinued operations presentation. The revised guidance only allows disposals of components of an entity that represent a strategic shift (e.g., disposal of a major geographical area, a major line of business, a major equity method investment, or other major parts of an entity) and that have a major effect on a reporting entity's operations and financial results to be reported as discontinued operations. The revised guidance also requires expanded disclosure in the financial statements for discontinued operations as well as for disposals of significant components of an entity that do not qualify for discontinued operations presentation. The updated guidance is effective for the quarter ending March 31, 2015. The adoption of this guidance is not expected to have a material effect on the Company's results of operations, financial position or liquidity.

### ***Revenue from Contracts with Customers***

In May 2014, the FASB issued updated guidance to clarify the principles for recognizing revenue. While insurance contracts are not within the scope of this updated guidance, the Company's fee income related to providing limited services will be subject to this updated guidance.

The updated guidance requires an entity to recognize revenue as performance obligations are met, in order to reflect the transfer of promised goods or services to customers in an amount that reflects the consideration the entity is entitled to receive for those goods or services. The following steps are applied in the updated guidance: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation.

The updated guidance is effective for the quarter ending March 31, 2017. The adoption of this guidance is not expected to have a material effect on the Company's results of operations, financial position, or liquidity.

### ***Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period***

In June 2014, the FASB issued updated guidance to resolve diversity in practice concerning employee share-based payments that contain performance targets that could be achieved after the requisite service period. Many reporting entities account for performance targets that could be achieved after the requisite service period as performance conditions that affect the vesting of the award and, therefore, do not reflect the performance targets in the estimate of the grant-date fair value of the award. Other reporting entities treat those performance targets as nonvesting conditions that affect the grant-date fair value of the award.

The updated guidance requires that a performance target that affects vesting and that can be achieved after the requisite service period be treated as a performance condition. As such, the performance target that affects vesting should not be reflected in estimating that fair value of the award at the grant date. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which service has been rendered. If the performance target becomes probable of being achieved before the end of the service period, the remaining unrecognized compensation cost for which requisite service has not yet been rendered is recognized prospectively over the remaining service period. The total amount of compensation cost recognized during and after the service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest.

The updated guidance is effective for annual and interim periods beginning after December 15, 2015, with early adoption permitted. The adoption of this guidance is not expected to have a material effect on the Company's results of operations, financial position or liquidity.



## ***Future Application of Accounting Standards***

The Company is currently required to prepare its financial statements in accordance with U.S. GAAP. During the last several years, the SEC has been evaluating whether, when and how IFRS should be incorporated into the U.S. financial reporting system. Before making a decision, the SEC set forth a work plan to evaluate the remaining differences between GAAP and IFRS, determine whether IFRS represent high quality standards, consider how the IASB is funded and its governance structure and examine the variations in the way IFRS was applied by various foreign companies that file financial statements with the SEC. In July 2012, the SEC staff issued a final report on the SEC work plan which concluded that IFRS provided high quality accounting standards, but also indicated concerns with funding, consistency of application and enforcement of IFRS globally. The report did not give a recommendation to the SEC on whether, when and how IFRS should be incorporated into the U.S. financial reporting system. In addition, the SEC has not indicated a timeline for further consideration of incorporating IFRS.

The FASB and the IASB have a convergence program with the intent of developing global standards for several significant areas of accounting, including the accounting for insurance contracts. In June 2012, the FASB issued a statement that indicated that based on the nature and totality of differences between the FASB's and IASB's views, it is not likely that the two boards will achieve convergence on this project. The FASB further noted that the FASB and IASB have very different perspectives on the project, given that the U.S. has existing guidance on insurance contracts whereas there is currently no comprehensive IFRS accounting standard for insurance contracts.

In June 2013, each board issued for comment an exposure draft of the accounting for insurance contracts that has significant differences from the other board's draft as well as from current GAAP. Both exposure drafts proposed changes that, if ultimately adopted, could significantly impact the accounting by insurers, including the Company, for premiums, policyholders' account balances, future policy benefits, policy claims and claims adjustment expenses, reinsurance and deferred acquisition costs. In February 2014, due to the evaluation of responses received from its 2013 exposure draft, the FASB announced that it has decided to consider targeted improvements to GAAP related to insurance contracts rather than a comprehensive overhaul of GAAP related to insurance contracts.

The FASB and the IASB also continue to deliberate the three remaining projects intended to bring convergence between GAAP and IFRS for accounting for financial instruments and leasing. The Boards currently have different positions on certain key aspects of the financial instrument project (the classification and measurement and impairment) but both Boards intend to complete their financial instrument project during the first half of 2014. The timing of the leasing project is not known at this time.

The Company is not able to predict whether it will be required to adopt IFRS or how the adoption of IFRS (or the potential convergence of GAAP and IFRS, including the joint project for valuing insurance contract liabilities) may impact the Company's financial statements in the future.

## **Business Segments**

FASB guidance requires a "management approach" in the presentation of business segments based on how management internally evaluates the operating performance of business units. The discussion of segment operating results that follows is being provided based on segment data prepared in accordance with this methodology.

Prior to January 1, 2014, the Company's quarterly and annual segment data was reported based upon a life insurance segment, consisting of the operations of TLIC and FBLIC, a premium financing segment, consisting of the operations of FTCC and SIS and a corporate segment. Prior to January 1, 2014, the results for the parent company, after elimination of intercompany amounts, were included in the corporate segment.



Our business segments beginning January 1, 2014 are as follows:

- Life insurance operations, consisting of the life insurance operations of TLIC and FBLIC;
- Annuity operations, consisting of the annuity operations of TLIC and FBLIC and
- Corporate operations, which includes the results of the parent company, FTCC and SIS after the elimination of intercompany amounts.

Please see below and Note 4 to the Consolidated Financial Statements for the three and six months ended June 30, 2014 and 2013 and as of June 30, 2014 and December 31, 2013 for additional information regarding segment information. The segment data as of December 31, 2013 and for the three and six months ended June 30, 2013 have been restated from what was previously reported and now follows the new segmentation methodology established on January 1, 2014.

The following is a discussion and analysis of our financial condition, results of operations and liquidity and capital resources.

## FINANCIAL IDGHLIGHTS

### Consolidated Condensed Results of Operations for the Three Months Ended June 30, 2014 and 2013

|   | (Unaudited)                 |                  |                        |                      |
|---|-----------------------------|------------------|------------------------|----------------------|
|   | Three Months Ended June 30, |                  | Increase<br>(Decrease) | Percentage<br>Change |
|   | 2014                        | 2013             | 2014 less 2013         | 2014 to 2013         |
| Premiums                                      | \$ 1,932,055                | \$ 1,921,494     | \$ 10,561              | 0.5%                 |
| Net investment income                         | 2,261,603                   | 1,764,367        | 497,236                | 28.2%                |
| Net realized investment gains                 | 465,151                     | 126,932          | 338,219                | 266.5%               |
| Other income                                  | 6,763                       | 4,739            | 2,024                  | 42.7%                |
| Total revenues                                | 4,665,572                   | 3,817,532        | 848,040                | 22.2%                |
| Benefits and claims                           | 2,648,244                   | 2,318,195        | 330,049                | 14.2%                |
| Expenses                                      | 1,566,061                   | 1,407,520        | 158,541                | 11.3%                |
| Total benefits, claims and expenses           | 4,214,305                   | 3,725,715        | 488,590                | 13.1%                |
| Income before federal income tax expense      | 451,267                     | 91,817           | 359,450                | 391.5%               |
| Federal income tax expense                    | 17,087                      | 19,267           | (2,180)                | -11.3%               |
| Net income                                    | <u>\$ 434,180</u>           | <u>\$ 72,550</u> | <u>\$ 361,630</u>      | 498.5%               |
| Net income per common share basic and diluted | <u>\$ 0.06</u>              | <u>\$ 0.01</u>   | <u>\$ 0.05</u>         |                      |

**Consolidated Condensed Results of Operations for the Six Months Ended June 30, 2014 and 2013**

|  | (Unaudited)               |                   |                               |                                      |
|--|---------------------------|-------------------|-------------------------------|--------------------------------------|
|  | Six Months Ended June 30, |                   | Increase<br>2014 less<br>2013 | Percentage<br>Change<br>2014 to 2013 |
|  | 2014                      | 2013              |                               |                                      |
| Premiums   | \$ 3,942,038              | \$ 3,849,044      | \$ 92,994                     | 2.4%                                 |
| Net investment income                              | 4,232,411                 | 3,415,990         | 816,421                       | 23.9%                                |
| Net realized investment gains                      | 761,716                   | 276,201           | 485,515                       | 175.8%                               |
| Other income                                       | 20,075                    | 7,758             | 12,317                        | 158.8%                               |
| Total revenues                                     | 8,956,240                 | 7,548,993         | 1,407,247                     | 18.6%                                |
| Benefits and claims                                | 5,170,531                 | 4,487,658         | 682,873                       | 15.2%                                |
| Expenses   | 3,068,944                 | 2,619,390         | 449,554                       | 17.2%                                |
| Total benefits, claims and expenses                | 8,239,475                 | 7,107,048         | 1,132,427                     | 15.9%                                |
| Income before federal income tax expense (benefit) | 716,765                   | 441,945           | 274,820                       | 62.2%                                |
| Federal income tax expense (benefit)               | 39,431                    | (11,597)          | 51,028                        | -440.0%                              |
| Net income   | <u>\$ 677,334</u>         | <u>\$ 453,542</u> | <u>\$ 223,792</u>             | 49.3%                                |
| Net income per common share<br>basic and diluted   | <u>\$ 0.09</u>            | <u>\$ 0.06</u>    | <u>\$ 0.03</u>                |                                      |

**Consolidated Condensed Financial Position as of June 30, 2014 and December 31, 2013**

|  | (Unaudited)<br>June 30, 2014 | December 31,<br>2013 | Increase<br>2014 to 2013 | Percentage<br>Change<br>2014 to 2013 |
|--|------------------------------|----------------------|--------------------------|--------------------------------------|
| Investment assets                          | \$ 173,242,293               | \$150,056,278        | \$ 23,186,015            | 15.5%                                |
| Other assets                               | 33,887,891                   | 33,116,881           | 771,010                  | 2.3%                                 |
| Total assets                               | <u>\$ 207,130,184</u>        | <u>\$183,173,159</u> | <u>\$ 23,957,025</u>     | 13.1%                                |
| Policy liabilities                         | \$ 163,582,185               | \$147,806,056        | \$ 15,776,129            | 10.7%                                |
| Notes payable                              | 4,076,473                    | -                    | 4,076,473                | 100.0%                               |
| Deferred federal income taxes              | 3,115,239                    | 2,543,825            | 571,414                  | 22.5%                                |
| Other liabilities                          | 2,676,217                    | 2,182,264            | 493,953                  | 22.6%                                |
| Total liabilities                          | 173,450,114                  | 152,532,145          | 20,917,969               | 13.7%                                |
| Shareholders' equity                       | 33,680,070                   | 30,641,014           | 3,039,056                | 9.9%                                 |
| Total liabilities and shareholders' equity | <u>\$ 207,130,184</u>        | <u>\$183,173,159</u> | <u>\$ 23,957,025</u>     | 13.1%                                |
| Shareholders' equity per common share      | <u>\$ 4.30</u>               | <u>\$ 3.90</u>       | <u>\$ 0.40</u>           |                                      |

## Results of Operations— Three Months Ended June 30, 2014 and 2013

### Revenues

Our primary sources of revenue are life insurance premium income and investment income. Premium payments are classified as first-year, renewal and single. In addition, realized gains and losses on investment holdings can significantly impact revenues from period to period.

Our revenues for the three months ended June 30, 2014 and 2013 are summarized as follows:

|                               | (Unaudited)                 |                     |                   |            |
|-------------------------------|-----------------------------|---------------------|-------------------|------------|
|                               | Three Months Ended June 30, |                     | Increase          | Percentage |
|                               | 2014                        | 2013                | 2014 less 2013    | Change     |
| Premiums                      | \$ 1,932,055                | \$ 1,921,494        | \$ 10,561         | 0.5%       |
| Net investment income         | 2,261,603                   | 1,764,367           | 497,236           | 28.2%      |
| Net realized investment gains | 465,151                     | 126,932             | 338,219           | 266.5%     |
| Other income                  | 6,763                       | 4,739               | 2,024             | 42.7%      |
| Total revenues                | <u>\$ 4,665,572</u>         | <u>\$ 3,817,532</u> | <u>\$ 848,040</u> | 22.2%      |

The increase in total revenues of \$848,040 for the three months ended June 30, 2014 is discussed below.

### Premiums

Our premiums for the three months ended June 30, 2014 and 2013 are summarized as follows:

|                                | (Unaudited)                 |                     |                           |            |
|--------------------------------|-----------------------------|---------------------|---------------------------|------------|
|                                | Three Months Ended June 30, |                     | Increase                  | Percentage |
|                                | 2014                        | 2013                | (Decrease) 2014 less 2013 | Change     |
| Whole life and term first year | \$ 12,386                   | \$ 34,807           | \$ (22,421)               | -64.4%     |
| Whole life and term renewal    | 617,086                     | 667,077             | (49,991)                  | -7.5%      |
| Final expense first year       | 201,488                     | 239,575             | (38,087)                  | -15.9%     |
| Final expense renewal          | <u>1,101,095</u>            | <u>980,035</u>      | <u>121,060</u>            | 12.4%      |
| Total premiums                 | <u>\$ 1,932,055</u>         | <u>\$ 1,921,494</u> | <u>\$ 10,561</u>          | 0.5%       |

The \$10,561 increase in premiums for the three months ended June 30, 2014 is primarily due to a \$121,060 increase in final expense renewal premiums that exceeded a \$110,499 decrease in whole life and term first year and renewal premiums and final expense first year premiums.

The increase in final expense renewal premiums reflects the persistency of prior years' final expense production. Our marketing efforts are focused on final expense and annuity production and we have not been focused on whole life and term production the past few years. The decrease in final expense first year premiums is primarily due to the impact of competition and the interrelationships of our premium rates, commission rates and underwriting policies compared to those of other life insurance companies also focusing on final expense production.

## Net Investment Income

The major components of our net investment income for the three months ended June 30, 2014 and 2013 are summarized as follows:

|                                  | (Unaudited)             |                     |                   |              |
|----------------------------------|-------------------------|---------------------|-------------------|--------------|
|                                  | Three Months Ended June |                     | Increase          | Percentage   |
|                                  | 30,                     |                     | (Decrease)        | Change       |
|                                  | 2014                    | 2013                | 2014 less 2013    | 2014 to 2013 |
| Fixed maturity securities        | \$ 1,128,167            | \$ 1,094,086        | \$ 34,081         | 3.1%         |
| Equity securities                | 10,747                  | 7,371               | 3,376             | 45.8%        |
| Other long-term investments      | 418,379                 | 419,843             | (1,464)           | -0.3%        |
| Mortgage loans                   | 581,733                 | 266,145             | 315,588           | 118.6%       |
| Policy loans                     | 25,435                  | 24,961              | 474               | 1.9%         |
| Real estate                      | 204,799                 | 90,710              | 114,089           | 125.8%       |
| Short-term and other investments | 35,781                  | 17,536              | 18,245            | 104.0%       |
| Gross investment income          | 2,405,041               | 1,920,652           | 484,389           | 25.2%        |
| Investment expenses              | (143,438)               | (156,285)           | (12,847)          | 8.2%         |
| Net investment income            | <u>\$ 2,261,603</u>     | <u>\$ 1,764,367</u> | <u>\$ 497,236</u> | 28.2%        |

The \$484,389 increase in gross investment income for the three months ended June 30, 2014 is due to the 2014 investment of excess cash primarily in mortgage loans, real estate and fixed maturity securities. In the twelve months since June 30, 2013, our investments in mortgage loans have increased approximately \$15.1 million. In addition, since December 1, 2013, we have purchased four retail business buildings located in Indiana, Missouri, Oklahoma and Texas for approximately \$6.7 million. Investments in fixed maturity securities have also increased \$10.4 million since June 30, 2013. The interest and rental income on these investments in mortgage loans, real estate and fixed maturity securities accounted for \$463,758 of the \$484,389 increase in gross investment income.

The \$12,847 decrease in investment expenses for the three months ended June 30, 2014 is due to the Company reversing approximately \$51,000 of depreciation on investment real estate that should not have been expensed during first quarter 2014. Without this reversal, investment expenses would have increased approximately \$38,000 in second quarter 2014 due to fees and expenses associated with our increased investments in mortgage loans and real estate.

## Net Realized Investment Gains

There was a \$338,219 increase in net realized investment gains for the three months ended June 30, 2014.

The net realized investment gains from the sales and maturities of fixed maturity securities available-for-sale of \$266,427 for the three months ended June 30, 2014 resulted from proceeds of \$5,149,728 for these securities that had carrying values of \$4,883,301 at the 2014 disposal dates.

The net realized investment gains from the sales and maturities of fixed maturity securities available-for-sale of \$6,178 for the three months ended June 30, 2013 resulted from proceeds of \$1,256,225 for these securities that had carrying values of \$1,250,047 as of the 2013 disposal dates.

The net realized investment gains from mortgage loans on real estate of \$177,324 for the three months ended June 30, 2014, resulted from the early payoff of mortgage loans that we had acquired at a discount price.

The net realized investment gains from mortgage loans on real estate of \$120,754 for the three months ended June 30, 2013, resulted from the early payoff of a mortgage loan that we had also acquired at a discount price.

The net realized investment gains from the sales of equity securities available-for-sale of \$21,400 for the three months ended June 30, 2014 resulted from proceeds of \$101,080 for these securities that had carrying values of \$79,680 at the 2014 disposal dates.



We have recorded no other-than-temporary impairments in 2014 and 2013.

### Total Benefits, Claims and Expenses

Our benefits, claims and expenses are primarily generated from benefit payments, surrenders, interest credited to policyholders, change in reserves, commissions and other undeiwriting, insurance and acquisition expenses. Benefit payments can significantly impact expenses from period to period.

Our benefits, claims and expenses for the three months ended June 30, 2014 and 2013 are summarized as follows:

|  | (Unaudited)                 |              |                     |                   |
|--|-----------------------------|--------------|---------------------|-------------------|
|  | Three Months Ended June 30, |              | Increase (Decrease) | Percentage Change |
|  | 2014                        | 2013         | 2014 less 2013      | 2014 to 2013      |
| <b>Benefits and claims</b>                                   |                             |              |                     |                   |
| Increase in future policy benefits                           | \$ 594,832                  | \$ 575,056   | \$ 19,776           | 3.4%              |
| Death benefits   | 750,013                     | 601,828      | 148,185             | 24.6%             |
| Surrenders   | 152,492                     | 179,940      | (27,448)            | -15.3%            |
| Interest credited to policyholders                           | 1,079,517                   | 892,263      | 187,254             | 21.0%             |
| Dividend, endowment and supplementary life contract benefits | 71,390                      | 69,108       | 2,282               | 3.3%              |
| Total benefits and claims                                    | 2,648,244                   | 2,318,195    | 330,049             | 14.2%             |
| <b>Expenses</b>  |                             |              |                     |                   |
| Policy acquisition costs deferred                            | (558,309)                   | (511,059)    | (47,250)            | 9.2%              |
| Amortization of deferred policy acquisition costs            | 308,272                     | 126,171      | 182,101             | 144.3%            |
| Amortization of value of insurance business acquired         | 96,744                      | 120,956      | (24,212)            | -20.0%            |
| Commissions  | 529,531                     | 533,795      | (4,264)             | -0.8%             |
| Other undetwriting, insurance and acquisition expenses       | 1,189,823                   | 1,137,657    | 52,166              | 4.6%              |
| Total expenses   | 1,566,061                   | 1,407,520    | 158,541             | 11.3%             |
| Total benefits, claims and expenses                          | \$ 4,214,305                | \$ 3,725,715 | \$ 488,590          | 13.1%             |

The increase of \$488,590 in total benefits, claims and expenses for the three months ended June 30, 2014 is discussed below.

### Benefits and Claims

The \$329,949 increase in benefits and claims for the three months ended June 30, 2014 is primarily due to the following:

- \$187,254 increase in interest credited to policyholders that is primarily due to an approximate \$23.3 million increase in the amount of policyholders' account balances in the consolidated statement of financial position (increased deposits and interest credited in excess of withdrawals) since June 30, 2013.
- \$148,185 increase in death benefits is primarily due to increased number of claims and increased average amount per claim. This is as expected due to an increase in final expense life insurance in force.

## ***Deferred and Amortization of Deferred Acquisition Costs***

Certain costs related to the successful acquisition of traditional life insurance policies are capitalized and amortized over the premium-paying period of the policies. Certain costs related to the successful acquisition of insurance and annuity policies that subject us to mortality or morbidity risk over a period that extends beyond the period or periods in which premiums are collected and that have terms that are fixed and guaranteed (i.e., limited-payment long-duration annuity contracts) are capitalized and amortized in relation to the present value of actual and expected gross profits on the policies. These acquisition costs, which are referred to as deferred policy acquisition costs, include commissions and other successful costs of acquiring life insurance, which vary with, and are primarily related to, the successful production of new and renewal insurance and annuity contracts.

For the three months ended June 30, 2014 and 2013, capitalized costs were \$558,309 and \$511,059, respectively. Amortization of deferred policy acquisition costs for the three months ended June 30, 2014 and 2013 were \$308,272 and \$126,171, respectively.

The \$47,250 increase in the acquisition costs deferred primarily relates to increased production of final expense products by FBLIC appointed agents based upon expansion into additional states and recruiting of additional agents. The \$182,101 increase in the 2014 amortization of deferred acquisition costs is due to increased lapsation of whole life and term renewal products originally sold by TLIC. This does not include the in force business acquired as a result of the purchases of FLAC and FBLIC in 2008 and 2011, respectively.

## ***Amortization of Value of Insurance Business Acquired***

The cost of acquiring insurance business is amortized over the emerging profit of the related policies using the same assumptions that were used in computing liabilities for future policy benefits. Amortization of the value of insurance business acquired was \$96,744 and \$120,956 for the three months ended June 30, 2014 and 2013, respectively. The \$24,212 decrease in the 2014 amortization of value of insurance business acquired is due to the persistency of the FLAC and FBLIC business acquired in 2008 and 2011, respectively, due to our continuing conservation efforts.

## ***Commissions***

Our commissions for the three months ended June 30, 2014 and 2013 are summarized as follows:

|                                | (Unaudited)                 |                   | Increase          | Percentage   |
|--------------------------------|-----------------------------|-------------------|-------------------|--------------|
|                                | Three Months Ended June 30, |                   | (Decrease)        | Change       |
|                                | 2014                        | 2013              | 2014 less 2013    | 2014 to 2013 |
| Annuity                        | \$ 167,038                  | \$ 113,607        | \$ 53,431         | 47.0%        |
| Whole life and term first year | 10,926                      | 24,200            | (13,274)          | -54.9%       |
| Whole life and term renewal    | 27,554                      | 25,290            | 2,264             | 9.0%         |
| Final expense first year       | 227,427                     | 278,395           | (50,968)          | -18.3%       |
| Final expense renewal          | 96,586                      | 92,303            | 4,283             | 4.6%         |
| Total commissions              | <u>\$ 529,531</u>           | <u>\$ 533,795</u> | <u>\$ (4,264)</u> | -0.8%        |

The \$4,264 decrease in commissions for the three months ended June 30, 2014 is primarily due to:

- \$50,968 decrease in final expense first year commissions that correspond to the \$38,087 decrease in final expense first year premiums.
- \$13,274 decrease in whole life and term first year commissions that correspond to the \$22,421 decrease in whole life and term first year premiums.
- \$53,431 increase in annuity first year, single and renewal commissions that corresponds to \$1,890,289 of increased annuity considerations deposited.





### ***Other Underwriting, Insurance and Acquisition Expenses***

The \$52,166 increase in other underwriting, insurance and acquisition expenses for the three months ended June 30, 2014 is primarily due to increased 2014 costs associated with the regularly scheduled triennial insurance examinations routinely conducted by the OID for TLIC and Missouri Department of Insurance ("MDI") for FBLIC. In addition, we have incurred increased legal costs in 2014. Salaries have also risen due to an asset growth bonus payment related to an employment contract since the Company has recently exceeded \$200.0 million in U. S. GAAP assets.

### ***Federal Income Taxes***

FTFC files a consolidated federal income tax return with FTCC but does not file a consolidated tax return with TLIC or FBLIC. TLIC and FBLIC are taxed as life insurance companies under the provisions of the Internal Revenue Code. Life insurance companies must file separate tax returns until they have been a member of the consolidated filing group for five years. However, in 2013, we filed a combined life insurance company 2012 federal tax return for TLIC and FBLIC and intend to also file a combined life insurance company 2013 federal tax return for TLIC and FBLIC in 2014.

Certain items included in income reported for financial statement purposes are not included in taxable income for the current period, resulting in deferred income taxes.

For the three months ended June 30, 2014 and 2013, current income tax expense was \$28,191 and \$55,724, respectively. Deferred federal income tax benefits were \$11,104 and \$36,457 for the three months ended June 30, 2014 and 2013, respectively.

### ***Net Income Per Common Share Basic and Diluted***

Net income was \$434,180 (\$0.06 per common share basic and diluted) and \$72,550 (\$0.01 per common share basic and diluted) for the three months ended June 30, 2014 and 2013, respectively. Net income per common share basic and diluted is calculated using the weighted average number of common shares outstanding and subscribed during the year. The weighted average outstanding and subscribed common shares basic and diluted for the three months ended June 30, 2014 and 2013 were 7,831,934 and 7,851,984, respectively.

### ***Business Segments***

The Company has a life insurance segment, consisting of the life insurance operations of TLIC and FBLIC, an annuity segment, consisting of the annuity operations of TLIC and FBLIC and a corporate segment. Results for the parent company and the operations of FTCC and SIS, after elimination of intercompany amounts, are included in the corporate segment. Prior to January 1, 2014, the Company's quarterly and annual segment data was reported based upon a life insurance segment, consisting of the operations of TLIC and FBLIC, a premium financing segment, consisting of the operations of FTCC and SIS and a corporate segment. Prior to January 1, 2014, the results for the parent company, after elimination of intercompany amounts, were included in the corporate segment.

The segment data as of December 31, 2013 and for the three months ended June 30, 2013 have been restated from what was previously reported and now follows the new segmentation methodology established on January 1, 2014.

The revenues and income (loss) before federal income taxes from our business segments for the three months ended June 30, 2014 and 2013 are summarized as follows:

|                                    | (Unaudited)                 |                     |                        |                      |
|------------------------------------|-----------------------------|---------------------|------------------------|----------------------|
|                                    | Three Months Ended June 30, |                     | Increase<br>(Decrease) | Percentage<br>Change |
|                                    | 2014                        | 2013                | 2014 to 2013           | 2014 to 2013         |
| Revenues:                          |                             |                     |                        |                      |
| Life insurance operations          | \$ 2,501,936                | \$ 2,352,794        | \$ 149,142             | 6.3%                 |
| Annuity operations                 | 2,091,196                   | 1,405,019           | 686,177                | 48.8%                |
| Corporate operations               | 72,440                      | 59,719              | 12,721                 | 21.3%                |
| Total                              | <u>\$ 4,665,572</u>         | <u>\$ 3,817,532</u> | <u>\$ 848,040</u>      | 22.2%                |
| Income (loss) before income taxes: |                             |                     |                        |                      |
| Life insurance operations          | \$ (110,708)                | \$ (99,151)         | \$ (11,557)            | 11.7%                |
| Annuity operations                 | 502,614                     | 334,467             | 168,147                | 50.3%                |
| Corporate operations               | 59,361                      | (143,499)           | 202,860                | -141.4%              |
| Total                              | <u>\$ 451,267</u>           | <u>\$ 91,817</u>    | <u>\$ 359,450</u>      | 391.5%               |

### ***Life Insurance Operations***

The \$149,142 increase in revenues from Life Insurance Operations for the three months ended June 30, 2014 is primarily due to the following:

- \$78,392 increase in net realized investment gains
- \$56,519 increase in net investment income
- \$10,561 increase in premiums

The \$11,557 increased loss from Life Insurance Operations for the three months ended June 30, 2014 is primarily due to the following:

- \$148,185 increase in death benefits
- \$137,658 decrease in policy acquisition costs deferred net of amortization
- \$10,561 increase in premiums
- \$27,448 decrease in surrenders
- \$37,196 decrease in other underwriting, insurance and acquisition expenses
- \$56,519 increase in net investment income
- \$57,695 decrease in commissions
- \$78,392 increase in net realized investment gains

### ***Annuity Operations***

The \$686,177 increase in revenues from Annuity Operations for the three months ended June 30, 2014 is due to the following:

- \$426,351 increase in net investment income
- \$259,827 increase in net realized investment gains

The \$168,147 increased profitability from Annuity Operations for the three months ended June 30, 2014 is due to the following:

- \$426,350 increase in net investment income
- \$259,827 increase in net realized investment gains
- \$280,150 increase in other underwriting, insurance and acquisition expenses
- \$187,254 increase in interest credited to policyholders
- \$53,431 increase in commissions

### ***Corporate Operations***

The \$12,721 increase in revenues from Corporate Operations for the three months ended June 30, 2014 is primarily due to \$14,366 of increased net investment income.

The \$202,860 increased Corporate Operations profitability for the three months ended June 30, 2014 is primarily due to \$14,366 of increased net investment income and \$188,000 of decreased operating expenses. The decreased Corporate segment operating expenses relate to decreased expenses incurred by that segment. The focus of our marketing and executive team is on expanding FBLIC into additional states utilizing final expense and annuity products. There is also significant marketing and executive focus on increasing TLIC production of life insurance and annuity products in TLIC's current eight licensed states.

## Results of Operations— Six Months Ended June 30, 2014 and 2013

### Revenues

Our primary sources of revenue are life insurance premium income and investment income. Premium payments are classified as first-year, renewal and single. In addition, realized gains and losses on investment holdings can significantly impact revenues from period to period.

Our revenues for the six months ended June 30, 2014 and 2013 are summarized as follows:

|                               | (Unaudited)               |                     |                     |            |
|-------------------------------|---------------------------|---------------------|---------------------|------------|
|                               | Six Months Ended June 30, |                     | Increase            | Percentage |
|                               | 2014                      | 2013                | 2014 less 2013      | Change     |
| Premiums                      | \$ 3,942,038              | \$ 3,849,044        | \$ 92,994           | 2.4%       |
| Net investment income         | 4,232,411                 | 3,415,990           | 816,421             | 23.9%      |
| Net realized investment gains | 761,716                   | 276,201             | 485,515             | 175.8%     |
| Other income                  | 20,075                    | 7,758               | 12,317              | 158.8%     |
| Total revenues                | <u>\$ 8,956,240</u>       | <u>\$ 7,548,993</u> | <u>\$ 1,407,247</u> | 18.6%      |

The increase in total revenues of \$1,407,247 for the six months ended June 30, 2014 is discussed below.

### Premiums

Our premiums for the six months ended June 30, 2014 and 2013 are summarized as follows:

|                                | (Unaudited)               |                     |                           |            |
|--------------------------------|---------------------------|---------------------|---------------------------|------------|
|                                | Six Months Ended June 30, |                     | Increase                  | Percentage |
|                                | 2014                      | 2013                | (Decrease) 2014 less 2013 | Change     |
| Whole life and term first year | \$ 31,917                 | \$ 58,002           | \$ (26,085)               | -45.0%     |
| Whole life and term renewal    | 1,338,662                 | 1,388,694           | (50,032)                  | -3.6%      |
| Final expense first year       | 388,272                   | 492,458             | (104,186)                 | -21.2%     |
| Final expense renewal          | 2,183,187                 | 1,909,890           | 273,297                   | 14.3%      |
| Total premiums                 | <u>\$ 3,942,038</u>       | <u>\$ 3,849,044</u> | <u>\$ 92,994</u>          | 2.4%       |

The \$92,944 increase in premiums for the six months ended June 30, 2014 is primarily due to a \$273,297 increase in final expense renewal premiums that exceeded a \$180,303 decrease in whole life and term first year and renewal premiums and final expense first year premiums.

The increase in final expense renewal premiums reflects the persistency of prior years' final expense production. Our marketing efforts are focused on final expense and annuity production and we have not been focused on whole life and term production the past few years. The decrease in final expense first year premiums is primarily due to the impact of competition and the interrelationships of our premium rates, commission rates and underwriting policies compared to those of other life insurance companies also focusing on final expense production.

## Net Investment Income

The major components of our net investment income for the six months ended June 30, 2014 and 2013 are summarized as follows:

|                                  | (Unaudited)<br>Six Months Ended June<br>30, |                     | Increase          | Percentage<br>Change |
|----------------------------------|---|---------------------|-------------------|----------------------|
|                                  | 2014  | 2013                | 2014 less 2013    | 2014 to 2013         |
| Fixed maturity securities        | \$ 2,248,063                                | \$ 2,192,919        | \$ 55,144         | 2.5%                 |
| Equity securities                | 21,404                                      | 14,686              | 6,718             | 45.7%                |
| Other long-term investments      | 833,790                                     | 815,478             | 18,312            | 2.2%                 |
| Mortgage loans                   | 1,035,705                                   | 476,167             | 559,538           | 117.5%               |
| Policy loans                     | 50,378                                      | 49,065              | 1,313             | 2.7%                 |
| Real estate                      | 377,994                                     | 181,420             | 196,574           | 108.4%               |
| Short-term and other investments | 72,078                                      | 27,964              | 44,114            | 157.8%               |
| Gross investment income          | 4,639,412                                   | 3,757,699           | 881,713           | 23.5%                |
| Investment expenses              | (407,001)                                   | (341,709)           | 65,292            | -19.1%               |
| Net investment income            | <u>\$ 4,232,411</u>                         | <u>\$ 3,415,990</u> | <u>\$ 816,421</u> | 23.9%                |

The \$881,713 increase in gross investment income for the six months ended June 30, 2014 is due to the 2014 investment of excess cash primarily in mortgage loans, real estate and fixed maturity securities. In the twelve months since June 30, 2013, our investments in mortgage loans have increased approximately \$15.1 million. In addition, since December 1, 2013, we have purchased four retail business buildings located in Indiana, Missouri, Oklahoma and Texas for approximately \$6.7 million. Investments in fixed maturity securities have also increased \$10.4 million since June 30, 2013. The interest and rental income on these investments in mortgage loans, real estate and fixed maturity securities accounted for \$811,256 of the \$881,713 increase in gross investment income.

The \$65,292 increase in investment expenses for the six months ended June 30, 2014 is primarily related to fees and expenses associated with our increased investments in mortgage loans and real estate.

## Net Realized Investment Gains

There was a \$485,515 increase in net realized investment gains for the six months ended June 30, 2014.

The net realized investment gains from the sales and maturities of fixed maturity securities available-for-sale of \$545,031 for the six months ended June 30, 2014 resulted from proceeds of \$8,580,058 for these securities that had carrying values of \$8,035,027 at the 2014 disposal dates.

The net realized investment gains from the sales and maturities of fixed maturity securities available-for-sale of \$52,932 for the six months ended June 30, 2013 resulted from proceeds of \$3,043,743 for these securities that had carrying values of \$2,990,811 as of the 2013 disposal dates.

The net realized investment gains from mortgage loans on real estate of \$195,285 for the six months ended June 30, 2014, resulted from the early payoff of mortgage loans that we had acquired at a discount price.

The net realized investment gains from mortgage loans on real estate of \$223,269 for the six months ended June 30, 2013, resulted from the early payoff of three mortgage loans that the Company had acquired at a discount price.

The net realized investment gains from the sales of equity securities available-for-sale of \$21,400 for the six months ended June 30, 2014 resulted from proceeds of \$101,080 for these securities that had carrying values of \$79,680 at the 2014 disposal dates.



We have recorded no other-than-temporary impairments in 2014 and 2013.

### Total Benefits, Claims and Expenses

Our benefits, claims and expenses are primarily generated from benefit payments, surrenders, interest credited to policyholders, change in reserves, commissions and other undetwriting, insurance and acquisition expenses. Benefit payments can significantly impact expenses from period to period.

Our benefits, claims and expenses for the six months ended June 30, 2014 and 2013 are summarized as follows:

|  | (Unaudited)               |                     |                     |                   |
|--|---------------------------|---------------------|---------------------|-------------------|
|  | Six Months Ended June 30, |                     | Increase (Decrease) | Percentage Change |
|  | 2014                      | 2013                | 2014 less 2013      | 2014 to 2013      |
| <b>Benefits and claims</b>                                   |                           |                     |                     |                   |
| Increase in future policy benefits                           | \$ 1,214,804              | \$ 1,165,747        | \$ 49,057           | 4.2%              |
| Death benefits   | 1,472,462                 | 1,095,694           | 376,768             | 34.4%             |
| Surrenders   | 243,938                   | 308,976             | (65,038)            | -21.0%            |
| Interest credited to policyholders                           | 2,101,727                 | 1,795,303           | 306,424             | 17.1%             |
| Dividend, endowment and supplementary life contract benefits | 137,600                   | 121,938             | 15,662              | 12.8%             |
| Total benefits and claims                                    | <u>5,170,531</u>          | <u>4,487,658</u>    | <u>682,873</u>      | 15.2%             |
| <b>Expenses</b>  |                           |                     |                     |                   |
| Policy acquisition costs deferred                            | (1,086,471)               | (1,152,594)         | 66,123              | -5.7%             |
| Amortization of deferred policy acquisition costs            | 589,554                   | 383,709             | 205,845             | 53.6%             |
| Amortization of value of insurance business acquired         | 202,598                   | 215,800             | (13,202)            | -6.1%             |
| Commissions  | 1,039,981                 | 1,052,437           | (12,456)            | -1.2%             |
| Other undetwriting, insurance and acquisition expenses       | 2,323,282                 | 2,120,038           | 203,244             | 9.6%              |
| Total expenses   | <u>3,068,944</u>          | <u>2,619,390</u>    | <u>449,554</u>      | 17.2%             |
| Total benefits, claims and expenses                          | <u>\$ 8,239,475</u>       | <u>\$ 7,107,048</u> | <u>\$ 1,132,427</u> | 15.9%             |

The increase of \$1,132,427 in total benefits, claims and expenses for the six months ended June 30, 2014 is discussed below.

### Benefits and Claims

The \$682,873 increase in benefits and claims for the six months ended June 30, 2014 is primarily due to the following:

- \$376,768 increase in death benefits is primarily due to increased number of claims and increased average amount per claim. This is as expected due to an increase in final expense life insurance in force.
- \$306,424 increase in interest credited to policyholders is primarily due to an approximate \$23.3 million increase in the amount of policyholders' account balances in the consolidated statement of financial position (increased deposits and interest credited in excess of withdrawals) since June 30, 2013.





## Deferral and Amortization of Deferred Acquisition Costs

Certain costs related to the successful acquisition of traditional life insurance policies are capitalized and amortized over the premium-paying period of the policies. Certain costs related to the successful acquisition of insurance and annuity policies that subject us to mortality or morbidity risk over a period that extends beyond the period or periods in which premiums are collected and that have terms that are fixed and guaranteed (i.e., limited-payment long-duration annuity contracts) are capitalized and amortized in relation to the present value of actual and expected gross profits on the policies. These acquisition costs, which are referred to as deferred policy acquisition costs, include commissions and other successful costs of acquiring life insurance, which vary with, and are primarily related to, the successful production of new and renewal insurance and annuity contracts.

For the six months ended June 30, 2014 and 2013, capitalized costs were \$1,086,471 and \$1,152,594, respectively. Amortization of deferred policy acquisition costs for the six months ended June 30, 2014 and 2013 were \$589,554 and \$383,709, respectively.

The \$66,123 decrease in the acquisition costs deferred primarily relates to our September 30, 2013 decisions to decrease the deferral of non-commission acquisition costs for products sold in 2013 and beyond and to increase the average final expense in force policy amount from \$5,000 to \$9,700 in the deferral calculation of non-commission acquisition costs for products sold in 2013 and beyond. The \$205,845 increase in the 2014 amortization of deferred acquisition costs is due to increased lapsation of whole life and term renewal products originally sold by TLIC. This does not include the in force business acquired as a result of the purchases of FLAC and FBLIC in 2008 and 2011, respectively.

## Amortization of Value of Insurance Business Acquired

The cost of acquiring insurance business is amortized over the emerging profit of the related policies using the same assumptions that were used in computing liabilities for future policy benefits. Amortization of the value of insurance business acquired was \$202,598 and \$215,800 for the six months ended June 30, 2014 and 2013, respectively. The \$13,202 decrease in the 2014 amortization of value of insurance business acquired is due to the persistency of the FLAC and FBLIC business acquired in 2008 and 2011, respectively, due to our continuing conservation efforts.

## Commissions

Our commissions for the six months ended June 30, 2014 and 2013 are summarized as follows:

|                                | (Unaudited)               |                     | Increase           | Percentage   |
|--------------------------------|---------------------------|---------------------|--------------------|--------------|
|                                | Six Months Ended June 30, |                     | (Decrease)         | Change       |
|                                | 2014                      | 2013                | 2014 less 2013     | 2014 to 2013 |
| Annuity                        | \$ 332,381                | \$ 205,144          | \$ 127,237         | 62.0%        |
| Whole life and term first year | 27,462                    | 41,196              | (13,734)           | -33.3%       |
| Whole life and term renewal    | 53,559                    | 50,974              | 2,585              | 5.1%         |
| Final expense first year       | 434,561                   | 575,224             | (140,663)          | -24.5%       |
| Final expense renewal          | 192,018                   | 179,899             | 12,119             | 6.7%         |
| Total commissions              | <u>\$ 1,039,981</u>       | <u>\$ 1,052,437</u> | <u>\$ (12,456)</u> | -1.2%        |

The \$12,456 decrease in commissions for the six months ended June 30, 2014 is primarily due to:

- \$140,663 decrease in final expense first year commissions that correspond to the \$104,186 decrease in final expense first year premiums.
- \$127,237 increase in annuity first year, single and renewal commissions that corresponds to \$4,348,319 of increased annuity considerations deposited.

### ***Other Underwriting, Insurance and Acquisition Expenses***

The \$203,244 increase in other underwriting, insurance and acquisition expenses for the six months ended June 30, 2014 is primarily due to increased 2014 costs associated with the regularly scheduled triennial insurance examinations routinely conducted by the OID for TLIC and Missouri Department of Insurance ("MDI") for FBLIC. In addition, we have incurred increased legal costs in 2014. Salaries have also risen due to an asset growth bonus payment related to an employment contract since the Company has recently exceeded \$200.0 million in U. S. GAAP assets.

### ***Federal Income Taxes***

FTFC files a consolidated federal income tax return with FTCC but does not file a consolidated tax return with TLIC or FBLIC. TLIC and FBLIC are taxed as life insurance companies under the provisions of the Internal Revenue Code. Life insurance companies must file separate tax returns until they have been a member of the consolidated filing group for five years. However, in 2013, we filed a combined life insurance company 2012 federal tax return for TLIC and FBLIC and intend to also file a combined life insurance company 2013 federal tax return for TLIC and FBLIC in 2014.

Certain items included in income reported for financial statement purposes are not included in taxable income for the current period, resulting in deferred income taxes.

For the six months ended June 30, 2014 and 2013, current income tax expense was \$78,450 and \$103,248, respectively. Deferred federal income tax benefit was \$39,019 and \$114,845 for the six months ended June 30, 2014 and 2013, respectively.

### ***Net Income Per Common Share Basic and Diluted***

Net income was \$677,334 (\$0.09 per common share basic and diluted) and \$453,542 (\$0.06 per common share basic and diluted) for the six months ended June 30, 2014 and 2013, respectively. Net income per common share basic and diluted is calculated using the weighted average number of common shares outstanding and subscribed during the year. The weighted average outstanding and subscribed common shares basic and diluted for the six months ended June 30, 2014 and 2013 were 7,833,605 and 7,852,045, respectively.

### ***Business Segments***

The Company has a life insurance segment, consisting of the life insurance operations of TLIC and FBLIC, an annuity segment, consisting of the annuity operations of TLIC and FBLIC and a corporate segment. Results for the parent company and the operations of FTCC and SIS, after elimination of intercompany amounts, are allocated to the corporate segment. Prior to January 1, 2014, the Company's quarterly and annual segment data was reported based upon a life insurance segment, consisting of the operations of TLIC and FBLIC, a premium financing segment, consisting of the operations of FTCC and SIS and a corporate segment. Prior to January 1, 2014, the results for the parent company, after elimination of intercompany amounts, were allocated to the corporate segment.

The segment data as of December 31, 2013 and for the six months ended June 30, 2013 have been restated from what was previously reported and now follows the new segmentation methodology established on January 1, 2014.

The revenues and income (loss) before federal income taxes from our business segments for the six months ended June 30, 2014 and 2013 are summarized as follows:

|                                    | (Unaudited)               |                     |                        |                      |
|------------------------------------|---------------------------|---------------------|------------------------|----------------------|
|                                    | Six Months Ended June 30, |                     | Increase<br>(Decrease) | Percentage<br>Change |
|                                    | 2014                      | 2013                | 2014 to 2013           | 2014 to 2013         |
| Revenues:                          |                           |                     |                        |                      |
| Life insurance operations          | \$ 5,015,313              | \$ 4,717,945        | \$ 297,368             | 6.3%                 |
| Annuity operations                 | 3,752,434                 | 2,726,142           | 1,026,292              | 37.6%                |
| Corporate operations               | 188,493                   | 104,906             | 83,587                 | 79.7%                |
| Total                              | <u>\$ 8,956,240</u>       | <u>\$ 7,548,993</u> | <u>\$ 1,407,247</u>    | 18.6%                |
| Income (loss) before income taxes: |                           |                     |                        |                      |
| Life insurance operations          | \$ (121,275)              | \$ 224,476          | \$ (345,751)           | -154.0%              |
| Annuity operations                 | 726,655                   | 573,694             | 152,961                | 26.7%                |
| Corporate operations               | 111,385                   | (356,225)           | 467,610                | -131.3%              |
| Total                              | <u>\$ 716,765</u>         | <u>\$ 441,945</u>   | <u>\$ 274,820</u>      | 62.2%                |

### ***Life Insurance Operations***

The \$297,368 increase in revenues from Life Insurance Operations for the six months ended June 30, 2014 is primarily due to the following:

- \$108,844 increase in net realized investment gains
- \$92,994 increase in premiums
- \$80,979 increase in net investment income

The \$345,751 increased loss from Life Insurance Operations for the six months ended June 30, 2014 is primarily due to the following:

- \$376,768 increase in death benefits
- \$322,920 decrease in policy acquisition costs deferred net of amortization
- \$97,296 increase in other underwriting, insurance and acquisition expenses
- \$80,979 increase in net investment income
- \$92,994 increase in premiums
- \$108,844 increase in net realized investment gains
- \$139,693 decrease in commissions

### ***Annuity Operations***

The \$1,026,292 increase in revenues from Annuity Operations for the six months ended June 30, 2014 is due to the following:

- \$649,621 increase in net investment income
- \$376,671 increase in net realized investment gains

The \$152,961 increased profitability from Annuity Operations for the six months ended June 30, 2014 is due to the following:

- \$649,621 increase in net investment income
- \$376,671 increase in net realized investment gains
- \$50,952 increase in policy acquisition costs deferred net of amortization
- \$490,622 increase in other underwriting, insurance and acquisition expenses
- \$306,424 increase in interest credited to policyholders
- \$127,237 increase in commissions

### ***Corporate Operations***

The \$83,587 increase in revenues from Corporate Operations for the six months ended June 30, 2014 is primarily due to \$85,821 of increased net investment income.

The \$467,610 increased Corporate Operations profitability for the six months ended June 30, 2014 is primarily due to \$85,821 of increased net investment income and \$382,000 of decreased operating expenses. The decreased Corporate segment operating expenses relate to decreased expenses incurred by that segment. The focus of our marketing and executive team is on expanding FBLIC into additional states utilizing final expense and annuity products. There is also significant marketing and executive focus on increasing TLIC production of life insurance and annuity products in TLIC's current eight licensed states.

## Consolidated Financial Condition

Our invested assets as of June 30, 2014 and December 31, 2013 are summarized as follows:

|   | (Unaudited)<br>June 30, 2014 | December 31,<br>2013 | Increase<br>2014 to 2013 | Percentage<br>Change<br>2014 to 2013 |
|---|------------------------------|----------------------|--------------------------|--------------------------------------|
| <b>Assets</b>   |                              |                      |                          |                                      |
| Investments   |                              |                      |                          |                                      |
| Available-for-sale fixed maturity securities at fair value (amortized cost: \$105,305,377 and \$98,218,823 as of June 30, 2014 and December 31, 2013, respectively) | \$110,590,195                | \$100,429,711        | \$ 10,160,484            | 10.1%                                |
| Available-for-sale equity securities at fair value (cost: \$593,558 and \$567,697 as of June 30, 2014 and December 31, 2013, respectively)                          | 746,081                      | 717,433              | 28,648                   | 4.0%                                 |
| Mortgage loans on real estate   | 28,662,291                   | 19,124,869           | 9,537,422                | 49.9%                                |
| Investment real estate  | 9,237,834                    | 6,531,971            | 2,705,863                | 41.4%                                |
| Policy loans  | 1,517,997                    | 1,488,646            | 29,351                   | 2.0%                                 |
| Other long-term investments   | <u>22,487,895</u>            | <u>21,763,648</u>    | <u>724,247</u>           | 3.3%                                 |
| Total investments   | <u>\$173,242,293</u>         | <u>\$150,056,278</u> | <u>\$ 23,186,015</u>     | 15.5%                                |

The \$10,160,484 increase in available-for-sale fixed maturity securities for the six months ended June 30, 2014 is primarily due to purchases of \$15,551,685, net realized investment gains of \$545,031, increase in unrealized appreciation of \$3,073,930 in excess of sales and maturities of \$8,580,058 and premium amortization of \$430,104. This portfolio is reported at fair value with unrealized gains and losses, net of applicable income taxes, reflected as a separate component in shareholders' equity within "Accumulated Other Comprehensive Income." The available-for-sale fixed maturity securities portfolio is invested primarily in a variety of companies, U. S. government and government agencies, states and political subdivisions and foreign securities.

As of June 30, 2014, we held 48 available-for-sale fixed maturity securities with an unrealized loss of \$347,929, fair value of \$13,026,385 and amortized cost of \$13,374,314.

The \$28,648 increase in available-for-sale equity securities for the six months ended June 30, 2014 is due to purchases of \$105,542, net realized investment gains of \$21,400 and a \$2,787 increase in unrealized appreciation of available-for-sale equity securities in excess of sales of \$101,080. This portfolio is also reported at fair value with unrealized gains and losses, net of applicable income taxes, reflected as a separate component in shareholders' equity within "Accumulated Other Comprehensive Income." The available-for-sale equity securities portfolio is invested in several companies.

As of June 30, 2014, we held three available-for-sale equity securities with an unrealized loss of \$19,256, fair value of \$199,190 and cost of \$218,446.

The \$9,537,422 increase in mortgage loans for the six months ended June 30, 2014 is primarily due to the purchase or origination of \$12,342,197 of mortgage loans, \$49,500 capitalization of loan origination fees, \$195,285 of realized gains on the early pay off of loans purchased at a discount, discount accretion of \$55,571 less principal payments of \$3,010,790, increase in the allowance for bad debts of \$46,404 and \$47,937 of amortization of loan origination fees.

The \$724,247 increase in other long-term investments (comprised of lottery receivables) for the six months ended June 30, 2014 is primarily due to the purchases of \$1,837,619, accretion of discount of \$833,790 less principal payments of \$1,947,162.

The \$2,705,863 increase in investment real estate for the six months ended June 30, 2014 is primarily due to the February 2014 purchases of one acre of land in Houston, Texas that included a 9,195 square foot building constructed on approximately 25% of this land at a cost of \$977,013 (including closing costs of \$31,063) and three-fourths of an acre of land in Harrisonville, Missouri that included a 6,895 square foot building constructed on approximately 20% of this land at

a cost of\$1,752,397 (including closing costs of\$44,864).

Our assets other than invested assets as of June 30, 2014 and December 31, 2013 are summarized as follows:

|                                      | (Unaudited)<br>June 30,<br>2014 | December<br>31, 2013 | Increase<br>(Decrease)<br>2014 to 2013 | Percentage<br>Change<br>2014 to 2013 |
|--------------------------------------|---------------------------------|----------------------|--|--------------------------------------|
| Cash and cash equivalents            | \$ 8,881,179                    | \$ 10,608,438        | \$ (1,727,259)                         | -16.3%                               |
| Short-term investments               | 1,392,649                       | -                    | 1,392,649                              | 100.0%                               |
| Accrued investment income            | 1,680,209                       | 1,558,153            | 122,056                                | 7.8%                                 |
| Recoverable from reinsurers          | 1,181,055                       | 1,200,807            | (19,752)                               | -1.6%                                |
| Agents' balances and due premiums    | 271,568                         | 285,033              | (13,465)                               | -4.7%                                |
| Deferred policy acquisition costs    | 8,644,979                       | 8,172,627            | 472,352                                | 5.8%                                 |
| Value of insurance business acquired | 6,884,192                       | 7,086,790            | (202,598)                              | -2.9%                                |
| Property and equipment, net          | 104,460                         | 130,287              | (25,827)                               | -19.8%                               |
| Other assets                         | 4,847,600                       | 4,074,746            | 772,854                                | 19.0%                                |
| Assets other than investment assets  | <u>\$ 33,887,891</u>            | <u>\$ 33,116,881</u> | <u>\$ 771,010</u>                      | 2.3%                                 |

Other assets consist primarily of recoverable federal and state income taxes, guaranty funds, notes receivable, customer account balances receivable, prepaid expenses, other receivables and loans from premium financing. The \$772,854 increase in other assets is primarily due to \$203,000 of increased customer account balances receivable, \$186,000 of increased other receivables and \$437,000 of increased recoverable federal and state income taxes.

Our liabilities as of June 30, 2014 and December 31, 2013 are summarized as follows:

|                                 | (Unaudited)<br>June 30, 2014 | December 31,<br>2013 | Increase<br>(Decrease)<br>2014 to 2013 | Percentage<br>Change<br>2014 to 2013 |
|---------------------------------|------------------------------|----------------------|--|--------------------------------------|
| Policy liabilities              |                              |                      |  |                                      |
| Policyholders' account balances | \$128,271,756                | \$113,750,681        | \$ 14,521,075                          | 12.8%                                |
| Future policy benefits          | 34,586,650                   | 33,354,454           | 1,232,196                              | 3.7%                                 |
| Policy claims                   | 630,030                      | 611,417              | 18,613                                 | 3.0%                                 |
| Other policy liabilities        | 93,749                       | 89,504               | 4,245                                  | 4.7%                                 |
| Total policy liabilities        | <u>163,582,185</u>           | <u>147,806,056</u>   | <u>15,776,129</u>                      | 10.7%                                |
| Notes payable                   | 4,076,473                    | -                    | 4,076,473                              | 100.0%                               |
| Deferred federal income taxes   | 3,115,239                    | 2,543,825            | 571,414                                | 22.5%                                |
| Other liabilities               | 2,676,217                    | 2,182,264            | 493,953                                | 22.6%                                |
| Total liabilities               | <u>\$173,450,114</u>         | <u>\$152,532,145</u> | <u>\$ 20,917,969</u>                   | 13.7%                                |

The \$15,776,129 increase in policy liabilities is primarily due to deposits on annuity and deposit-type contracts exceeding withdrawals by \$12,419,347, interest credited to policyholders' account balances of \$2,101,727 and increased future policy benefit reserves of \$1,232,196 due to the actuarial exposure of the life insurance policies being in force for six additional months.

On March 26, 2014, we issued two notes payable totaling \$4,076,473. The first promissory note totaling \$3,009,265 is collateralized by three properties, located in Indiana, Oklahoma and Texas, purchased for a total of \$4,940,647 in December 2013 and February 2014 including assignment of the tenant leases.

In December 2013, TLIC purchased one acre of land in Greensburg, Indiana that included a 3,975 square foot building constructed on approximately 8% of this land at a cost of \$2,444,203 (including closing costs of \$50,516). The building is leased through October 31, 2027 plus four future five year extensions effective on November 1, 2027, November 1, 2032, November 1, 2037 and November 1, 2042. The terms of the lease have the lessee responsible for paying real estate taxes, building insurance and building and ground maintenance. The monthly lease payments are as follows: \$14,661 in 2014; \$14,881 in 2015; \$15,104 in 2016; \$15,531 in 2017; \$15,561 in 2018 and \$15,794 in 2019.





In December 2013, TLIC also purchased one acre of land in Norman, Oklahoma that included a 9,100 square foot building constructed on approximately 18% of this land at a cost of \$1,519,431 (including closing costs of \$37,931). The building is leased through August 31, 2028 plus three future five year extensions on September 1, 2028, September 1, 2033 and September 1, 2038. The terms of the lease have the lessee responsible for paying real estate taxes, building insurance and building and ground maintenance. The monthly lease payments are \$8,004 through August 31, 2028.

In February 2014, TLIC purchased one acre of land in Houston, Texas that included a 9,195 square foot building constructed on approximately 25% of this land at a cost of \$977,013 (including closing costs of \$31,063). The building is leased through December 31, 2023 plus four future five year extension effective on January 1, 2024, January 1, 2029, January 1, 2034 and January 31, 2039. The terms of the lease have the lessee responsible for paying real estate taxes and building insurance. TLIC is responsible for building and ground maintenance. The monthly lease payments are \$5,833 through December 31, 2018 and \$6,417 in 2019.

The second promissory note totaling \$1,067,208 is collateralized (including assignment of the tenant leases) by the February 2014 TLIC purchase of three-fourths of an acre of land in Harrisonville, Missouri that included a 6,895 square foot building constructed on approximately 20% of this land at a cost of \$1,752,397 (including closing costs of \$44,864). The building is leased through October 31, 2028 plus three future five year extensions on November 1, 2028, November 1, 2033 and November 1, 2038. The terms of the lease have the lessee responsible for paying real estate taxes, building insurance and building and ground maintenance. The monthly lease payments are \$9,463 through October 31, 2028.

The \$571,414 increase in deferred federal income taxes during the six months ended June 30, 2014 was due to \$610,430 of increased deferred federal income taxes on the unrealized appreciation of available-for-sale fixed maturity and equity securities. This increase was offset by \$39,019 of operating deferred tax benefits.

Other liabilities consist primarily of accrued expenses, account payables, deposits on pending policy applications and unearned investment income. The \$493,953 increase in other liabilities is primarily due to a \$547,000 increase in deposits on pending applications and a \$45,000 increase in accrued expenses that exceeded capitalized and unamortized loan origination fees of \$98,000.

## **Liquidity and Capital Resources**

Our operations have been financed primarily through the private placement of equity securities and intrastate public stock offerings. Through June 30, 2014, we have received \$27,119,480 from the sale of four shares.

The Company raised \$1,450,000 from two private placements during 2004 and \$25,669,480 from two public stock offerings and one private placement from June 22, 2005 through February 23, 2007; June 29, 2010 through April 30, 2012; and August 15, 2012 through March 8, 2013. The Company issued 7,347,488 shares of its common stock and incurred \$3,624,518 of offering costs during these private placements and public stock offerings.

Our operations have been profitable and have generated \$6,638,960 of net income from operations since we were incorporated in 2004. The Company also issued 702,705 shares of its common stock in connection with two stock dividends paid to shareholders in 2011 and 2012 that resulted in accumulated earnings being charged \$5,270,288 with an offsetting credit of \$5,270,288 to common stock and additional paid-in capital. The impact of these two stock dividend charges of \$5,270,288 to accumulated earnings decreased the balance of accumulated earnings as of June 30, 2014 to \$1,368,672, as shown in the accumulated earnings caption in the June 30, 2014 consolidated statement of financial position.

The Company has also purchased 218,259 shares of treasury stock at a cost of \$773,731 from former members of the Board of Directors, a former agent and a charitable organization where a former member of the Board of Directors had donated shares of the Company's common stock.

As of June 30, 2014, we had cash and cash equivalents totaling \$8,881,179. As of June 30, 2014, cash and cash equivalents of \$5,746,834 and \$2,488,473, respectively, of the total \$8,881,179 were held by TLIC and FBLIC and may not be available for use by FTFC due to the required pre-approval by the OID and MDI of any dividend or intercompany transaction to

transfer funds to FTFC. The maximum dividend, which may be paid in any twelve-month period without notification or approval, is limited to the greater of 10% of statutory surplus as of December 31 of the preceding year or the net gain from operations of the preceding calendar year.

Cash dividends may only be paid out of surplus derived from realized net profits. Based on these limitations, there is capacity for TLIC to pay a dividend up to \$1,283,361 in 2014 without prior approval. In addition, based on those limitations, there is the capacity for FBLIC to pay a dividend up to \$976,941 in 2014 without prior approval. FBLIC paid a dividend of \$850,000 to TLIC in December 2013. This dividend was eliminated in consolidation.

The Company maintains cash and cash equivalents at multiple institutions. The Federal Deposit Insurance Corporation insures interest and non-interest bearing accounts up to \$250,000. Uninsured balances aggregate \$5,080,015 as of June 30, 2014. Uninsured balances aggregated \$2,576,504 as of December 31, 2013. The primary reason for this \$2,503,511 increase in uninsured balances is due to a late June 2014 influx of annuity deposits that have not yet been invested. Other funds are invested in mutual funds that invest in U.S. government securities. We monitor the solvency of all financial institutions in which we have funds to minimize the exposure for loss. The Company has not experienced any losses in such accounts.

Our cash flows for the six months ended June 30, 2014 and 2013 are summarized as follows:

|  | (Unaudited)<br>Six Months Ended June 30, |                      | Increase<br>(Decrease)<br>2014 to 2013 | Percentage<br>Change<br>2014 to 2013 |
|--|--|----------------------|--|--------------------------------------|
|  | 2014                                     | 2013                 |  |                                      |
| Net cash provided by operating activities        | \$ 817,731                               | \$ 816,163           | \$ 1,568                               | 0.2%                                 |
| Net cash used in investing activities            | (18,960,810)                             | (8,688,210)          | (10,272,600)                           | 118.2%                               |
| Net cash provided by financing activities        | 16,415,820                               | 8,018,752            | 8,397,068                              | 104.7%                               |
| Increase (decrease) in cash and cash equivalents | (1,727,259)                              | 146,705              | (1,873,964)                            | -1277.4%                             |
| Cash and cash equivalents, beginning of period   | 10,608,438                               | 10,947,474           | (339,036)                              | -3.1%                                |
| Cash and cash equivalents, end of period         | <u>\$ 8,881,179</u>                      | <u>\$ 11,094,179</u> | <u>\$ (2,213,000)</u>                  | -19.9%                               |

The \$10,272,600 increase in cash used for investing activities during the six months ended June 30, 2014 was primarily related to increased purchases of fixed maturity securities, mortgage loans and investment real estate in 2014 compared to 2013 that exceeded increased sales and maturities of fixed maturity securities, increased payments of mortgage loans and decreased purchases of other long-term investments (i.e., lottery receivables).

The \$8,397,068 increase in cash provided by financing activities for the six months ended June 30, 2014 primarily resulted from \$4,322,227 of increased policyholder account deposits in excess of withdrawals and \$4,076,473 in proceeds from the issuance of two promissory notes payable in excess of \$34,864 of increased purchases of treasury shares.

Our shareholders' equity as of June 30, 2014 and December 31, 2013 is summarized as follows:

|   | (Unaudited)<br>June 30,<br>2014 | December<br>31, 2013 | Increase<br>(Decrease)<br>2014 to 2013 | Percentage<br>Change<br>2014 to 2013 |
|---|---------------------------------|----------------------|--|--------------------------------------|
| Common stock, par value \$.01 per share, 20,000,000 shares authorized, and 8,050,193 issued as of June 30, 2014 and December 31, 2013 and 7,831,934 and 7,851,984 outstanding as of June 30, 2014 and December 31, 2013, respectively | \$ 80,502                       | \$ 80,502            | \$ -                                   | 0.0%                                 |
| Additional paid-in capital  | 28,684,748                      | 28,684,748           | -                                      | 0.0%                                 |
| Treasury stock, at cost (218,259 and 198,209 shares as of June 30, 2014 and December 31, 2013, respectively)  | (773,731)                       | (693,731)            | (80,000)                               | 11.5%                                |
| Accumulated other comprehensive income  | 4,319,879                       | 1,878,157            | 2,441,722                              | 130.0%                               |
| Accumulated earnings  | 1,368,672                       | 691,338              | 677,334                                | 98.0%                                |
| Total shareholders' equity  | <u>\$ 33,680,070</u>            | <u>\$ 30,641,014</u> | <u>\$ 3,039,056</u>                    | 9.9%                                 |



The increase in shareholders' equity of \$3,039,056 for the six months ended June 30, 2014 is due to \$2,441,722 of other comprehensive income, \$677,334 of net income less \$80,000 for purchases of 20,050 shares of treasury stock from a former TLIC agent.

Equity per common share outstanding increased 10.3% to \$4.30 as of June 30, 2014 compared to \$3.90 per share as of December 31, 2013, based upon 7,831,934 common shares outstanding as of June 30, 2014 and 7,851,984 common shares outstanding as of December 31, 2013.

The liquidity requirements of our life insurance companies are met primarily by funds provided from operations. Premium deposits and revenues, investment income and investment maturities are the primary sources of funds, while investment purchases, policy benefits, and operating expenses are the primary uses of funds. There were no liquidity issues in 2014 or 2013. Our investments consist primarily of marketable debt securities that could be readily converted to cash for liquidity needs.

We are subject to various market risks. The quality of our investment portfolio and the current level of shareholders' equity continue to provide a sound financial base as we strive to expand our marketing to offer competitive products. Our investment portfolio had unrealized appreciation on available-for-sale securities of \$5,437,341 and \$2,360,624 as of June 30, 2014 and December 31, 2013, respectively, prior to the impact of income taxes and deferred acquisition cost adjustments. An increase of \$3,838,433 in unrealized gains arising for the six months ended June 30, 2014 has been offset by the 2014 net realized investment gains of \$761,716 originating from the sale and call activity for available-for-sale fixed maturity and equity securities and early payoffs of mortgage loans on real estate purchased at a discount resulting in net unrealized gains on investments of \$3,076,717.

A primary liquidity concern is the risk of an extraordinary level of early policyholder withdrawals. We include provisions within our insurance policies, such as surrender charges, that help limit and discourage early withdrawals. Individual life insurance policies are less susceptible to withdrawal than annuity reserves and deposit liabilities because policyholders may incur surrender charges and undergo a new underwriting process in order to obtain a new insurance policy. Cash flow projections and cash flow tests under various market interest rate scenarios are also performed annually to assist in evaluating liquidity needs and adequacy. We currently anticipate that available liquidity sources and future cash flows will be adequate to meet our needs for funds.

One of our significant risks relates to the fluctuations in interest rates. Regarding interest rates, the value of our available-for-sale fixed maturity securities investment portfolio will increase or decrease in an inverse relationship with fluctuations in interest rates, while net investment income earned on newly acquired available-for-sale fixed maturity securities increases or decreases in direct relationship with interest rate changes. From an income perspective, we are exposed to rising interest rates which could be a significant risk, as TLIC's and FBLIC's annuity business is impacted by changes in interest rates. Life insurance company policy liabilities bear fixed rates. From a liquidity perspective, our fixed rate policy liabilities are relatively insensitive to interest rate fluctuations.

We believe gradual increases in interest rates do not present a significant liquidity exposure for the life insurance policies. We maintain conservative durations in our fixed maturity portfolio. As of June 30, 2014, cash and cash equivalents, short-term investments, the fair value of fixed maturity available-for-sale securities with maturities of less than one year and the fair value of lottery receivables with maturities of less than one year equaled 11.6% of total policy liabilities. If interest rates rise significantly in a short time frame, there can be no assurance that the life insurance industry, including the Company, would not experience increased levels of surrenders and reduced sales, and thereby be materially adversely affected.

In addition to the measures described above, TLIC and FBLIC must comply with the NAIC promulgated Standard Valuation Law ("SVL") which specifies minimum reserve levels and prescribes methods for determining them, with the intent of enhancing solvency. Upon meeting certain tests, which TLIC and FBLIC met during 2013, the SVL also requires the Company to perform annual cash flow testing for TLIC and FBLIC. This testing is designed to ensure that statutory reserve levels will maintain adequate protection in a variety of potential interest rate scenarios. The Actuarial Standards Board of the American Academy of Actuaries also requires cash flow testing as a basis for the actuarial opinion on the adequacy of the reserves which is a required part of the annual statutory reporting process.

Our marketing plan could be modified to emphasize certain product types and reduce others. New business levels could be

varied in order to find the optimum level. We believe that our current liquidity, current bond portfolio maturity distribution and cash position give us substantial resources to administer our existing business and fund growth generated by direct sales.

The operations of TLIC and FBLIC may require additional capital contributions to meet statutory capital and surplus requirements mandated by state insurance departments. Life insurance contract liabilities are generally long term in nature and are generally paid from future cash flows or existing assets and reserves.

We will service other expenses and commitments by: (1) using available cash, (2) dividends from TLIC and FBLIC that are limited by law to the greater of prior year net operating income or 10% of prior year-end surplus unless specifically approved by the controlling insurance department, (3) public and private offerings of our common stock and (4) corporate borrowings, if necessary.

We are not aware of any commitments or unusual events that could materially affect our capital resources. We are not aware of any current recommendations by any regulatory authority which, if implemented, would have a material adverse effect on our liquidity, capital resources or operations. We believe that our existing cash and cash equivalents as of June 30, 2014 will be sufficient to fund our anticipated operating expenses.

### **Off-Balance Sheet Arrangements**

The Company does not have any off-balance sheet arrangements.

### **SPECIAL NOTE CONCERNING FORWARD-LOOKING STATEMENTS**

Certain statements contained herein are forward-looking statements. The forward-looking statements are made pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, and include estimates and assumptions related to economic, competitive and legislative developments. Forward-looking statements may be identified by words such as "expects," "intends," "anticipates," "plans," "believes," "estimates," "will" or words of similar meaning; and include, but are not limited to, statements regarding the outlook of our business and financial performance. These forward-looking statements are subject to change and uncertainty, which are, in many instances, beyond our control and have been made based upon our expectations and beliefs concerning future developments and their potential effect upon us. There can be no assurance that future developments will be in accordance with our expectations, or that the effect of future developments on us will be as anticipated. These forward-looking statements are not a guarantee of future performance and involve risks and uncertainties. There are certain important factors that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements. These factors include among others:

- general economic conditions and financial factors, including the performance and fluctuations of fixed income, equity, real estate, credit capital and other financial markets;
- differences between actual experience regarding mortality, morbidity, persistency, surrenders, investment returns, and our pricing assumptions establishing liabilities and reserves or for other purposes;
- the effect of increased claims activity from natural or man-made catastrophes, pandemic disease, or other events resulting in catastrophic loss of life;
- adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities, including and in connection with our divestiture or winding down of businesses such as FTCC;
- inherent uncertainties in the determination of investment allowances and impairments and in the determination of the valuation allowance on the deferred income tax asset;
- investment losses and defaults;
- competition in our product lines;
- attraction and retention of qualified employees and agents;
- ineffectiveness of risk management policies and procedures in identifying, monitoring and managing risks;
- the availability, affordability and adequacy of reinsurance protection;
- the effects of emerging claim and coverage issues;
- the cyclical nature of the insurance business;
- interest rate fluctuations;
- changes in our experiences related to deferred policy acquisition costs;
- the ability and willingness of counterparties to our reinsurance arrangements and derivative instruments to pay balances due to us;
- rating agencies' actions;
- domestic or international military actions;

- the effects of extensive government regulation of the insurance industry;
- changes in tax and securities law;
- changes in statutory or U.S. generally accepted accounting principles ("GAAP"), practices or policies;
- regulatory or legislative changes or developments;
- the effects of anticipated events on our disaster recovery and business continuity planning;
- failures or limitations of our computer, data security and administration systems;
- risks of employee error or misconduct;
- the introduction of alternative healthcare solutions;
- the assimilation of life insurance businesses we acquire and the sound management of these businesses; and
- the availability of capital to expand our business.



It is not our corporate policy to make specific projections relating to future earnings, and we do not endorse any projections regarding future performance made by others. In addition, we do not publicly update or revise forward-looking statements based on the outcome of various foreseeable or unforeseeable developments.

#### **Item 4. Controls and Procedures**

##### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer ("Certifying Officers"), has evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934 as amended ("Exchange Act") as of the end of the fiscal period covered by this Quarterly Report on Form 10-Q. Based upon such evaluation, the Certifying Officers have concluded that the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is made known to management, including our Certifying Officers, as appropriate, to allow timely decisions regarding disclosure and that such information is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

##### **Changes to Internal Control over Financial Reporting**

There were no changes in the Company's internal control over financial reporting during the three months ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings.

The Company and Chairman, President and Chief Executive Officer, Gregg E. Zahn, filed an action in the District Court of Tulsa County, Oklahoma in 2013, Case No. CJ-2013-03385, against former Company Board of Directors member, Wayne Pettigrew and Mr. Pettigrew's company, Group & Pension Planners, Inc. (the "Defendants"). The petition filed in the case alleges that Mr. Pettigrew, during and after the time he was a member of the Company's Board of Directors, made defamatory statements regarding the Company and Mr. Zahn. The defendants are alleged to have made defamatory statements to certain shareholders of the Company, to the press and to the OID and the Oklahoma Department of Securities. Mr. Pettigrew has denied the allegations.

The Board of Directors, represented by independent counsel, concluded that there was no action to be taken against Mr. Zahn and that the allegations by Mr. Pettigrew were without substance. The Company has been informed by the OID that it would take no action and was also informed that the Oklahoma Department of Securities, after its investigation of the allegations, concluded that no proceedings were needed with respect to the alleged matters. It is the Company's intention to vigorously prosecute this action against the Defendants for damages and for the correction of the defamatory statements. In the opinion of the Company's management, the ultimate resolution of any contingencies that may arise from this litigation is not considered material in relation to the financial position or results of operations of the Company.

Prior to its acquisition by TLIC, FBLIC developed, marketed, and sold life insurance products known as "Decreasing Tenn to 95" policies. On January 17, 2013, FBLIC's Board of Directors voted that, effective March 1, 2013, it was not approving, and therefore was not providing, a dividend for the Decreasing Tenn to 95 policies. On November 22, 2013, three individuals who owned Decreasing Tenn to 95 policies filed a Petition in the Circuit Court of Greene County, Missouri asserting claims against FBLIC relating to FBLIC's decision to not provide a dividend under the Decreasing Tenn to 95 policies.

The Petition asserts claims for breach of contract and anticipatory breach of contract and alleges that FBLIC breached, and will anticipatorily breach, the Decreasing Tenn to 95 policies of insurance by not providing a dividend sufficient to purchase a one year term life insurance policy which would keep the death benefit under the Decreasing Tenn to 95 policies the same as that provided during the first year of coverage under the policy. In addition to these claims, the Petition asserts claims for negligent misrepresentation, fraud, and violation of the Missouri Merchandising Practices Act. It alleges that during its sale of the Decreasing Tenn to 95 policies, FBLIC represented that the owners of these policies would always be entitled to dividends to purchase a one-year term life insurance policy and that the owners would have a level death benefit without an increase in premium.

The Petition also seeks to certify a class of individuals with similar claims but no class has been certified by the Court. FBLIC denies the allegations in the Petition and will continue to defend against them. It is the Company's intention to vigorously defend the request for class certification, as well as to defend vigorously against the individual allegations. The Company is unable to determine the potential magnitude of the claims in the event of a final certification and the plaintiffs prevailing on the substantive action.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None

### Item 3. Defaults Upon Senior Securities.

None

### Item 4. Mine Safety Disclosures

None



**Item 5. Other Information**

None

**Item 6. Exhibits**

|           |   |
|-----------|---|
| 31.1      | Rule 13a-14(a)/15d-14(a) Certification ofPrincipal Executive Officer  |
| 31.2      | Rule 13a-14(a)/15d-14(a) Certification ofPrincipal Financial Officer  |
| 32.1      | Section 1350 Certification ofPrincipal Executive Officer  |
| 32.2      | Section 1350 Certification ofPrincipal Financial Officer  |
| 101.INS** | XBRL Instance   |
| 101.SCH** | XBRL Taxonomy Extension Schema  |
| 101.CAL** | XBRL Taxonomy Extension Calculation   |
| 101.DEF** | XBRL Taxonomy Extension Definition  |
| 101.LAB** | XBRL Taxonomy Extension Labels  |
| 101.PRE** | XBRL Taxonomy Extension Presentation  |
| **XBRL    | Information is furnished and not filed as part of a registration statement or prospectus for purposes of 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections. |

**SIGNATURES**

In accordance with requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST TRINITY FINANCIAL CORPORATION  
an Oklahoma corporation

August 14, 2014

By: /s/ Gregg E. Zahn  
Gregg E. Zahn, President and Chief Executive Officer

August 14, 2014

By: /s/ Jeffrey J. Wood  
Jeffrey J. Wood, Chief Financial Officer