

SECURITY NATIONAL FINANCIAL CORP
Form 10-Q
May 16, 2016

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended March 31, 2016, or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _____ to _____

Commission file number: 000-09341

SECURITY NATIONAL FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

UTAH 87-0345941
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

5300 South 360 West, Suite 250, Salt Lake City, Utah 84123
(Address of principal executive offices) (Zip Code)

(801) 264-1060
(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 Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

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

<u>Class A Common Stock, \$2.00 par value</u>	<u>13,137,702</u>
Title of Class	Number of Shares Outstanding as of May 16, 2016

<u>Class C Common Stock, \$2.00 par value</u>	<u>1,716,020</u>
Title of Class	Number of Shares Outstanding as of May 16, 2016

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
FORM 10-Q

QUARTER ENDED MARCH 31, 2016

TABLE OF CONTENTS

	Page No.
PART I - FINANCIAL INFORMATION	
Item 1. Financial Statements	
Condensed Consolidated Balance Sheets as of March 31, 2016 and December 31, 2015 (unaudited)	3-4
Condensed Consolidated Statements of Earnings for the Three Months Ended March 31, 2016 and 2015 (unaudited)	5
Condensed Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2016 and 2015 (unaudited)	6
Condensed Consolidated Statements of Stockholders' Equity as of March 31, 2016 and March 31, 2015 (unaudited)	7
Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2016 and 2015 (unaudited)	8
Notes to Condensed Consolidated Financial Statements (unaudited)	9
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	38
Item 3. Quantitative and Qualitative Disclosures about Market Risk	42
Item 4. Controls and Procedures	42
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings	43
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	45
Item 3. Defaults Upon Senior Securities	45
Mine Safety Disclosures	45

Item 4.		
Item 5.	Other Information	45
Item 6.	Exhibits	46
	Signature Page	48

2

SECURITY NATIONAL FINANCIAL CORPORATION
AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

Part I - Financial Information

Item 1. Financial Statements.

	March 31 2016	December 31 2015
Assets		
Investments:		
Fixed maturity securities, held to maturity, at amortized cost	\$ 147,445,997	\$ 145,558,425
Equity securities, available for sale, at estimated fair value	8,941,232	8,431,090
Mortgage loans on real estate and construction loans, held for investment net of allowances for loan losses of \$2,078,948 and \$1,848,120 for 2016 and 2015	133,393,868	112,546,905
Real estate held for investment, net of accumulated depreciation of \$12,940,497 and \$12,210,346 for 2016 and 2015	116,700,727	114,852,432
Policy loans and other investments, net of allowances for doubtful accounts of \$1,032,736 and \$906,616 for 2016 and 2015	39,279,484	39,582,421
Short-term investments	17,809,307	16,915,808
Accrued investment income	2,559,069	2,553,819
Total investments	466,129,684	440,440,900
Cash and cash equivalents	46,703,959	40,053,242
Mortgage loans sold to investors	85,906,980	115,286,455
Receivables, net	16,728,173	16,026,100
Restricted assets	8,114,572	9,359,802
Cemetery perpetual care trust investments	2,938,732	2,848,759
Receivable from reinsurers	13,387,534	13,400,527
Cemetery land and improvements	10,748,630	10,780,996
Deferred policy and pre-need contract acquisition costs	61,116,736	59,004,909
Mortgage servicing rights, net	13,688,362	12,679,755
Property and equipment, net	12,020,600	11,441,660
Value of business acquired	8,410,685	8,743,773
Goodwill	2,765,570	2,765,570
Other	8,689,264	7,100,869
Total Assets	\$ 757,349,481	\$ 749,933,317

See accompanying notes to condensed consolidated financial statements.

SECURITY NATIONAL FINANCIAL CORPORATION
AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (Continued)
(Unaudited)

	March 31 2016	December 31 2015
Liabilities and Stockholders' Equity		
Liabilities		
Future life, annuity, and other benefits	\$ 519,840,644	\$ 517,177,388
Unearned premium reserve	4,672,289	4,737,305
Bank and other loans payable	41,253,242	40,908,915
Deferred pre-need cemetery and mortuary contract revenues	12,664,028	12,816,227
Cemetery perpetual care obligation	3,477,506	3,465,771
Accounts payable	2,830,831	3,502,046
Other liabilities and accrued expenses	31,265,273	31,027,381
Income taxes	26,756,136	25,052,059
Total liabilities	642,759,949	638,687,092
Stockholders' Equity		
Common Stock:		
Class A: common stock - \$2.00 par value; 20,000,000 shares authorized; issued 13,137,697 shares in 2016 and 13,109,100 shares in 2015	26,275,394	26,218,200
Class B: non-voting common stock - \$1.00 par value; 5,000,000 shares authorized; none issued or outstanding	-	-
Class C: convertible common stock - \$2.00 par value; 2,000,000 shares authorized; issued 1,716,024 shares in 2016 and 1,709,640 shares in 2015	3,432,048	3,419,280
Additional paid-in capital	30,489,006	30,232,582
Accumulated other comprehensive income, net of taxes	2,651,399	1,533,828
Retained earnings	53,771,475	52,021,764
Treasury stock at cost - 884,785 Class A shares in 2016 and 930,546 Class A shares in 2015	(2,029,790)	(2,179,429)
Total stockholders' equity	114,589,532	111,246,225
Total Liabilities and Stockholders' Equity	\$ 757,349,481	\$ 749,933,317

See accompanying notes to condensed consolidated financial statements.

SECURITY NATIONAL FINANCIAL CORPORATION
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)

	Three Months Ended	
	March 31	
	2016	2015
Revenues:		
Insurance premiums and other considerations	\$ 14,451,575	\$ 13,853,515
Net investment income	8,992,191	7,822,844
Net mortuary and cemetery sales	3,245,856	2,872,335
Realized gains on investments and other assets	97,922	420,064
Other than temporary impairments on investments	(73,630)	(55,896)
Mortgage fee income	37,769,975	37,821,800
Other	1,530,426	1,315,070
Total revenues	66,014,315	64,049,732
Benefits and expenses:		
Death benefits	7,824,001	7,927,872
Surrenders and other policy benefits	518,321	653,734
Increase in future policy benefits	4,160,260	4,179,812
Amortization of deferred policy and pre-need acquisition costs and value of business acquired	2,212,836	1,167,499
Selling, general and administrative expenses:		
Commissions	16,842,270	18,566,047
Personnel	17,197,372	14,313,316
Advertising	1,078,010	1,416,290
Rent and rent related	2,064,325	1,885,076
Depreciation on property and equipment	521,455	562,737
Provision for loan losses and loss reserve	586,778	666,739
Costs related to funding mortgage loans	2,154,397	2,183,011
Other	6,480,711	6,085,503
Interest expense	1,064,195	985,346
Cost of goods and services sold-mortuaries and cemeteries	458,619	458,266
Total benefits and expenses	63,163,550	61,051,248
Earnings before income taxes	2,850,765	2,998,484
Income tax expense	(1,057,233)	(1,134,681)
Net earnings	\$ 1,793,532	\$ 1,863,803
Net earnings per Class A Equivalent common share (1)	\$0.13	\$0.14
Net earnings per Class A Equivalent common share-assuming dilution (1)	\$0.12	\$0.13
Weighted-average Class A equivalent common share outstanding (1)	13,939,377	13,592,260
Weighted-average Class A equivalent common shares outstanding-assuming dilution (1)	14,373,499	14,154,098

(1) Net earnings per share amounts have been adjusted retroactively for the effect of annual stock dividends.

See accompanying notes to condensed consolidated financial statements.

5

SECURITY NATIONAL FINANCIAL CORPORATION
 AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Unaudited)

	Three Months Ended	
	March 31	
	2016	2015
Net earnings	\$1,793,532	\$1,863,703
Other comprehensive income:		
Net unrealized gains on derivative instruments	819,674	1,520,023
Net unrealized gains (losses) on available for sale securities	297,897	(228,256)
Other comprehensive income	1,117,571	1,291,767
Comprehensive income	\$2,911,103	\$3,155,470

See accompanying notes to condensed consolidated financial statements.

6

SECURITY NATIONAL FINANCIAL CORPORATION
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Class A Common Stock	Class C Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2014	\$24,918,480	\$2,788,138	\$25,931,119	\$1,438,566	\$44,101,252	\$(2,086,454)	\$97,091,101
Net earnings	-	-	-	-	1,863,703	-	1,863,703
Other comprehensive income	-	-	-	1,291,767	-	-	1,291,767
Grant of stock options	-	-	85,545	-	-	-	85,545
Exercise of stock options	-	228,046	15,963	-	-	(244,009)	-
Sale of treasury stock	-	-	134,619	-	-	105,715	240,334
Stock Dividends	480	2	728	-	(1,210)	-	-
Conversion Class C to Class A	1,064	(1,064)	-	-	-	-	-
Balance at March 31, 2015	\$24,920,024	\$3,015,122	\$26,167,974	\$2,730,333	\$45,963,745	\$(2,224,748)	\$100,572,450
Balance at December 31, 2015	\$26,218,200	\$3,419,280	\$30,232,582	\$1,533,828	\$52,021,764	\$(2,179,429)	\$111,246,225
Net earnings	-	-	-	-	1,793,532	-	1,793,532
Other comprehensive income	-	-	-	1,117,571	-	-	1,117,571
Grant of stock options	-	-	84,452	-	-	-	84,452
Exercise of stock options	56,920	-	4,367	-	-	-	61,287
Sale of treasury stock	-	-	136,826	-	-	149,639	286,465
Stock Dividends	274	12,768	30,779	-	(43,821)	-	-
Balance at March 31, 2016	\$26,275,394	\$3,432,048	\$30,489,006	\$2,651,399	\$53,771,475	\$(2,029,790)	\$114,589,532

See accompanying notes to condensed consolidated financial statements.

7

SECURITY NATIONAL FINANCIAL CORPORATION
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended	
	March 31	
	2016	2015
Cash flows from operating activities:		
Net cash provided by operating activities	\$25,863,034	\$711,854
Cash flows from investing activities:		
Securities held to maturity:		
Purchase-fixed maturity securities	(4,481,397)	(720,168)
Calls and maturities - fixed maturity securities	2,470,005	2,423,142
Securities available for sale:		
Purchase - equity securities	(1,651,302)	(970,123)
Sales - equity securities	1,487,110	1,115,336
Purchase of short-term investments	(3,258,070)	(19,289,330)
Sales of short-term investments	2,364,571	25,728,589
Sales (purchases) of restricted assets	1,242,342	(477,434)
Changes in assets for perpetual care trusts	(51,461)	(77,547)
Amount received for perpetual care trusts	11,735	14,734
Mortgage loans, policy loans, and other investments made	(112,920,364)	(98,936,237)
Payments received for mortgage loans, policy loans and other investments	99,348,725	85,963,685
Purchase of property and equipment	(1,084,975)	(371,843)
Purchase of real estate	(3,432,051)	(1,695,631)
Sale of real estate	843,701	1,924,500
Cash received from reinsurance	-	15,113,391
Net cash provided by (used in) investing activities	(19,111,431)	9,745,064
Cash flows from financing activities:		
Annuity contract receipts	2,516,596	2,507,650
Annuity contract withdrawals	(3,025,833)	(3,496,843)
Proceeds from stock options exercised	61,287	-
Repayment of bank loans on notes and contracts	(390,168)	(607,286)
Proceeds from borrowing on bank loans	737,232	1,028,848
Net cash used in financing activities	(100,886)	(567,631)
Net change in cash and cash equivalents	6,650,717	9,889,287
Cash and cash equivalents at beginning of period	40,053,242	30,855,320
Cash and cash equivalents at end of period	\$46,703,959	\$40,744,607
Non Cash Investing and Financing Activities		
Mortgage loans foreclosed into real estate	\$87,000	\$2,389,330

See accompanying notes to condensed consolidated financial statements.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

1) 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 for interim financial information and with the instructions to Form 10 Q and Articles 8 and 10 of Regulation S X. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements of the Company and notes thereto for the year ended December 31, 2015, included in the Company's Annual Report on Form 10-K (file number 000-09341). In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

The estimates susceptible to significant change are those used in determining the value of interest rate locks and commitments, those used in determining deferred acquisition costs and the value of business acquired, those used in determining the value of mortgage loans foreclosed to REO, those used in determining the liability for future policy benefits and unearned revenue, those used in determining the estimated future costs for pre-need sales, those used in determining the value of mortgage servicing rights, those used in determining valuation allowances for mortgage loans on real estate, those used in determining loan loss reserve, and those used in determining deferred tax assets and liabilities. Although some variability is inherent in these estimates, management believes the amounts provided are fairly stated in all material respects.

2) Recent Accounting Pronouncements

ASU No. 2014-09: "Revenue from Contracts with Customers (Topic 606)" - Issued in May 2014, ASU 2014-09 supersedes the revenue recognition requirements in ASC Topic 605, "Revenue Recognition", and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Insurance contracts are excluded from the scope of this new guidance. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2017. The Company is in the process of evaluating the potential impact of this standard, which is not expected to be material to the Company's results of operations or financial position.

ASU No. 2016-01: "Financial Instruments – Overall (Topic 825-10)" – Issued in January 2016, ASU 2016-01 changes the accounting for non-consolidated equity investments that are not accounted for under the equity method of accounting by requiring changes in fair value to be recognized in income. Under current guidance, changes in fair value for investments of this nature are recognized in accumulated other comprehensive income as a component of stockholders' equity. Additionally, ASU 2016-01 simplifies the impairment assessment of equity investments without readily determinable fair values; requires entities to use the exit price when estimating the fair value of financial instruments; and modifies various presentation disclosure requirements for financial instruments. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2017. The Company is

in the process of evaluating the potential impact of this standard.

ASU No. 2016-02: "Leases (Topic 842)" - Issued in February 2016, ASU 2016-02 supersedes the leases requirements in ASC Topic 840, "Leases", and was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2018. The Company is in the process of evaluating the potential impact of this standard.

The Company has reviewed other recent accounting pronouncements and has determined that they will not significantly impact the Company's results of operations or financial position.

9

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments

The Company's investments in fixed maturity securities held to maturity and equity securities available for sale as of March 31, 2016 are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<u>March 31, 2016</u>				
Fixed maturity securities held to maturity carried at amortized cost:				
Bonds:				
U.S. Treasury securities and obligations of U.S. Government agencies				
	\$3,558,169	\$378,157	\$-	\$3,936,326
	1,803,498	200,444	(455)	2,003,487
	133,970,698	11,576,671	(4,997,905)	140,549,464
	7,501,609	303,697	(173,323)	7,631,983
	612,023	47,811	-	659,834
Total fixed maturity securities held to maturity	\$147,445,997	\$12,506,780	\$(5,171,683)	\$154,781,094
Equity securities available for sale at estimated fair value:				
Common stock:				
Industrial, miscellaneous and all other				
	\$10,051,680	\$295,489	\$(1,405,937)	\$8,941,232
Total equity securities available for sale at estimated fair value	\$10,051,680	\$295,489	\$(1,405,937)	\$8,941,232
Mortgage loans on real estate and construction loans held for investment at amortized cost:				
	\$53,488,217			
	42,926,820			
	39,057,779			
	(2,078,948)			
Total mortgage loans on real estate and construction loans held for investment	\$133,393,868			
Real estate held for investment - net of depreciation	\$116,700,727			
Policy loans and other investments are shown at amortized cost except for other investments that are shown at estimated fair value:				
	\$6,892,022			
Insurance assignments	32,149,213			

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Promissory notes	48,797
Other investments at estimated fair value	1,222,188
Less: Allowance for doubtful accounts	(1,032,736)
Total policy loans and other investments	\$39,279,484
Short-term investments at amortized cost	\$17,809,307

10

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments (Continued)

The Company's investments in fixed maturity securities held to maturity and equity securities available for sale as of December 31, 2015 are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<u>December 31, 2015:</u>				
Fixed maturity securities held to maturity carried at amortized cost:				
Bonds:				
U.S. Treasury securities and obligations of U.S. Government agencies				
	\$3,560,579	\$292,869	\$(4,743)	\$3,848,705
	1,805,828	182,073	(1,040)	1,986,861
	134,488,108	9,836,355	(5,501,743)	138,822,720
	5,091,887	190,867	(75,580)	5,207,174
	612,023	29,675	-	641,698
Total fixed maturity securities held to maturity	\$145,558,425	\$10,531,839	\$(5,583,106)	\$150,507,158
Equity securities available for sale at estimated fair value:				
Common stock:				
	\$9,891,500	\$213,683	\$(1,674,093)	\$8,431,090
Total securities available for sale carried at estimated fair value	\$9,891,500	\$213,683	\$(1,674,093)	\$8,431,090
Mortgage loans on real estate and construction loans held for investment at amortized cost:				
	\$46,020,490			
	34,851,557			
	33,522,978			
Less: Allowance for loan losses	(1,848,120)			
Total mortgage loans on real estate and construction loans held for investment	\$112,546,905			
Real estate held for investment - net of depreciation	\$114,852,432			
Policy loans and other investments are shown at amortized cost except for other investments that are shown at estimated fair value:				

Policy loans	\$6,896,457
Insurance assignments	32,369,014
Promissory notes	48,797
Other investments at estimated fair value	1,174,769
Less: Allowance for doubtful accounts	(906,616)
Total policy loans and other investments	\$39,582,421
Short-term investments at amortized cost	\$16,915,808

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments (Continued)Fixed Maturity Securities

The following tables summarize unrealized losses on fixed maturity securities, which are carried at amortized cost, at March 31, 2016 and December 31, 2015. The unrealized losses were primarily related to interest rate fluctuations. The tables set forth unrealized losses by duration and number of investment positions, together with the fair value of the related fixed maturity securities:

	Unrealized Losses for Less than Twelve Months	No. of Investment Positions	Unrealized Losses for More than Twelve Months	No. of Investment Positions	Total Unrealized Loss
<u>At March 31, 2016</u>					
U.S. Treasury Securities and Obligations of U.S. Government Agencies	\$-	0	\$-	0	\$-
Obligations of states and political subdivisions	-	0	455	1	455
Corporate securities including public utilities	2,267,982	70	2,729,923	25	4,997,905
Mortgage-backed securities	173,323	6	-	0	173,323
Total unrealized losses	\$2,441,305	76	\$2,730,378	26	\$5,171,683
Fair Value	\$21,751,797		\$6,404,000		\$28,155,797
<u>At December 31, 2015</u>					
U.S. Treasury Securities and Obligations of U.S. Government Agencies	\$4,743	2	\$-	0	\$4,743
Obligations of states and political subdivisions	-	0	1,040	1	1,040
Corporate securities including public utilities	3,701,572	98	1,800,171	18	5,501,743
Mortgage-backed securities	75,580	4	-	0	75,580
Total unrealized losses	\$3,781,895	104	\$1,801,211	19	\$5,583,106
Fair Value	\$34,076,401		\$3,809,957		\$37,886,358

The average market value of the related fixed maturities was 84.5% and 87.2% of amortized cost as of March 31, 2016 and December 31, 2015, respectively. During the three months ended March 31, 2016 and 2015 an other than temporary decline in fair value resulted in the recognition of credit losses on fixed maturity securities of \$30,000 for each reporting period.

On a quarterly basis, the Company reviews its available for sale and held to maturity fixed investment securities related to corporate securities and other public utilities, consisting of bonds and preferred stocks that are in a loss position. The review involves an analysis of the securities in relation to historical values, and projected earnings and revenue growth rates. Based on the analysis, a determination is made whether a security will likely recover from the loss position within a reasonable period of time. If it is unlikely that the investment will recover from the loss position, the loss is considered to be other than temporary, the security is written down to the impaired value and an impairment loss is recognized.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments (Continued)Equity Securities

The following tables summarize unrealized losses on equity securities that were carried at estimated fair value based on quoted trading prices at March 31, 2016 and December 31, 2015. The unrealized losses were primarily the result of decreases in fair value due to overall equity market declines. The tables set forth unrealized losses by duration and number of investment positions, together with the fair value of the related equity securities available for sale in a loss position:

	Unrealized Losses for Less than Twelve Months	No. of Investment Positions	Unrealized Losses for More than Twelve Months	No. of Investment Positions	Total Unrealized Losses
<u>At March 31, 2016</u>					
Industrial, miscellaneous and all other	\$ 798,607	180	\$ 607,330	68	\$ 1,405,937
Total unrealized losses	\$ 798,607	180	\$ 607,330	68	\$ 1,405,937
Fair Value	\$ 3,955,133		\$ 1,154,812		\$ 5,109,945
<u>At December 31, 2015</u>					
Industrial, miscellaneous and all other	\$ 997,862	222	\$ 676,232	74	\$ 1,674,094
Total unrealized losses	\$ 997,862	222	\$ 676,232	74	\$ 1,674,094
Fair Value	\$ 4,177,709		\$ 760,860		\$ 4,938,569

The average market value of the equity securities available for sale was 78.4% and 74.7% of the original investment as of March 31, 2016 and December 31, 2015, respectively. The intent of the Company is to retain equity securities for a period of time sufficient to allow for the recovery in fair value. However, the Company may sell equity securities during a period in which the fair value has declined below the amount of the original investment. In certain situations, new factors, including changes in the business environment, can change the Company's previous intent to continue holding a security. During the three months ended March 31, 2016 and 2015, an other than temporary decline in the fair value resulted in the recognition of an impairment loss on equity securities of \$43,630 and \$25,896, respectively.

On a quarterly basis, the Company reviews its investment in industrial, miscellaneous and all other equity securities that are in a loss position. The review involves an analysis of the securities in relation to historical values, price earnings ratios, projected earnings and revenue growth rates. Based on the analysis a determination is made whether a security will likely recover from the loss position within a reasonable period of time. If it is unlikely that the investment will recover from the loss position, the loss is considered to be other than temporary, the security is written down to the impaired value and an impairment loss is recognized.

The fair values of fixed maturity securities are based on quoted market prices, when available. For fixed maturity securities not actively traded, fair values are estimated using values obtained from independent pricing services, or in the case of private placements, are estimated by discounting expected future cash flows using a current market value

applicable to the coupon rate, credit and maturity of the investments. The fair values for equity securities are based on quoted market prices.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments (Continued)

The amortized cost and estimated fair value of fixed maturity securities at March 31, 2016, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Held to Maturity:		
Due in 2016	\$4,298,647	\$4,345,102
Due in 2017 through 2020	33,393,520	35,451,062
Due in 2021 through 2025	35,564,893	37,200,353
Due after 2025	66,075,305	69,492,760
Mortgage-backed securities	7,501,609	7,631,983
Redeemable preferred stock	612,023	659,834
Total held to maturity	\$147,445,997	\$154,781,094

The cost and estimated fair value of available for sale securities at March 31, 2016, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Equities are valued using the specific identification method.

	Cost	Estimated Fair Value
Available for Sale:		
Common stock	\$10,051,680	\$8,941,232
Total available for sale	\$10,051,680	\$8,941,232

The Company's realized gains and losses and other than temporary impairments from investments and other assets, are summarized as follows:

	Three Months Ended March 31	
	2016	2015
Fixed maturity securities held to maturity:		
Gross realized gains	\$-	\$85,997
Gross realized losses	(24,795)	(9,776)
Other than temporary impairments	(30,000)	(30,000)
Securities available for sale:		
Gross realized gains	63,495	87,720
Gross realized losses	(23,878)	(1,016)
Other than temporary impairments	(43,630)	(25,896)

Other assets:		
Gross realized gains	84,768	257,139
Gross realized losses	(1,668)	-
Total	\$24,292	\$364,168

The net carrying amount of held to maturity securities sold was \$-0- and \$257,962 for the three months ended March 31, 2016 and 2015, respectively. The net realized gain related to these sales was \$-0- and \$8,962 for the three months ended March 31, 2016 and 2015, respectively.

There were no investments, aggregated by issuer, in excess of 10% of shareholders' equity (before net unrealized gains and losses on available for sale securities) at March 31, 2016, other than investments issued or guaranteed by the United States Government.

14

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments (Continued)

Major categories of net investment income are as follows:

	Three Months Ended	
	March 31	
	2016	2015
Fixed maturity securities	\$2,050,569	\$1,980,696
Equity securities	71,041	59,418
Mortgage loans on real estate	2,026,515	1,874,158
Real estate	2,838,484	2,120,650
Policy loans	182,206	188,546
Insurance assignments	3,104,788	2,789,006
Short-term investments, principally interest on sale of mortgage loans and other	1,863,144	1,511,095
Gross investment income	12,136,747	10,523,569
Investment expenses	(3,144,556)	(2,700,725)
Net investment income	\$8,992,191	\$7,822,844

Net investment income includes income earned by the restricted assets of the cemeteries and mortuaries of \$87,976 and \$92,922 for the three months ended March 31, 2016 and 2015, respectively.

Net investment income on real estate consists primarily of rental revenue.

Investment expenses consist primarily of depreciation, property taxes, operating expenses of real estate and an estimated portion of administrative expenses relating to investment activities.

Securities on deposit for regulatory authorities as required by law amounted to \$8,813,368 at March 31, 2016 and \$8,815,542 at December 31, 2015. The restricted securities are included in various assets under investments on the accompanying condensed consolidated balance sheets.

Real Estate

The Company continues to strategically deploy resources into real estate to match the income and yield durations of its primary obligations. The sources for these real estate assets come through its various business units in the form of acquisition, development and foreclosures on delinquent mortgage loans.

Commercial Real Estate Held for Investment

The Company owns and manages commercial real estate assets as a means of generating investment income. These assets are acquired in accordance with the Company's goals and objectives for risk-adjusted returns. Due diligence is conducted on each asset using internal and third party reports. Geographic locations and asset classes of the investment activity is determined by senior management under the direction of the Board of Directors.

The Company employs full-time employees to attend to the day-to-day operations of those assets within the greater Salt Lake area and close surrounding markets. The Company utilizes third party property managers when the geographic boundary does not warrant full-time staff or through strategic lease-up periods. The Company generally looks to acquire assets in regions that are high growth regions for employment and population and in assets that

provide operational efficiencies.

The Company currently owns and operates 10 commercial properties in 7 states. These properties include industrial warehouses, office building and retail centers. The assets are primarily held without debt; however, the Company does use debt in strategic cases to leverage established yields or to acquire higher quality, or class, of asset.

15

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments (Continued)

The following is a summary of the Company's investment in commercial real estate for the periods presented:

	Net Ending Balance		Total Square Footage	
	March 31 2016	December 31 2015	March 31 2016	December 31 2015
Arizona	\$460,465 (1)	\$463,774 (1)	16,270	16,270
Arkansas	103,527	-	3,200	-
Kansas	11,720,154	11,537,335	222,679	222,679
Mississippi	3,152,040	-	21,521	-
New Mexico	7,000 (1)	7,000 (1)	-	-
Texas	3,755,070	3,768,542	23,470	23,470
Utah	17,194,441	17,403,746	233,244	253,244
	\$36,392,697	\$33,180,397	520,384	515,663

(1) Includes undeveloped land

Residential Real Estate Held for Investment

The Company owns a portfolio of residential homes primarily as a result of loan foreclosures. The strategy has been to lease these homes to produce cash flow, and allow time for the economic fundamentals to return to the various markets. Once the market for these homes return, the Company engages in the disposition of these assets at prices above the book value or at a discount far less than what would have been realized at the time of foreclosure.

The Company established Security National Real Estate Services ("SNRE") in 2013 to manage the residential portfolio. SNRE cultivates and maintains the preferred vendor relationships necessary to manage costs and quality of work performed on the portfolio of homes across the country.

As of March 31, 2016, SNRE manages 141 residential properties in 10 states across the United States which includes a newly constructed apartment complex, Dry Creek at East Village, in Sandy Utah.

The following is a summary of the Company's investment in residential real estate for the periods presented:

	Net Ending Balance	
	March 31 2016	December 31 2015
Arizona	\$940,537	\$944,614
California	5,929,061	6,158,253
Colorado	549,214	553,230

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Florida	9,082,242	9,203,624
Illinois	-	165,800
Oklahoma	99,264	99,862
Oregon	120,000	120,000
South Carolina	676,200	823,872
Texas	1,279,327	1,198,860
Utah	61,346,004	62,117,738
Washington	286,181	286,182
	\$80,308,030	\$81,672,035

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments (Continued)Real Estate Owned and Occupied by the Company

The primary business units of the Company occupy a portion of the real estate owned by the Company. Currently, the Company occupies nearly 70,000 square feet, or 13% of the overall commercial real estate holdings.

As of March 31, 2016, real estate owned and occupied by the company is summarized as follows:

Location	Business Segment	Approximate Square Footage	Square Footage Occupied by the Company	
5300 South 360 West, Salt Lake City, UT (1)	Corporate Offices, Life Insurance and Cemetery/Mortuary Operations	36,000	100	%
5201 Green Street, Salt Lake City, UT	Mortgage Operations	36,899	34	%
3935 I-55 South Frontage Road, Jackson, MS (1)	Life Insurance Operations	12,300	100	%

(1) These two assets are included in property and equipment on the Condensed Consolidated Balance Sheet

Mortgage Loans

Mortgage loans consist of first and second mortgages. The mortgage loans bear interest at rates ranging from 2.0% to 10.5%, maturity dates range from three months to 30 years and are secured by real estate. Concentrations of credit risk arise when a number of mortgage loan debtors have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. Although the Company has a diversified mortgage loan portfolio consisting of residential mortgages, commercial loans and residential construction loans and requires collateral on all real estate exposures, a substantial portion of its debtors' ability to honor obligations is reliant on the economic stability of the geographic region in which the debtors do business. At March 31, 2016, the Company had 53%, 14%, 10%, 7%, and 5% of its mortgage loans from borrowers located in the states of Utah, California, Texas, Florida, and Oregon, respectively. The mortgage loans on real estate balances on the consolidated balance sheet are reflected net of an allowance for loan losses of \$2,078,948 and \$1,848,120 at March 31, 2016 and December 31, 2015, respectively.

17

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments (Continued)

The Company establishes a valuation allowance for credit losses in its portfolio. The following is a summary of the allowance for loan losses as a contra-asset account for the periods presented:

Allowance for Credit Losses and Recorded Investment in Mortgage Loans

	Commercial	Residential	Residential Construction	Total
<u>March 31, 2016</u>				
Allowance for credit losses:				
Beginning balance - January 1, 2016	\$ 187,129	\$ 1,560,877	\$ 100,114	\$ 1,848,120
Charge-offs	-	(18,374)	-	(18,374)
Provision	-	249,202	-	249,202
Ending balance -March 31, 2016	\$ 187,129	\$ 1,791,705	\$ 100,114	\$ 2,078,948
Ending balance: individually evaluated for impairment	\$-	\$508,655	\$-	\$508,655
Ending balance: collectively evaluated for impairment	\$ 187,129	\$ 1,283,050	\$ 100,114	\$ 1,570,293
Ending balance: loans acquired with deteriorated credit quality	\$-	\$-	\$-	\$-
Mortgage loans:				
Ending balance	\$39,057,779	\$53,488,217	\$42,926,820	\$ 135,472,816
Ending balance: individually evaluated for impairment	\$-	\$5,091,409	\$-	\$5,091,409
Ending balance: collectively evaluated for impairment	\$39,057,779	\$48,396,808	\$42,926,820	\$ 130,381,407
Ending balance: loans acquired with deteriorated credit quality	\$-	\$-	\$-	\$-
<u>December 31, 2015</u>				
Allowance for credit losses:				
Beginning balance - January 1, 2015	\$ 187,129	\$ 1,715,812	\$ 100,114	\$ 2,003,055
Charge-offs	-	(123,942)	-	(123,942)
Provision	-	(30,993)	-	(30,993)
Ending balance - December 31, 2015	\$ 187,129	\$ 1,560,877	\$ 100,114	\$ 1,848,120
Ending balance: individually evaluated for impairment	\$-	\$305,962	\$-	\$305,962
Ending balance: collectively evaluated for impairment	\$ 187,129	\$ 1,254,915	\$ 100,114	\$ 1,542,158

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Ending balance: loans acquired with deteriorated credit quality	\$-	\$-	\$-	\$-
Mortgage loans:				
Ending balance	\$33,522,978	\$46,020,490	\$34,851,557	\$114,395,025
Ending balance: individually evaluated for impairment	\$-	\$3,087,161	\$93,269	\$3,180,430
Ending balance: collectively evaluated for impairment	\$33,522,978	\$42,933,329	\$34,758,287	\$111,214,594
Ending balance: loans acquired with deteriorated credit quality	\$-	\$-	\$-	\$-

18

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments (Continued)

The following is a summary of the aging of mortgage loans for the periods presented:

Analysis of Past Due Mortgage Loans

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days (1)	In Foreclosure (1)	Total Past Due	Current	Total Mortgage Loans	Allowance for Loan Losses	Net Mortgage Loans
March 31, 2016									
Commercial	\$-	\$-	\$-	\$-	\$-	\$39,057,779	\$39,057,779	\$(187,129)	\$38,870,650
Residential	151,779	354,152	726,159	5,091,409	6,323,499	47,164,718	53,488,217	(1,791,705)	51,696,512
Residential Construction	-	-	64,895	-	64,895	42,861,925	42,926,820	(100,114)	42,826,706
Total	\$151,779	\$354,152	\$791,054	\$5,091,409	\$6,388,394	\$129,084,422	\$135,472,816	\$(2,078,948)	\$133,393,868
December 31, 2015									
Commercial	\$-	\$-	\$-	\$-	\$-	\$33,522,978	\$33,522,978	\$(187,129)	\$33,335,849
Residential	1,162,102	884,143	2,212,993	3,087,161	7,346,399	38,674,091	46,020,490	(1,560,877)	44,459,612
Residential Construction	-	-	64,895	93,269	158,164	34,693,393	34,851,557	(100,114)	34,751,443
Total	\$1,162,102	\$884,143	\$2,277,888	\$3,180,430	\$7,504,563	\$106,890,462	\$114,395,025	\$(1,848,120)	\$112,546,905

(1) Interest income is not recognized on loans past due greater than 90 days or in foreclosure.

19

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments (Continued)Impaired Mortgage Loans

Impaired mortgage loans include loans with a related specific valuation allowance or loans whose carrying amount has been reduced to the expected collectible amount because the impairment has been considered other than temporary. The recorded investment in and unpaid principal balance of impaired loans along with the related loan specific allowance for losses, if any, for each reporting period and the average recorded investment and interest income recognized during the time the loans were impaired were as follows:

Impaired Loans

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
March 31, 2016					
With no related allowance recorded:					
Commercial	\$-	\$-	\$-	\$-	\$ -
Residential	-	-	-	-	-
Residential construction	-	-	-	-	-
With an allowance recorded:					
Commercial	\$-	\$-	\$-	\$-	\$ -
Residential	5,091,409	5,091,409	508,655	5,091,409	-
Residential construction	-	-	-	-	-
Total:					
Commercial	\$-	\$-	\$-	\$-	\$ -
Residential	5,091,409	5,091,409	508,655	5,091,409	-
Residential construction	-	-	-	-	-
December 31, 2015					
With no related allowance recorded:					
Commercial	\$-	\$-	\$-	\$-	\$ -
Residential	-	-	-	-	-
Residential construction	93,269	93,269	-	93,269	-
With an allowance recorded:					
Commercial	\$-	\$-	\$-	\$-	\$ -
Residential	3,087,161	3,087,161	305,962	3,087,161	-
Residential construction	-	-	-	-	-
Total:					
Commercial	\$-	\$-	\$-	\$-	\$ -
Residential	3,087,161	3,087,161	305,962	3,087,161	-

Residential construction	93,269	93,269	-	93,269	-
--------------------------	--------	--------	---	--------	---

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

3) Investments (Continued)Credit Risk Profile Based on Performance Status

The Company's mortgage loan portfolio is monitored based on performance of the loans. Monitoring a mortgage loan increases when the loan is delinquent or earlier if there is an indication of impairment. The Company defines non-performing mortgage loans as loans 90 days or greater delinquent or on non-accrual status.

The Company's performing and non-performing mortgage loans were as follows:

Mortgage Loan Credit Exposure

Credit Risk Profile Based on Payment Activity

	Commercial		Residential		Residential Construction		Total	
	March	December	March	December	March	December	March	December
	31, 2016	31, 2015	31, 2016	31, 2015	31, 2016	31, 2015	31, 2016	31, 2015
Performing	\$39,057,779	\$33,522,978	\$47,670,650	\$40,720,336	\$42,861,925	\$34,693,393	\$129,590,354	\$108,936,707
Nonperforming	-	-	5,817,567	5,300,154	64,895	158,164	5,882,462	5,458,318
Total	\$39,057,779	\$33,522,978	\$53,488,217	\$46,020,490	\$42,926,820	\$34,851,557	\$135,472,816	\$114,395,025

Non-Accrual Mortgage Loans

Once a loan is past due 90 days, it is the policy of the Company to end the accrual of interest income on the loan and write off any income that had been accrued. Interest not accrued on these loans totals \$440,000 and \$268,000 as of March 31, 2016 and December 31, 2015, respectively.

The following is a summary of mortgage loans on a nonaccrual status for the periods presented.

	Mortgage Loans on Nonaccrual Status	
	As of March 31 2016	As of December 31 2015
Residential	\$5,817,567	\$5,300,154
Residential construction	64,895	158,164
Total	\$5,882,462	\$5,458,318

Loan Loss Reserve

When a repurchase demand is received from a third party investor, the relevant data is reviewed and captured so that an estimated future loss can be calculated. The key factors that are used in the estimated loss calculation are as follows: (i) lien position, (ii) payment status, (iii) claim type, (iv) unpaid principal balance, (v) interest rate, and (vi) validity of the demand. Other data is captured and is useful for management purposes; the actual estimated loss is generally based on these key factors. The Company conducts its own review upon the receipt of a repurchase demand. In many instances, the Company is able to resolve the issues relating to the repurchase demand by the third party investor without having to make any payments to the investor.

The following is a summary of the loan loss reserve that is included in other liabilities and accrued expenses:

	As of March 31 2016	As of December 31 2015
Balance, beginning of period	\$2,805,900	\$1,718,150
Provisions for losses	586,778	6,295,043
Charge-offs	(40,041)	(5,207,293)
Balance, end of period	\$3,352,637	\$2,805,900

The Company believes the loan loss reserve represents probable loan losses incurred as of the balance sheet date. Actual loan loss experience could change, in the near-term, from the established reserve based upon claims that could be asserted by third party investors. SecurityNational Mortgage believes there is potential to resolve any alleged claims by third party investors on acceptable terms. If SecurityNational Mortgage is unable to resolve such claims on acceptable terms, legal action may ensue. In the event of legal action by any third party investor, SecurityNational Mortgage believes it has significant defenses to any such action and intends to vigorously defend itself against such action.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

4) Stock-Based Compensation

The Company has four fixed option plans (the "2003 Plan", the "2006 Director Plan", the "2013 Plan" and the "2014 Director Plan"). Compensation expense for options issued of \$84,452 and \$85,545 has been recognized for these plans for the three months ended March 31, 2016 and 2015, respectively. As of March 31, 2016, the total unrecognized compensation expense related to the options issued in December 2015 was \$228,136, which is expected to be recognized over the vesting period of one year.

The Company generally estimates the expected life of the options based upon the contractual term of the options adjusted for actual experience. Future volatility is estimated based upon the a weighted historical volatility of the Company's Class A common stock and three peer company stocks over a period equal to the estimated life of the options. Common stock issued upon exercise of stock options are generally new share issuances rather than from treasury shares.

A summary of the status of the Company's stock incentive plans as of March 31, 2016, and the changes during the three months ended March 31, 2016, are presented below:

	Number of Class A Shares	Weighted Average Exercise Price	Number of Class C Shares	Weighted Average Exercise Price
Outstanding at December 31, 2015	618,261	\$ 3.89	577,436	\$ 3.54
Granted	-		-	
Exercised	(28,460)	2.15	-	
Cancelled	-		-	
Outstanding at March 31, 2016	589,801	\$ 3.97	577,436	\$ 3.54
As of March 31, 2016:				
Options exercisable	484,659	\$ 3.45	498,686	\$ 2.99
As of March 31, 2016:				
Available options for future grant	454,842		57,750	
Weighted average contractual term of option outstanding at March 31, 2016	7.50 years		2.50 years	
Weighted average contractual term of options exercisable at March 31, 2016	7.03 years		2.16 years	
Aggregated intrinsic value of options outstanding at March 31, 2016				
(1)	\$844,342		\$1,096,391	

Aggregated intrinsic value of options exercisable at March 31, 2016 (1)	\$844,342	\$1,096,391
--	-----------	-------------

(1) The Company used a stock price of \$5.09 as of March 31, 2016 to derive intrinsic value.

22

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

4) Stock Based Compensation (Continued)

A summary of the status of the Company's stock incentive plans as of March 31, 2015, and the changes during the three months ended March 31, 2015, are presented below:

	Number of Class A Shares	Weighted Average Exercise Price	Number of Class C Shares	Weighted Average Exercise Price
Outstanding at December 31, 2014	512,795	\$ 3.20	691,591	\$ 2.00
Granted	-		-	
Exercised	-		(114,023)	2.14
Cancelled	(8,846)	2.31	-	
Outstanding at March 31, 2015	503,949	\$ 3.21	577,568	\$ 2.62
As of March 31, 2015:				
Options exercisable	379,946	\$ 2.75	471,943	\$ 2.15
As of March 31, 2015:				
Available options for future grant	266,649		-	
Weighted average contractual term of options outstanding at March 31, 2015	7.57 years		2.93 years	
Weighted average contractual term of options exercisable at March 31, 2015	6.91 years		2.30 years	
Aggregated intrinsic value of options outstanding at March 31, 2015 (1)	\$1,076,880		\$1,572,653	
Aggregated intrinsic value of options exercisable at March 31, 2015 (1)	\$988,022		\$1,506,415	

(1) The Company used a stock price of \$5.34 as of March 31, 2015 to derive intrinsic value.

The total intrinsic value (which is the amount by which the fair value of the underlying stock exceeds the exercise price of an option on the exercise date) of stock options exercised during the three months ended March 31, 2016 and 2015 was \$91,989 and \$438,989, respectively.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

5) Earnings Per Share

The basic and diluted earnings per share amounts were calculated as follows:

	Three Months Ended	
	March 31 2016	2015
Numerator:		
Net earnings	\$ 1,793,532	\$ 1,863,703
Denominator:		
Basic weighted-average shares outstanding	13,939,377	13,592,260
Effect of dilutive securities:		
Employee stock options	434,122	561,838
Diluted weighted-average shares outstanding	14,373,499	14,154,098
Basic net earnings per share	\$0.13	\$0.14
Diluted net earnings per share	\$0.12	\$0.13

Net earnings per share amounts have been adjusted for the effect of annual stock dividends. For the three months ended March 31, 2016 and 2015, there were 250,039 and 4,632 of anti-dilutive employee stock option shares, respectively, that were not included in the computation of diluted net loss per common share as their effect would be anti-dilutive.

6) Business SegmentsDescription of Products and Services by Segment

The Company has three reportable business segments: life insurance, cemetery and mortuary, and mortgage. The Company's life insurance segment consists of life insurance premiums and operating expenses from the sale of insurance products sold by the Company's independent agency force and net investment income derived from investing policyholder and segment surplus funds. The Company's cemetery and mortuary segment consists of revenues and operating expenses from the sale of at-need cemetery and mortuary merchandise and services at its mortuaries and cemeteries, pre-need sales of cemetery spaces after collection of 10% or more of the purchase price and the net investment income from investing segment surplus funds. The Company's mortgage segment consists of fee income and expenses from the originations of residential mortgage loans and interest earned and interest expenses from warehousing pre-sold loans before the funds are received from financial institutional investors.

Measurement of Segment Profit or Loss and Segment Assets

The accounting policies of the reportable segments are the same as those described in the Significant Accounting Principles of the Form 10-K for the year ended December 31, 2015. Intersegment revenues are recorded at cost plus an agreed upon intercompany profit, and are eliminated upon consolidation.

Factors Management Used to Identify the Enterprise's Reportable Segments

The Company's reportable segments are business units that are managed separately due to the different products provided and the need to report separately to the various regulatory jurisdictions. The Company regularly reviews the quantitative thresholds and other criteria to determine when other business segments may need to be reported.

24

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

6) Business Segments (Continued)

	Life Insurance	Cemetery/ Mortuary	Mortgage	Eliminations	Consolidated
For the Three Months Ended					
<u>March 31, 2016</u>					
Revenues from external customers	\$22,075,134	\$3,330,766	\$40,608,415	\$-	\$66,014,315
Intersegment revenues	3,103,446	286,925	79,479	(3,469,850)	-
Segment profit before income taxes	1,065,168	469,055	1,316,542	-	2,850,765
Identifiable Assets	724,858,698	96,827,903	69,077,738	(133,414,858)	757,349,481
Goodwill	2,765,570	-	-	-	2,765,570
For the Three Months Ended					
<u>March 31, 2015</u>					
Revenues from external customers	\$20,985,500	\$3,098,238	\$39,965,894	\$-	\$64,049,632
Intersegment revenues	2,818,867	311,998	88,487	(3,219,352)	-
Segment profit before income taxes	1,403,851	409,175	1,185,358	-	2,998,384
Identifiable Assets	677,059,957	104,778,721	62,765,551	(142,826,038)	701,778,191
Goodwill	2,765,570	-	-	-	2,765,570

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

7) Fair Value of Financial Instruments

Generally accepted accounting principles (GAAP) defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. GAAP also specifies a fair value hierarchy based upon the observability of inputs used in valuation techniques. Observable inputs (highest level) reflect market data obtained from independent sources, while unobservable inputs (lowest level) reflect internally developed market assumptions. Fair value measurements are classified under the following hierarchy:

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

Level 2: Financial assets and financial liabilities whose values are based on the following:

- a) Quoted prices for similar assets or liabilities in active markets;
- b) Quoted prices for identical or similar assets or liabilities in non-active markets; or
- c) Valuation models whose inputs are observable, directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Financial assets and financial liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs may reflect our estimates of the assumptions that market participants would use in valuing the financial assets and financial liabilities.

The Company utilizes a combination of third party valuation service providers, brokers, and internal valuation models to determine fair value.

The following methods and assumptions were used by the Company in estimating the fair value disclosures related to other significant financial instruments:

The items shown under Level 1 and Level 2 are valued as follows:

Securities Available for Sale and Held to Maturity: The fair values of investments in fixed maturity and equity securities along with methods used to estimate such values are disclosed in Note 3 of the Notes to Condensed Consolidated Statements.

Restricted Assets: A portion of these assets include mutual funds and equity securities that have quoted market prices. Also included are cash and cash equivalents and participations in mortgage loans. The carrying amounts reported in the accompanying consolidated balance sheet for these financial instruments approximate their fair values.

Cemetery Perpetual Care Trust Investments: A portion of these assets include equity securities that have quoted market prices. Also included are cash and cash equivalents. The carrying amounts reported in the accompanying

consolidated balance sheet for these financial instruments approximate their fair values.

Call and Put Options: The Company uses quoted market prices to value its call and put options.

The items shown under Level 3 are valued as follows:

Policyholder Account Balances and Future Policy Benefits-Annuities: Future policy benefit reserves for interest-sensitive insurance products are computed under a retrospective deposit method and represent policy account balances before applicable surrender charges. Policy benefits and claims that are charged to expense include benefit claims incurred in the period in excess of related policy account balances. Interest crediting rates for interest-sensitive insurance products ranged from 4% to 6.5%. The fair values for the Company's liabilities under investment-type insurance contracts (disclosed as policyholder account balances and future policy benefits – annuities) are estimated based on the contracts' cash surrender values.

26

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

7) Fair Value of Financial Instruments (Continued)

The fair values for the Company's insurance contracts other than investment-type contracts are not required to be disclosed. However, the fair values of liabilities under all insurance contracts are taken into consideration in the Company's overall management of interest rate risk, such that the Company's exposure to changing interest rates is minimized through the matching of investment maturities with amounts due under insurance contracts.

Interest Rate Lock Commitments: The Company's mortgage banking activities enters into interest rate lock commitments with potential borrowers and forward commitments to sell loans to third-party investors. The Company also implements a hedging strategy for these transactions. A mortgage loan commitment binds the Company to lend funds to a qualified borrower at a specified interest rate and within a specified period of time, generally up to 30 days after inception of the mortgage loan commitment. Mortgage loan commitments are defined to be derivatives under generally accepted accounting principles and are recognized at fair value on the consolidated balance sheet with changes in their fair values recorded as part of other comprehensive income from mortgage banking operations.

The Company estimates the fair value of a mortgage loan commitment based on the change in estimated fair value of the underlying mortgage loan and the probability that the mortgage loan will fund within the terms of the commitment. The change in fair value of the underlying mortgage loan is measured from the date the mortgage loan commitment is issued. Therefore, at the time of issuance, the estimated fair value is zero. Following issuance, the value of a mortgage loan commitment can be either positive or negative depending upon the change in value of the underlying mortgage loans. Fallout rates derived from the Company's recent historical empirical data are used to estimate the quantity of mortgage loans that will fund within the terms of the commitments.

Bank Loan Interest Rate Swaps: Management considers the interest rate swap instruments to be an effective cash flow hedge against the variable interest rate on bank borrowings since the interest rate swap mirrors the term of the note payable and expires on the maturity date of the bank loan it hedges. The interest rate swaps are a derivative financial instruments carried at its fair value. The fair value of the interest rate swap was derived from a proprietary model of the bank from whom the interest rate swap was purchased and to whom the note is payable.

Other Investments: The fair values are estimated using one or more valuation techniques for which sufficient and reliable data is available. Factors considered when estimating the fair value include the original transaction price, recent transactions in the same or similar properties, historical lease rates, comparable lease rates of similar properties, discount rates, market capitalization rates, expected vacancy rates, and changes in financial ratios or cash flow.

Mortgage Loans on Real Estate: The fair values are estimated using interest rates currently being offered for similar loans to borrowers with similar credit ratings. Loans with similar characteristics are aggregated for purposes of the calculations. The carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values.

Real Estate Held for Investment: The Company believes that in an orderly market, fair value will approximate the replacement cost of a home and the rental income provides a cash flow stream for investment analysis. The Company believes the highest and best use of the properties are as income producing assets since it is the Company's intent to hold the properties as rental properties, matching the income from the investment in rental properties with the funds required for future estimated policy claims. Accordingly, the fair value determination will be weighted more heavily toward the rental analysis.

It should be noted that for replacement cost, when determining the fair value of mortgage properties, the Company uses Marshall and Swift, a provider of building cost information to the real estate construction industry. For the investment analysis, the Company used market data based upon its real estate operation experience and projected the present value of the net rental income over seven years. The Company used 60% of the projected cash flow analysis and 40% of the replacement cost to approximate fair value of the collateral.

27

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

7) Fair Value of Financial Instruments (Continued)

In addition to this analysis performed by the Company, the Company depreciates Other Real Estate Held for Investment. This depreciation reduces the book value of these properties and lessens the exposure to the Company from further deterioration in real estate values.

Mortgage Servicing Rights: The Company initially recognizes Mortgage Servicing Rights ("MSRs") at their estimated fair values derived from the net cash flows associated with the servicing contracts, where the Company assumes the obligation to service the loan in the sale transaction. The precise fair value of MSRs cannot be readily determined because MSRs are not actively traded in stand-alone markets. Considerable judgment is required to estimate the fair values of these assets and the exercise of such judgment can significantly affect the Company's earnings.

The Company's subsequent accounting for MSRs is based on the class of MSRs. The Company has identified two classes of MSRs: MSRs backed by mortgage loans with initial term of 30 years and MSRs backed by mortgage loans with initial term of 15 years. The Company distinguishes between these classes of MSRs due to their differing sensitivities to change in value as the result of changes in market. After being initially recorded at fair value, MSRs backed by mortgage loans are accounted for using the amortization method. MSR amortization is determined by amortizing the balance straight-line over an estimated seven and nine year life.

The Company periodically assesses MSRs for impairment. Impairment occurs when the current fair value of the MSR falls below the asset's carrying value (carrying value is the amortized cost reduced by any related valuation allowance). If MSRs are impaired, the impairment is recognized in current-period earnings and the carrying value of the MSRs is adjusted through a valuation allowance.

Management periodically reviews the various loan strata to determine whether the value of the MSRs in a given stratum is impaired and likely to recover. When management deems recovery of the value to be unlikely in the foreseeable future, a write-down of the cost of the MSRs for that stratum to its estimated recoverable value is charged to the valuation allowance.

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a recurring basis by their classification in the condensed consolidated balance sheet at March 31, 2016.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a recurring basis				
Common stock	\$8,941,232	\$8,941,232	\$ -	\$-
Total securities available for sale	\$8,941,232	\$8,941,232	\$ -	\$-
Restricted assets of cemeteries and mortuaries	\$687,214	\$687,214	\$ -	\$-
Cemetery perpetual care trust investments	669,366	669,366	-	-

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Derivatives - interest rate lock commitments	5,096,573	-	-	5,096,573
Other investments	1,222,188	-	-	1,222,188
Total assets accounted for at fair value on a recurring basis	\$16,616,573	\$10,297,812	\$ -	\$6,318,761
Liabilities accounted for at fair value on a recurring basis				
Policyholder account balances	\$(50,451,491)	\$-	\$ -	\$(50,451,491)
Future policy benefits - annuities	(69,287,925)	-	-	(69,287,925)
Derivatives - bank loan interest rate swaps	(11,210)	-	-	(11,210)
- call options	(63,686)	(63,686)	-	-
- put options	(12,102)	(12,102)	-	-
- interest rate lock commitments	(422,490)	-	-	(422,490)
Total liabilities accounted for at fair value on a recurring basis	\$(120,248,904)	\$(75,788)	\$ -	\$(120,173,116)

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

7) Fair Value of Financial Instruments (Continued)

Following is a summary of changes in the condensed consolidated balance sheet line items measured using level 3 inputs:

	Policyholder Account Balances	Future Policy Benefits - Annuities	Interest Rate Lock Commitments	Bank Loan Interest Rate Swaps	Other Investments
Balance - December 31, 2015	\$(50,694,953)	\$(69,398,617)	\$ 3,333,091	\$(13,947)	\$ 1,174,769
Total gains (losses):					
Included in earnings	243,462	110,692	-	-	-
Included in other comprehensive income	-	-	1,340,992	2,737	47,419
Balance - March 31, 2016	\$(50,451,491)	\$(69,287,925)	\$ 4,674,083	\$(11,210)	\$ 1,222,188

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a nonrecurring basis by their classification in the condensed consolidated balance sheet at March 31, 2016.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a nonrecurring basis				
Mortgage servicing rights	\$ 1,499,786	\$ -	\$ -	\$ 1,499,786
Real estate held for investment	1,242,000	-	-	1,242,000
Total assets accounted for at fair value on a nonrecurring basis	\$ 2,741,786	\$ -	\$ -	\$ 2,741,786

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

7) Fair Value of Financial Instruments (Continued)

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a recurring basis by their classification in the condensed consolidated balance sheet at December 31, 2015.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a recurring basis				
Common stock	\$8,431,090	\$8,431,090	\$ -	\$-
Total securities available for sale	\$8,431,090	\$8,431,090	\$ -	\$-
Restricted assets of cemeteries and mortuaries	\$686,444	\$686,444	\$ -	\$-
Cemetery perpetual care trust investments	630,854	630,854	-	-
Derivatives - interest rate lock commitments	3,440,758	-	-	3,440,758
Other investments	1,174,769	-	-	1,174,769
Total assets accounted for at fair value on a recurring basis	\$14,363,915	\$9,748,388	\$ -	\$4,615,527
Liabilities accounted for at fair value on a recurring basis				
Policyholder account balances	\$(50,694,953)	\$-	\$ -	\$(50,694,953)
Future policy benefits - annuities	(69,398,617)	-	-	(69,398,617)
Derivatives - bank loan interest rate swaps	(13,947)	-	-	(13,947)
- call options	(16,342)	(16,342)	-	-
- put options	(28,829)	(28,829)	-	-
- interest rate lock commitment	(107,667)	-	-	(107,667)
Total liabilities accounted for at fair value on a recurring basis	\$(120,260,355)	\$(45,171)	\$ -	\$(120,215,184)

Following is a summary of changes in the condensed consolidated balance sheet line items measured using level 3 inputs:

	Policyholder Account Balances	Future Policy Benefits - Annuities	Interest Rate Lock Commitments	Bank Loan Interest Rate Swaps	Other Investments
Balance - December 31, 2014	\$(45,310,699)	\$(65,540,985)	\$ 1,929,851	\$(31,370)	\$-
Purchases	-	-	-	-	1,200,000

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Total gains (losses):

Included in earnings	(5,384,254)	(3,857,632)	-	-	-
Included in other comprehensive income	-	-	1,403,240	17,423	(25,231)
Balance - December 31, 2015	\$(50,694,953)	\$(69,398,617)	\$ 3,333,091	\$(13,947)	\$ 1,174,769

30

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

7) Fair Value of Financial Instruments (Continued)

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a nonrecurring basis by their classification in the condensed consolidated balance sheet at December 31, 2015.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a nonrecurring basis				
Mortgage servicing rights	\$6,217,551	\$ -	\$ -	\$ 6,217,551
Real estate held for investment	95,000	-	-	95,000
Total assets accounted for at fair value on a nonrecurring basis	\$6,312,551	\$ -	\$ -	\$ 6,312,551

Fair Value of Financial Instruments Carried at Other Than Fair Value

ASC 825, Financial Instruments, requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent limitations in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates presented herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction at March 31, 2016 and December 31, 2015. The estimated fair value amounts for March 31, 2016 and December 31, 2015 have been measured as of period-end, and have not been reevaluated or updated for purposes of these Condensed Consolidated Financial Statements subsequent to those dates. As such, the estimated fair values of these financial instruments subsequent to the reporting date may be different than the amounts reported at period-end.

The carrying values and estimated fair values for such financial instruments, and their corresponding placement in the fair value hierarchy, are summarized as follows as of March 31, 2016:

Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
-------------------	------------	------------	---------	-------------------------------------

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Assets

Mortgage loans:

Residential	\$51,696,512	\$ -	\$ -	\$55,117,152	\$55,117,152
Residential construction	42,826,706	-	-	42,826,706	42,826,706
Commercial	38,870,650	-	-	40,272,245	40,272,245
Mortgage loans, net	\$133,393,868	\$ -	\$ -	\$138,216,103	\$138,216,103
Policy loans	6,892,022	-	-	6,892,022	6,892,022
Insurance assignments, net	31,165,274	-	-	31,165,274	31,165,274
Short-term investments	17,809,307	-	-	17,809,307	17,809,307

Liabilities

Bank and other loans payable	\$(41,242,032)	\$ -	\$ -	\$(41,242,032)	\$(41,242,032)
------------------------------	----------------	------	------	----------------	----------------

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

7) Fair Value of Financial Instruments (Continued)

The carrying values and estimated fair values for such financial instruments, and their corresponding placement in the fair value hierarchy, are summarized as follows as of December 31, 2015:

	Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
Assets					
Mortgage loans:					
Residential	\$44,459,613	\$ -	\$ -	\$47,193,950	\$47,193,950
Residential construction	34,751,443	-	-	34,751,443	34,751,443
Commercial	33,335,849	-	-	34,778,136	34,778,136
Mortgage loans, net	\$112,546,905	\$ -	\$ -	\$116,723,529	\$116,723,529
Policy loans	6,896,457	-	-	6,896,457	6,896,457
Insurance assignments, net	31,511,195	-	-	31,511,195	31,511,195
Short-term investments	16,915,808	-	-	16,915,808	16,915,808
Liabilities					
Bank and other loans payable	\$(40,894,968)	\$ -	\$ -	\$(40,894,968)	\$(40,894,968)

The methods, assumptions and significant valuation techniques and inputs used to estimate the fair value of financial instruments are summarized as follows:

Mortgage Loans on Real Estate: The estimated fair value of the Company's mortgage loans is determined using various methods. The Company's mortgage loans are grouped into three categories: Residential, Residential Construction and Commercial. When estimating the expected future cash flows, it is assumed that all loans will be held to maturity, and any loans that are non-performing are evaluated individually for impairment.

Residential – The estimated fair value of mortgage loans originated prior to 2013 is determined by estimating expected future cash flows of interest payments and discounting them using current interest rates from single family mortgages. The estimated fair value of mortgage loans originated in 2013 thru 2016 is determined from pricing of similar loans that were sold in 2014 and 2015

Residential Construction – These loans are primarily short in maturity (4-6 months) accordingly, the estimated fair value is determined to be the net book value.

Commercial – The estimated fair value is determined by estimating expected future cash flows of interest payments and discounting them using current interest rates for commercial mortgages.

Policy Loans and Other Investments: The carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values.

Short-Term Investments: The carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values.

Bank and Other Loans Payable: The carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values.

32

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

8) Allowance for Doubtful Accounts, Allowance for Loan Losses and Impaired Loans

The Company records an allowance and recognizes an expense for potential losses from mortgage loans, other loans and receivables in accordance with generally accepted accounting principles.

Receivables are the result of cemetery and mortuary operations, mortgage loan operations and life insurance operations. The allowance is based upon the Company's historical experience for collectively evaluated impairment. Other allowances are based upon receivables individually evaluated for impairment. Collectability of the cemetery and mortuary receivables is significantly influenced by current economic conditions. The critical issues that impact recovery of mortgage loan operations are interest rate risk, loan underwriting, new regulations and the overall economy.

The Company provides allowances for losses on its mortgage loans held for investment through an allowance for loan losses. The allowance is comprised of two components. The first component is an allowance for collectively evaluated impairment that is based upon the Company's historical experience in collecting similar receivables. The second component is based upon individual evaluation of loans that are determined to be impaired. Upon determining impairment the Company establishes an individual impairment allowance based upon an assessment of the fair value of the underlying collateral. See the schedules in Note 3 for additional information. In addition, when a mortgage loan is past due more than 90 days, the Company does not accrue any interest income. When a loan becomes delinquent, the Company proceeds to foreclose on the real estate and all expenses for foreclosure are expensed as incurred. Once foreclosed, an adjustment for the lower of cost or fair value is made, if necessary, and the amount is classified as other real estate held for investment. The Company will rent the properties until it is deemed desirable to sell them.

The allowance for losses on mortgage loans held for investment could change based on changes in the value of the underlying collateral, the performance status of the loans, or the Company's actual collection experience. The actual losses could change, in the near term, from the established allowance, based upon the occurrence or non-occurrence of these events.

9) Derivative Commitments

Interest Rate Locks and Commitments

The Company is exposed to price risk due to the potential impact of changes in interest rates on the values of mortgage loan commitments from the time a derivative loan commitment is made to an applicant to the time the loan that would result from the exercise of that loan commitment is funded. Managing price risk is complicated by the fact that the ultimate percentage of derivative loan commitments that will be exercised (i.e., the number of loan commitments that will be funded) fluctuates. The probability that a loan will not be funded within the terms of the commitment is driven by a number of factors, particularly the change, if any, in mortgage rates following the inception of the interest rate lock. However, many borrowers continue to exercise derivative loan commitments even when interest rates have fallen.

In general, the probability of funding increases if mortgage rates rise and decreases if mortgage rates fall. This is due primarily to the relative attractiveness of current mortgage rates compared to the applicant's committed rate. The probability that a loan will not be funded within the terms of the mortgage loan commitment also is influenced by the source of the applications (retail, broker or correspondent channels), proximity to rate lock expiration, purpose for the

loan (purchase or refinance) product type and the application approval status. The Company has developed fallout estimates using historical data that take into account all of the variables, as well as renegotiations of rate and point commitments that tend to occur when mortgage rates fall. These fallout estimates are used to estimate the number of loans that the Company expects to be funded within the terms of the mortgage loan commitments and are updated periodically to reflect the most current data.

The Company estimates the fair value of a mortgage loan commitment based on the change in estimated fair value of the underlying mortgage loan and the probability that the mortgage loan will fund within the terms of the commitment. The change in fair value of the underlying mortgage loan is measured from the date the mortgage loan commitment is issued. Therefore, at the time of issuance, the estimated fair value is zero. Following issuance, the value of a mortgage loan commitment can be either positive or negative depending upon the change in value of the underlying mortgage loans. Fallout rates derived from the Company's recent historical empirical data are used to estimate the quantity of mortgage loans that will fund within the terms of the commitments. The Company utilizes forward loan sales commitments to economically hedge the price risk associated with its outstanding mortgage loan commitments. A forward loan sales commitment protects the Company from losses on sales of the loans arising from exercise of the loan commitments by securing the ultimate sales price and delivery date of the loans. Management expects these derivatives will experience changes in fair value opposite to changes in fair value of the derivative loan commitments, thereby reducing earnings volatility related to the recognition in earnings of changes in the values of the commitments.

33

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

9) Derivative Commitments (Continued)Call and Put Options

The Company has adopted a strategy of selling "out of the money" call options on its available for sale equity securities as a source of revenue. The options give the purchaser the right to buy from the Company specified equity securities at a set price up to a pre-determined date in the future. The Company has adopted the selling of put options as a means of generating cash or purchasing equity securities at lower than current market prices. The Company receives an immediate payment of cash for the value of the option and establishes a liability for the fair value of the option. In the event an option is exercised, the Company recognizes a gain on the sale of the equity security and a gain from the sale of the option. If the option expires unexercised, the Company recognizes a gain from the sale of the option.

The following table shows the fair value of derivatives as of March 31, 2016 and December 31, 2015.

	Fair Value of Derivative Instruments					
	Asset Derivatives		Liability Derivatives			
	March 31, 2016	December 31, 2015	March 31, 2016	December 31, 2015		
	Balance Sheet Location	Balance Sheet Location	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:						
Interest rate lock and forward sales commitments	other assets	other assets	Other liabilities	\$422,490	Other liabilities	\$107,667
Call options	-- --	-- --	Other liabilities	63,686	Other liabilities	16,342
Put options	-- --	-- --	Other liabilities	12,102	Other liabilities	28,829
Interest rate swaps	-- --	-- --	Bank loans payable	11,210	Bank loans payable	13,947
Total	\$5,096,573	\$3,440,758		\$509,488		\$166,785

The following table shows the gain on derivatives for the periods presented. There were no gains or losses reclassified from accumulated other comprehensive income (OCI) into income or gains or losses recognized in income on derivatives ineffective portion or any amounts excluded from effective testing.

Net Amount Gain
Recognized in OCI
Three Months Ended
March 31

<u>Derivative - Cash Flow Hedging Relationships:</u>	2016	2015
Interest Rate Lock Commitments	\$1,340,992	\$2,487,891
Interest Rate Swaps	2,737	3,951
Sub Total	1,343,729	2,491,842
Tax Effect	524,055	971,819
Total	\$819,674	\$1,520,023

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

10) Reinsurance, Commitments and Contingencies

Reinsurance

Reinsurance Agreement with North America Life Insurance Company

On May 8, 2015, the Company, through its wholly owned subsidiary, Security National Life, signed a paid-up business offer under the coinsurance agreement effective December 1, 2010 to reinsure certain life insurance policies from North America Life Insurance Company ("North America Life"). Pursuant to the paid-up business offer, North America Life ceded and transferred to Security National Life all contractual obligations and risks under the coinsured policies. Security National Life paid a ceding commission to North America Life in the amount of \$281,908. As a result of the ceding commission, North America Life transferred \$8,900,282 of cash and \$9,182,190 in statutory reserves, or liabilities, to Security National Life.

Reinsurance Agreement with American Republic Insurance Company

On February 11, 2015, the Company, through its wholly owned subsidiary, Security National Life, signed a coinsurance agreement to reinsure certain life insurance policies from American Republic Insurance Company ("American Republic"). The policies were previously reinsured by North America Life under a coinsurance agreement between World Insurance Company ("World Insurance") and North America Life entered into on July 22, 2009 which was commuted. World Insurance was subsequently purchased by and merged into American Republic. The current coinsurance agreement is between Security National Life and American Republic and became effective on January 1, 2015. As part of the coinsurance agreement, American Republic transferred all contractual obligations and risks to Security National Life and Security National Life took control of \$15,004,771 of assets in a trust account held by Texas Capital Bank as the trustee.

Mortgage Loan Loss Settlements

Future loan losses can be extremely difficult to estimate. However, management believes that the Company's reserve methodology and its current practice of property preservation allow it to estimate its potential losses on loans sold. The amounts expensed for loan losses for the three months ended March 31, 2016 and 2015 were \$587,000 and \$667,000, respectively. The estimated liability for indemnification losses is included in other liabilities and accrued expenses and, as of March 31, 2016 and December 31, 2015, the balances were \$3,353,000 and \$2,806,000, respectively.

Inquiry Regarding FHA Insured Loans

SecurityNational Mortgage has been cooperating with the U.S. Department of Justice and the Office of the Inspector General for the Department of Housing and Urban Development (HUD) in a civil investigation regarding compliance with requirements relating to certain mortgage loans insured by the Federal Housing Administration (FHA). No demand has been made from FHA and SecurityNational Mortgage has not established a liability for this matter absent a specific demand because it is not able to estimate a range of reasonably potential loss due to significant uncertainties resulting from: the absence of any specific demand from FHA, the potential remedies that SecurityNational Mortgage may have, including possible defenses, and the lack of information concerning the performance of its FHA insured originations, the majority of which SecurityNational Mortgage does not service. The investigation has focused on

loans originated by SecurityNational Mortgage on or after January 1, 2006. The FHA mortgage loans that SecurityNational Mortgage originated between January 1, 2006 and May 21, 2013 total approximately 45,900 loans with an original principal balance of approximately \$7.9 billion.

Mortgage Loan Loss Litigation

For a description of the litigation involving SecurityNational Mortgage and Lehman Brothers and Aurora Loan Services, reference is to Part II, Item 1. Legal Proceedings.

35

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

10) Reinsurance, Commitments and Contingencies (Continued)

Other Contingencies and Commitments

The Company has entered into commitments to fund new residential construction loans. As of March 31, 2016, the Company's commitments were \$66,443,000 for these loans of which \$42,927,000 had been funded. The Company will advance funds once the work has been completed and an independent inspection is made. The maximum loan commitment ranges between 50% and 80% of appraised value. The Company receives fees from the borrowers and the interest rate is generally 2% to 6.75% over the bank prime rate (3.50% as of March 31, 2016). Maturities range between six and twelve months.

The Company belongs to a captive insurance group for certain casualty insurance, worker compensation and liability programs. Insurance reserves are maintained relative to these programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the insurance liabilities and related reserves, the captive insurance management considers a number of factors, which include historical claims experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. If actual claims or adverse development of loss reserves occurs and exceed these estimates, additional reserves may be required. The estimation process contains uncertainty since captive insurance management must use judgment to estimate the ultimate cost that will be incurred to settle reported claims and unreported claims for incidents incurred but not reported as of the balance sheet date. At March 31, 2016, \$261,168 of reserves was established related to such insurance programs versus \$834,855 at December 31, 2015.

The Company is a defendant in various other legal actions arising from the normal conduct of business. Management believes that none of the actions will have a material effect on the Company's financial position or results of operations. Based on management's assessment and legal counsel's representations concerning the likelihood of unfavorable outcomes, no amounts have been accrued for the above claims in the consolidated financial statements.

The Company is not a party to any other material legal proceedings outside the ordinary course of business or to any other legal proceedings, which, if adversely determined, would have a material adverse effect on its financial condition or results of operations.

36

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2016 (Unaudited)

11) Mortgage Servicing Rights

The following is a summary of the MSR activity for the periods presented.

	As of March 31 2016	As of December 31 2015
Amortized cost:		
Balance before valuation allowance at beginning of year	\$ 12,679,755	\$ 7,834,747
MSRs proceeds from loan sales	1,499,786	6,217,551
Amortization	(491,179)	(1,372,543)
Application of valuation allowance to write down MSR with other than temporary impairment	-	-
Balance before valuation allowance at year end	\$ 13,688,362	\$ 12,679,755
Valuation allowance for impairment of MSRs:		
Balance at beginning of year	\$-	\$-
Additions	-	-
Application of valuation allowance to write down MSR with other than temporary impairment	-	-
Balance at end of period	\$-	\$-
Mortgage servicing rights, net	\$ 13,688,362	\$ 12,679,755
Estimated fair value of MSRs at end of period	\$ 14,354,525	\$ 13,897,160

The Company reports these MSRs pursuant to the accounting policy discussed in Note 7.

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

Overview

The Company's operations over the last several years generally reflect three trends or events which the Company expects to continue: (i) increased attention to "niche" insurance products, such as the Company's funeral plan policies and traditional whole life products; (ii) emphasis on cemetery and mortuary business; and (iii) capitalizing on relatively low interest rates by originating mortgage loans.

Insurance Operations

The Company's insurance business includes funeral plans, interest sensitive life insurance, as well as other traditional life and accident insurance, and health insurance products. The Company places specific marketing emphasis on funeral plans through pre-need planning.

A funeral plan is a small face value life insurance policy that generally has face coverage of up to \$25,000. The Company believes that funeral plans represent a marketing niche that has less competition because most insurance companies do not offer similar coverage. The purpose of the funeral plan policy is to pay the costs and expenses incurred at the time of the person's death. On a per thousand dollar cost of insurance basis, these policies can be more expensive to the policy holder than many types of non-burial insurance due to their low face amount, requiring the fixed cost of the policy administration to be distributed over a smaller policy size, and the simplified underwriting practices that result in higher mortality costs.

The following table shows the condensed financial results of the insurance operations for the three months ended March 31, 2016 and 2015. See Note 6 to the Condensed Consolidated Financial Statements.

	Three months ended March 31			
	(in thousands of dollars)			
	2016	2015	% Increase (Decrease)	
Revenues from external customers				
Insurance premiums	\$ 14,452	\$ 13,854	4	%
Net investment income	6,963	6,211	12	%
Income from loan originations	472	441	7	%
Other	188	480	(61)	(%)
Total	\$22,075	\$20,986	5	%
Intersegment revenue	\$3,103	\$2,819	10	%
Earnings before income taxes	\$ 1,065	\$ 1,404	(24)	(%)

Intersegment revenues are primarily interest income from the warehouse line provided to SecurityNational Mortgage Company. Profitability in the three months ended March 31, 2016 has decreased due to an increase in selling, general and administrative expenses, a decrease in realized gains on investments and other assets, offset by an increase in net investment income and an increase in insurance premiums.

Stock Purchase Agreement

Execution of Stock Purchase Agreement to Acquire First Guaranty Insurance Company

On March 5, 2016, the Company, through its wholly owned subsidiary, Security National Life entered into a stock purchase agreement with the shareholders of Reppond Holding Corporation, an Arkansas corporation ("Reppond Holding") and sole shareholder of First Guaranty Insurance Company, a Louisiana domestic stock legal reserve life insurance company ("First Guaranty"), to purchase all the outstanding shares of common stock of Reppond Holding. Under the terms of the stock purchase agreement, Security National Life will pay a total of \$6,753,000 to the shareholders of Reppond Holding in consideration for the purchase of all of their shares of stock of Reppond Holding, representing all of the outstanding shares of common stock of First Guaranty.

Cemetery and Mortuary Operations

The Company sells mortuary services and products through its seven mortuaries in Salt Lake City, Utah. The Company also sells cemetery products and services through its five cemeteries in Salt Lake City, Utah and one cemetery in San Diego County, California. Cemetery land sales and at-need product sales and services are recognized as revenue at the time of sale or when the services are performed. Pre-need cemetery product sales are deferred until the merchandise is delivered and services performed.

38

The following table shows the condensed financial results of the Cemetery and Mortuary operations for the three months ended March 31, 2016 and 2015. See Note 6 to the Condensed Consolidated Financial Statements.

	Three months ended March 31 (in thousands of dollars)			
	2016	2015	% Increase (Decrease)	
Revenues from external customers				
Mortuary revenues	\$1,366	\$1,242	10	%
Cemetery revenues	2,019	1,754	15	%
Other	(54)	102	(153	%)
Total	\$3,331	\$3,098	8	%
Earnings (loss) before income taxes	\$469	\$409	15	%

Included in other revenue is rental income from residential and commercial properties purchased from Security National Life. Memorial Estates purchased these properties from financing provided by Security National Life. The rental income is offset by property insurance, taxes, maintenance expenses and interest payments made to Security National Life. Memorial Estates has recorded depreciation on these properties of \$187,000 and \$222,000 for the three months ended March 31, 2016 and 2015, respectively.

Mortgage Operations

Overview

The Company's wholly owned subsidiaries, SecurityNational Mortgage Company and EverLEND Mortgage Company (formerly known as Green Street Mortgage Services, Inc.), are mortgage lenders incorporated under the laws of the State of Utah and approved and regulated by the Federal Housing Administration (FHA), a department of the U.S. Department of Housing and Urban Development (HUD), to originate mortgage loans that qualify for government insurance in the event of default by the borrower. SecurityNational Mortgage and EverLEND Mortgage obtain mortgage loans originated in retail offices and through independent brokers. Mortgage loans originated by the Company's mortgage subsidiaries are funded through loan purchase agreements from Security National Life and unaffiliated financial institutions.

The Company's mortgage subsidiaries receive fees from the borrowers and secondary fees from third party investors that purchase their loans. Loans originated by SecurityNational Mortgage are generally sold with mortgage servicing rights released to third party investors or retained by SecurityNational Mortgage. SecurityNational Mortgage currently retains the mortgage servicing rights on approximately 30% of its loan origination volume. These loans are serviced by an approved third party sub-servicer.

For the three months ended March 31, 2016 and 2015, SecurityNational Mortgage originated and sold 3,139 loans (\$586,580,000 total volume) and 3,275 loans (\$640,119,000 total volume), respectively. For the three months ended March 31, 2016 and 2015, EverLEND Mortgage originated and sold -0- loans (\$-0- total volume) and 78 loans (\$17,750,000 total volume), respectively.

The following table shows the condensed financial results of the mortgage operations for the three months ended March 31, 2016 and 2015. See Note 6 to the Condensed Consolidated Financial Statements.

	Three months ended March 31 (in thousands of dollars)			
	2016	2015		% Increase (Decrease)
Revenues from external customers				
Income from loan originations	\$33,353	\$34,256	(3	%)
Secondary gains from investors	7,255	5,710	27	%)
Total	\$40,608	\$39,966	2	%)
Earnings before income taxes	\$1,317	\$1,185	11	%)

The increase in earnings for the three months ended March 31, 2016 was due to higher secondary gains on mortgage loans sold to investors.

Mortgage Loan Loss Settlements

Future loan losses can be extremely difficult to estimate. However, management believes that the Company's reserve methodology and its current practice of property preservation allow it to estimate its potential losses on loans sold. The amounts expensed for loan losses for the three months ended March 31, 2016 and 2015 were \$587,000 and \$667,000, respectively. The estimated liability for indemnification losses is included in other liabilities and accrued expenses and, as of March 31, 2016 and December 31, 2015, the balances were \$3,353,000 and \$2,806,000, respectively.

Mortgage Loan Loss Demands

Inquiry Regarding FHA Insured Loans

SecurityNational Mortgage has been cooperating with the U.S. Department of Justice and the Office of the Inspector General for the Department of Housing and Urban Development (HUD) in a civil investigation regarding compliance with requirements relating to certain mortgage loans insured by the Federal Housing Administration (FHA). No demand has been made from FHA and SecurityNational Mortgage has not established a liability for this matter absent a specific demand because it is not able to estimate a range of reasonably potential loss due to significant uncertainties resulting from: the absence of any specific demand from FHA, the potential remedies that SecurityNational Mortgage may have, including possible defenses, and the lack of information concerning the performance of its FHA insured originations, the majority of which SecurityNational Mortgage does not service. The investigation has focused on loans originated by SecurityNational Mortgage on or after January 1, 2006. The FHA mortgage loans that SecurityNational Mortgage originated between January 1, 2006 and May 21, 2013 totaled approximately 45,900 loans with an original principal balance of approximately \$7.9 billion.

Mortgage Loan Loss Litigation

For a description of the litigation involving SecurityNational Mortgage and Lehman Brothers and Aurora Loan Services, reference is to Part I, Item 3. Legal Proceedings.

Consolidation

Three Months Ended March 31, 2016 Compared to Three Months Ended March 31, 2015

Total revenues increased by \$1,964,000, or 3.1%, to \$66,014,000 for the three months ended March 31, 2016, from \$64,050,000 for the comparable period in 2015. Contributing to this increase in total revenues was a \$1,169,000 increase in net investment income, a \$598,000 increase in insurance premiums and other considerations, a \$374,000 increase in net mortuary and cemetery sales, and a \$215,000 increase in other revenues. This increase in total revenues was partially offset by a \$322,000 decrease in realized gains on investments and other assets, a \$52,000 decrease in mortgage fee income, and an \$18,000 increase in other than temporary impairments on investments.

Insurance premiums and other considerations increased by \$598,000, or 4.3%, to \$14,452,000 for the three months ended March 31, 2016, from \$13,854,000 for the comparable period in 2015. This increase was primarily due to an increase in renewal premiums and an increase in first year premiums as a result of increased insurance sales.

Net investment income increased by \$1,169,000, or 14.9%, to \$8,992,000 for the three months ended March 31, 2016, from \$7,823,000 for the comparable period in 2015. This increase was primarily attributable to a \$718,000 increase in rental income from real estate owned, a \$352,000 increase in short-term investment income, a \$316,000 increase in insurance assignment income, a \$152,000 increase in mortgage loan interest, a \$70,000 increase in fixed maturity securities income, and a \$12,000 increase in equity securities income. This increase was partially offset by a \$444,000 increase in investment expenses and a \$6,000 decrease in policy loan income.

Net mortuary and cemetery sales increased by \$374,000, or 13.0%, to \$3,246,000 for the three months ended March 31, 2016, from \$2,872,000 for the comparable period in 2015. This increase was primarily due to an increase in

at-need sales and pre-need sales in both the cemetery and mortuary operations.

Realized gains on investments and other assets decreased by \$322,000, or 76.7%, to \$98,000 in realized gains for the three months ended March 31, 2016, from \$420,000 in realized gains for the comparable period in 2015. This decrease in realized gains on investments and other assets was primarily attributable to a \$174,000 decrease in realized gains on other assets, a \$101,000 decrease in realized gains on fixed maturity securities, and a \$47,000 decrease in realized gains on securities available for sale.

Other revenues increased by \$215,000, or 16.4%, to \$1,530,000 for the three months ended March 31, 2016, from \$1,315,000 for the comparable period in 2015. This increase was due to an increase in mortgage servicing fees.

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Total benefits and expenses were \$63,164,000, or 95.7% of total revenues, for the three months ended March 31, 2016, as compared to \$61,051,000, or 95.3% of total revenues, for the comparable period in 2015.

Death benefits, surrenders and other policy benefits, and future policy benefits decreased by an aggregate of \$259,000 or 2.0%, to \$12,503,000 for the three months ended March 31, 2016, from \$12,762,000 for the comparable period in 2015. This decrease was primarily the result of a \$135,000 decrease in surrender and other policy benefits, a \$104,000 decrease in death benefits, and a \$20,000 decrease in future policy benefits.

Amortization of deferred policy and pre-need acquisition costs and value of business acquired increased by \$1,045,000, or 89.5%, to \$2,213,000 for the three months ended March 31, 2016, from \$1,168,000 for the comparable period in 2015. This increase was primarily due to an increase in insurance sales expenses.

Selling, general and administrative expenses increased by \$1,246,000, or 2.7%, to \$46,925,000 for the three months ended March 31, 2016, from \$45,679,000 for the comparable period in 2015. This increase was primarily the result of a \$2,884,000 increase in personnel expenses, resulting from increased salaries for existing employees and the hiring of new employees, a \$395,000 increase in other expenses, and a \$179,000 increase in rent and rent related expenses. This increase was partially offset by a \$1,724,000 decrease in commissions, a \$338,000 decrease in advertising, an \$80,000 decrease in provision for loan losses and loan loss reserve, a \$41,000 decrease in depreciation on property and equipment, and a \$29,000 decrease in costs related to funding mortgage loans.

Interest expense increased by \$79,000, or 8.0%, to \$1,064,000 for the three months ended March 31, 2016, from \$985,000 for the comparable period in 2015. This increase was primarily due to the completion of the Dry Creek at East Village Apartments development in December 2015, resulting from interest from the bank loan that had been capitalized during the construction phase of each building and now being expensed.

Comprehensive income for the three months ended March 31, 2016 and 2015 amounted to gains of \$2,911,000 and \$3,155,000, respectively. This \$244,000 decrease in comprehensive income was primarily the result of a \$700,000 decrease in derivatives related to mortgage loans, and a \$70,000 decrease in net income. This decrease was partially offset by a \$526,000 increase in unrealized gains in securities available for sale.

Liquidity and Capital Resources

The Company's life insurance subsidiaries and cemetery and mortuary subsidiaries realize cash flow from premiums, contract payments and sales on personal services rendered for cemetery and mortuary business, from interest and dividends on invested assets, and from the proceeds from the maturity of held to maturity investments or sale of other investments. The mortgage subsidiaries realize cash flow from fees generated by originating and refinancing mortgage loans and interest earned on mortgages sold to investors. The Company considers these sources of cash flow to be adequate to fund future policyholder and cemetery and mortuary liabilities, which generally are long-term, and adequate to pay current policyholder claims, annuity payments, expenses related to the issuance of new policies, the maintenance of existing policies, debt service, and to meet current operating expenses.

During the three months ended March 31, 2016, the Company's operations provided cash of \$25,863,000. This was due primarily to a \$21,993,000 decrease in the balance of mortgage loans sold to investors. During the three months ended March 31, 2015, the Company's operations provided cash of \$712,000. This was due primarily to a \$7,774,000 increase in the balance of mortgage loans sold to investors and a \$4,336,000 increase in future policy benefits.

The Company's liability for future life, annuity and other benefits is expected to be paid out over the long-term due to the Company's market niche of selling funeral plans. Funeral plans are small face value life insurance that will pay the costs and expenses incurred at the time of a person's death. A person generally will keep these policies in force and will not surrender them prior to a person's death. Because of the long-term nature of these liabilities, the Company is

able to hold to maturity its bonds, real estate and mortgage loans, thus reducing the risk of liquidating these long-term investments as a result of any sudden changes in fair values.

The Company attempts to match the duration of invested assets with its policyholder and cemetery and mortuary liabilities. The Company may sell investments other than those held to maturity in the portfolio to help in this timing. The Company purchases short-term investments on a temporary basis to meet the expectations of short-term requirements of the Company's products. The Company's investment philosophy is intended to provide a rate of return that will persist during the expected duration of policyholder and cemetery and mortuary liabilities regardless of future interest rate movements.

The Company's investment policy is to invest predominantly in fixed maturity securities, real estate, mortgage loans, and warehousing of mortgage loans on a short-term basis before selling the loans to investors in accordance with the requirements and laws governing the life insurance subsidiaries. Bonds owned by the insurance subsidiaries amounted to \$146,834,000 and \$144,946,000 as of March 31, 2016 and December 31, 2015, respectively. This represents 34.1% and 35.8% of the total investments as of March 31, 2016 and December 31, 2015, respectively. Generally, all bonds owned by the life insurance subsidiaries are rated by the National Association of Insurance Commissioners (NAIC). Under this rating system, there are six categories used for rating bonds. At March 31, 2016, 9.98% (or \$14,655,000) and at December 31, 2015, 8.3% (or \$11,990,000) of the Company's total bond investments were invested in bonds in rating categories three through six, which were considered non investment grade.

The Company has classified certain of its fixed income securities, including high-yield securities, in its portfolio as available for sale, with the remainder classified as held to maturity. In accordance with Company policy, however, any such securities purchased in the future will be classified as held to maturity. Notwithstanding, business conditions may develop in the future which may indicate a need for a higher level of liquidity in the investment portfolio. In that event, the Company believes it could sell short-term investment grade securities before liquidating higher yielding longer-term securities.

The Company is subject to risk based capital guidelines established by statutory regulators requiring minimum capital levels based on the perceived risk of assets, liabilities, disintermediation, and business risk. At March 31, 2016 and December 31, 2015, the life insurance subsidiary was in compliance with the regulatory criteria.

The Company's total capitalization of stockholders' equity, bank debt and notes payable was \$155,841,000 as of March 31, 2016, as compared to \$152,154,000 as of December 31, 2015. Stockholders' equity as a percent of total capitalization was 73.5% and 73.1% as of March 31, 2016 and December 31, 2015, respectively.

Lapse rates measure the amount of insurance terminated during a particular period. The Company's lapse rate for life insurance in 2015 was 7.4% as compared to a rate of 7.0% for 2014. The 2016 lapse rate to date has been approximately the same as 2015.

At March 31, 2016, \$35,925,000 of the Company's consolidated stockholders' equity represented the statutory stockholders' equity of the Company's life insurance subsidiaries. The life insurance subsidiaries cannot pay a dividend to the Company, its parent company, without approval of state insurance regulatory authorities.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There have been no significant changes since the Annual Report on Form 10-K filed for the year ended December 31, 2015.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

As of March 31, 2016, the Company carried out an evaluation, under the supervision and with the participation of its Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed in the Securities and Exchange Commission (SEC) reports the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time period specified by the SEC's rules and forms and that such information is accumulated and communicated to management, including the Company's CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. The officers have concluded that the Company's disclosure controls and procedures were effective as of March 31, 2016, and that the unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q fairly present, in all material respects, the Company's financial condition, results of operations and cash flows for the periods presented in conformity with United States Generally Accepted Accounting Principles (GAAP).

Changes in Internal Control over Financial Reporting

There have been no changes in the Company's internal control over financial reporting during the most recently completed fiscal quarter 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.

Lehman Brothers and Aurora Loan Services Litigation - Utah

On April 15, 2005, SecurityNational Mortgage entered into a Loan Purchase Agreement with Lehman Brothers Bank, FSB ("Lehman Bank"), which agreement incorporated a Seller's Guide. Pursuant to the Loan Purchase Agreement, Lehman Bank purchased mortgage loans from time to time from SecurityNational Mortgage. Lehman Bank asserted that certain of the mortgage loans that it purchased several years ago from SecurityNational Mortgage contained alleged misrepresentations and early payment defaults. As a result, Lehman Bank contended it had the right to require SecurityNational Mortgage to repurchase certain loans or be liable for losses related to such Loans under the Loan Purchase Agreement. SecurityNational Mortgage disagreed with these claims.

On December 17, 2007, SecurityNational Mortgage entered into an Indemnification Agreement with Lehman Bank and Aurora Loan Services. Under the terms of the Indemnification Agreement, SecurityNational Mortgage agreed to indemnify Lehman Bank and Aurora Loan Services for 75% of actual losses, as defined, that Lehman Bank and Aurora Loan Services may incur on account of the breaches pertaining to certain identified loans. The Indemnification Agreement also required SecurityNational Mortgage to indemnify Lehman Bank and Aurora Loan Services for 100% of any future actual losses, as defined, incurred on mortgage loans with breaches not covered by the 75% provision. A reserve account was set up for covering said losses.

In addition to initial payments into the reserve account, SecurityNational Mortgage was to pay to Aurora Loan Services each calendar month the difference between the reserve account balance and \$645,000, but in no event would SecurityNational Mortgage be required to make payments into the reserve account in excess of \$125,000 for any calendar month. Since the time the reserve account was established, approximately \$4,300,000 was taken from the reserve account to indemnify Lehman Bank and Aurora Loan Services for alleged losses. On March 28, 2011 Lehman Bank and Aurora Loan Services assigned certain rights and remedies under the Indemnification Agreement to Lehman Brothers Holdings Inc. ("Lehman Holdings").

On May 11, 2011, SecurityNational Mortgage filed a complaint against Aurora Bank FSB (formerly known as Lehman Bank) and Aurora Loan Services in the United States District Court, Utah, which was assigned to Judge David Nuffer. The allegations in the complaint include breach of the Indemnification Agreement. SecurityNational Mortgage claimed it was entitled to a judgment of approximately \$4,000,000 against Lehman Bank, as well as Aurora Loan Services to the extent of its involvement, for payments which should not have been taken from the reserve account.

On June 8, 2011, Lehman Holdings, which had filed for bankruptcy in September 2008, filed a complaint in the United States District Court, Utah against SecurityNational Mortgage. The case was assigned to Judge Ted Stewart. The complaint alleged claims for damages for breach of contract and breach of warranty pursuant to the Loan Purchase Agreement, and initially claimed damages in excess of \$5,000,000. Lehman Holdings further alleged that Lehman Bank sold mortgage loans to it and assigned the contractual rights. SecurityNational Mortgage strongly disagreed with the claims in Lehman Holdings' complaint.

Discovery was completed in the two foregoing lawsuits. On December 24, 2014, Judge Nuffer issued an amended order granting SecurityNational Mortgage's motion for summary judgment against Lehman Bank and Aurora Loan Services for \$3,892,974, plus prejudgment interest at 9% per annum. The total amount of prejudgment interest awarded was \$1,674,240 through May 31, 2014, with a per diem of \$960 for each day after May 31, 2014 until final judgment. The court also indicated that further replenishment of the reserve account under the Indemnification Agreement appeared to be barred by a waiver, but that this issue had not been briefed.

Additionally, the court stated that the offset that Lehman Bank and Aurora Loan Services pled as an affirmative defense had not yet been adjudicated by the court. SecurityNational Mortgage asserts that Lehman Bank and Aurora Loan Services have no rights to a replenishment of the Indemnification Agreement reserve account, or for any offset. On March 30, 2015, SecurityNational Mortgage filed a response in opposition to the partial summary judgment motion of Lehman Bank and Aurora Loan Services concerning the reserve account replenishment and offset; SecurityNational Mortgage also filed its own partial summary judgment motion on the same issues. These motions are currently under advisement.

On April 21, 2015, Judge Stewart issued a memorandum decision and order denying SecurityNational Mortgage's motion for summary judgment against Lehman Holdings in the Lehman Holdings case. On January 16, 2015, SecurityNational Mortgage filed a separate motion for summary judgment against Lehman Holdings based on the statute of limitations. Because certain cases that arose in Colorado were pending before the United States Court of Appeals for the Tenth Circuit concerning statute of limitations issues involving Lehman Holdings, Judge Stewart inquired at a hearing as to whether his ruling on SecurityNational Mortgage's motion should be held in abeyance until a ruling is rendered by the Tenth Circuit. The parties agreed to an abeyance and Judge Stewart issued an order on May 11, 2015 postponing his ruling.

43

On January 27, 2016, the Tenth Circuit entered its order and judgment concerning the five cases before it upholding rulings of the U.S. District Court, Colorado dismissing the cases filed by Lehman Holdings with prejudice. Pursuant to an order from Judge Stewart, SecurityNational Mortgage and Lehman Holdings filed supplemental briefs on March 3, 2016 pertaining to SecurityNational Mortgage's summary judgment motion in view of the ruling of the Tenth Circuit. On March 23, 2016, the court denied SecurityNational Mortgage's motion based on a certain tolling provision in one of the agreements.

Lehman Brothers Litigation – Delaware and New York

In January 2014, Lehman Holdings entered into a settlement with the Federal National Mortgage Association (Fannie Mae) concerning the mortgage loan claims asserted by Fannie Mae against Lehman Holdings that were allegedly based on breaches of certain representations and warranties by Lehman Holdings. Lehman Holdings had acquired these loans from Lehman Bank, which in turn purchased the loans from residential mortgage loan originators, including SecurityNational Mortgage. A settlement based on similar circumstances was entered into between Lehman Holdings and the Federal Home Loan Mortgage Corporation (Freddie Mac) in February 2014. As a result of the Fannie Mae and Freddie Mac settlements, Lehman Holdings filed a motion in May 2014 with the U.S. Bankruptcy Court of the Southern District of New York to require the mortgage loan originators, including SecurityNational Mortgage, to engage in mediation, a nonbinding alternative dispute resolution process, as Lehman Holdings asserted alleged indemnification claims against the mortgage loan originators.

The mediation was not successful in resolving the potential issues between SecurityNational Mortgage and Lehman Holdings relative to the Fannie Mae and Freddie Mac settlements with Lehman Holdings. On January 26, 2016, SecurityNational Mortgage filed a declaratory judgment action against Lehman Holdings in the Superior Court for the State of Delaware. In the Delaware action, SecurityNational Mortgage asserted its right to obtain a declaration of rights in that there is allegedly millions of dollars in dispute with Lehman Holdings pertaining to approximately 136 loans. SecurityNational Mortgage seeks declaratory judgment as to its rights as it contends that it has no liability to Lehman Holdings as a result of Lehman Holdings' settlements with Fannie Mae and Freddie Mac.

On February 3, 2016, Lehman Holdings filed an adversary proceeding against approximately 150 parties, including SecurityNational Mortgage, in the U.S. Bankruptcy Court of the Southern District of New York seeking a declaration of rights similar in nature to the declaration of rights that SecurityNational Mortgage seeks in its Delaware lawsuit, and for damages relating to the defendants' obligations under indemnification provisions of the alleged agreements in an amount to be determined at trial, including interest, and attorneys' fees and related costs incurred by Lehman Holdings in enforcing the obligations of the defendants. The complaint filed on February 3, 2016 was not served on SecurityNational Mortgage and an amended complaint materially similar to the original complaint was filed March 7, 2016. As with SecurityNational Mortgage's Delaware action, and although SecurityNational Mortgage has not yet filed a response to the amended complaint, SecurityNational Mortgage denies that it has any liability to Lehman Holdings and intends to vigorously protect and defend such position.

The Company is not a party to any other material legal proceedings outside the ordinary course of business or to any other legal proceedings, which if adversely determined, would have a material adverse effect on its financial condition or results of operation.

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.

The Company's Board of Directors appointed Stephen C. Johnson to serve as the Company's Vice President of Mortgage Operations and the President of SecurityNational Mortgage, effective January 1, 2016. Mr. Johnson replaces J. Lynn Beckstead, Jr. who has served as the Company's Vice President of Mortgage Operations since 2003 and President of SecurityNational Mortgage since 1993. Mr. Beckstead's retirement was effective December 31, 2015, at which time he also retired as a director of the Company and a director of SecurityNational Mortgage. Mr. Beckstead served as a director of the Company since 2002 and a director of SecurityNational Mortgage since 1993.

Item 6. Exhibits, Financial Statements Schedules and Reports on Form 8-K.

(a)(1) Financial Statements

See "Table of Contents – Part I – Financial Information" under page 2 above

(a)(2) Financial Statement Schedules

None

All other schedules to the consolidated financial statements required by Article 7 of Regulation S X are not required under the related instructions or are inapplicable and therefore have been omitted.

(a)(3) Exhibits

The following Exhibits are filed herewith pursuant to Rule 601 of Regulation S K or are incorporated by reference to previous filings.

- 3.1 Articles of Restatement of Articles of Incorporation (3)
- 3.2 Amended Bylaws (5)
- 4.1 Specimen Class A Stock Certificate (1)
- 4.2 Specimen Class C Stock Certificate (1)
- 4.3 Specimen Preferred Stock Certificate and Certificate of Designation of Preferred Stock (1)
- 10.1 Restated and Amended Employee Stock Ownership Plan and Trust Agreement (1)
- 10.2 2003 Stock Option Plan (4)
- 10.3 2006 Director Stock Option Plan (7)
- 10.4 2013 Stock Option Plan (10)
- 10.5 Amended and Restated 2013 Stock Option Plan
- 10.6 2014 Director Stock Option Plan (12)
- 10.7 Deferred Compensation Plan (2)
- 10.8 Employment agreement with J. Lynn Beckstead, Jr. (6)
- 10.9 Employment agreement with Scott M. Quist (14)
- 10.10 Indemnification Agreement among SecurityNational Mortgage Company, Lehman Brothers Bank, and Aurora Loan Services (8)
- 10.11 Agreement and Plan of Reorganization among Security National Financial Corporation and certain subsidiaries (9)
- 10.12 Purchase Agreement among Security National Financial Corporation, SNFC Subsidiary, LLC, American Funeral Financial, LLC, and Hypershop, LLC (11)
- 21 Subsidiaries of the Registrant
- 23.1 Consent of Eide Bailly LLP (13)
- 23.2 Consent of Mackey Price & Mecham (13)
- 31.1 Certification pursuant to 18 U.S.C. Section 1350, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification pursuant to 18 U.S.C. Section 1350, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101.xml Instance Document
- 101.xsd Taxonomy Extension Schema Document
- 101.cal Taxonomy Extension Calculation Linkbase Document
- 101.def Taxonomy Extension Definition Linkbase Document
- 101.lab Taxonomy Extension Label Linkbase Document
- 101.pre Taxonomy Extension Presentation Linkbase Document

46

- (1) Incorporated by reference from Registration Statement on Form S-1, as filed on September 29, 1987
- (2) Incorporated by reference from Annual Report on Form 10-K, as filed on April 3, 2002
- (3) Incorporated by reference from Report on Form 8-K/A, as filed on January 8, 2003
- (4) Incorporated by reference from Schedule 14A Definitive Proxy Statement, as filed on September 5, 2003, relating to the Company's Annual Meeting of Stockholders
- (5) Incorporated by reference from Report on Form 10-Q, as filed on November 14, 2003
- (6) Incorporated by reference from Report on Form 10-K, as filed on March 30, 2004
- (7) Incorporated by reference from Schedule 14A Definitive Proxy Statement, as filed on June 1, 2007, relating to the Company's Annual Meeting of Stockholders
- (8) Incorporated by reference from Report on Form 10-K, as filed on March 31, 2009
- (9) Incorporated by reference from Report on Form 10-Q, as filed on November 13, 2013
- (10) Incorporated by reference from Schedule 14A Definitive Proxy Statement, as filed on June 5, 2013, relating to the Company's Annual Meeting of Stockholders
- (11) Incorporated by reference from Report on Form 8-K, as filed on June 13, 2014
- (12) Incorporated by reference from Schedule 14A Definitive Proxy Statement, as filed on June 2, 2014, related to Company's Annual Meeting of Stockholders
- (13) Incorporated by reference from Registration Statement on Form S-8, as filed on October 20, 2015.
- (14) Incorporated by reference from Report on Form 10-Q, as filed on November 13, 2015.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

REGISTRANT

SECURITY NATIONAL FINANCIAL CORPORATION

Registrant

Dated: May 16, 2016 /s/ Scott M. Quist
Scott M. Quist
Chairman of the Board, President and Chief Executive Officer
(Principal Executive Officer)

Dated: May 16, 2016 /s/ Garrett S. Sill
Garrett S. Sill
Chief Financial Officer and Treasurer
(Principal Financial Officer and Principal Accounting Officer)