

# **NLV Financial Corporation and Subsidiaries**

**Financial Results and Managements Discussion of Results of Operations  
Third Quarter 2009**

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**Index**

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## NLV FINANCIAL CORPORATION AND SUBSIDIARIES

### Basis of Presentation

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NLV Financial Corporation and Subsidiaries (“NLVF”) offers life insurance, annuity and mutual fund products through its wholly owned subsidiaries, National Life Insurance Company (“NLIC”), Life Insurance Company of the Southwest (“LSW”) and Sentinel Investments (“Sentinel”). The company’s principal insurance product lines include whole life, term life, universal life, indexed universal life, variable universal life, fixed annuities, indexed annuities and variable annuities. The company also offers mutual fund products through Sentinel.

Our target market is small business owners, professionals and middle to upper income individuals, including a strong presence in the 403(b) qualified tax deferred retirement savings market, with a particular emphasis on the K-12 teacher segment of that market.

We distribute our products through a network of over 9,000 independent agents, a career agency distribution system comprised of over 500 agents, and a number of affiliated and unaffiliated broker/dealers.

The following NLVF unaudited consolidated financial information represents the financial position as of September 30, 2009 and December 31, 2008 and the results of operations for the nine month periods ending September 30, 2009 and 2008. The NLVF unaudited consolidated financial information has been prepared under accounting principles generally accepted in the United States of America. The NLVF unaudited consolidated financial information should be read in conjunction with the audited consolidated NLVF financial statements as of and for the years ended December 31, 2008 and 2007.

The preparation of financial information requires management to make estimates and assumptions that impact the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the statutory financial statements, and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates include those used in determining the carrying values of investments, the liability for policyholders’ reserves and deposit-type contracts, the amount of mortgage loan investment valuation reserves, real estate held for sale, other-than-temporary impairments and the liability for taxes. Future events including, but not limited to, changes in the levels of mortality, morbidity, interest rates, persistency and asset valuations and defaults, could cause actual results to differ from the estimates used in the financial statements. Although some variability is inherent in these estimates, management believes the amounts presented are appropriate.

The results of past accounting periods are not necessarily indicative of the results to be expected in future periods.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**Consolidated Balance Sheets**

<i>(In Thousands)</i>	As of September 30, 2009	As of December 31, 2008
<b>Assets:</b>	<b>(Unaudited)</b>	
Cash and investments:		
Available-for-sale debt securities	\$ 11,245,193	\$ 9,036,202
Available-for-sale debt securities on loan	134,757	119,254
Total available-for-sale debt securities	11,379,950	9,155,456
Available-for-sale equity securities	94,540	86,908
Trading equity securities	18,391	15,714
Mortgage loans on real estate	1,602,954	1,676,877
Policy loans	713,126	719,251
Real estate investments	24,916	15,653
Securities lending invested collateral	55,121	81,440
Other invested assets	868,904	367,900
Cash and short term investments	464,047	147,987
Total cash and investments	15,221,949	12,267,186
Deferred policy acquisition costs	1,031,138	1,414,078
Accrued investment income	168,375	147,640
Premiums and fees receivable	10,121	23,774
Deferred income taxes	29,601	229,216
Amounts recoverable from reinsurers	149,991	142,775
Present value of future profits of insurance acquired	33,961	37,775
Property and equipment, net	51,441	50,912
Federal income tax recoverable	-	31,324
Other assets	208,445	199,715
Goodwill and intangibles	53,861	56,178
Separate account assets	684,406	609,236
<b>Total assets</b>	<b>\$ 17,643,289</b>	<b>\$ 15,209,809</b>
<b>Liabilities:</b>		
Policy liabilities:		
Policy benefit liabilities	\$ 4,615,107	\$ 4,670,993
Policyholder account liabilities	8,866,198	7,817,806
Policyholders' deposits	73,666	65,321
Policy claims payable	46,165	47,269
Policyholders' dividends	191,074	51,352
Total policy liabilities	13,792,210	12,652,741
Amounts payable to reinsurers	31,056	17,419
Securities lending payable	138,018	121,695
Other liabilities and accrued expenses	750,161	236,002
Federal income tax payable	4,673	-
Pension and other post-retirement benefit obligations	211,511	217,421
Debt	487,829	294,747
Separate account liabilities	684,406	609,236
<b>Total liabilities</b>	<b>16,099,864</b>	<b>14,149,261</b>
<b>Stockholder's Equity:</b>		
Class A common stock, 2,000 shares authorized, no shares issued and outstanding	-	-
Class B common stock, par value of \$0.01, 1,001 shares authorized, 100 shares issued and outstanding	-	-
Preferred stock, 500 shares authorized, no shares issued and outstanding	-	-
Retained earnings	1,549,546	1,483,880
Accumulated other comprehensive income (deficit)	(6,121)	(423,332)
<b>Total stockholder's equity</b>	<b>1,543,425</b>	<b>1,060,548</b>
<b>Total liabilities and stockholder's equity</b>	<b>\$ 17,643,289</b>	<b>\$ 15,209,809</b>

*These financial statements do not include the proper disclosures to be in compliance with GAAP.*

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**Consolidated Statements of Operations (unaudited)**

**For the nine months ended September 30,**

*(In Thousands)*

	<b>2009</b>	<b>2008</b>
<b>Revenues:</b>		
Insurance premiums	\$ 205,737	\$ 216,993
Policy and contract charges	169,870	153,704
Net investment income	687,547	421,512
Net realized investment gains (losses)	11,294	(68,140)
Change in value of trading equity securities	3,023	(4,093)
Mutual fund commissions and fee income	66,388	76,594
Other income	11,224	14,552
<b>Total revenues</b>	<b>1,155,083</b>	<b>811,122</b>
<b>Benefits and Expenses:</b>		
(Decrease) increase in policy liabilities	(27,088)	21,060
Policy benefits	322,899	286,830
Policyholders' dividends and dividend obligations	100,104	84,455
Interest credited to policyholder account liabilities	329,908	67,808
Operating expenses	137,505	131,165
Interest expense on debt	16,284	16,296
Policy acquisition expenses and amortization of present value of future profits, net	181,664	183,218
<b>Total benefits and expenses</b>	<b>1,061,276</b>	<b>790,832</b>
<b>Income before income taxes</b>	<b>93,807</b>	<b>20,290</b>
Income tax expense	28,143	8,271
<b>Net Income</b>	<b>\$ 65,664</b>	<b>\$ 12,019</b>

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**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**Consolidated Statements of Changes in Stockholder's (unaudited)**

<i>(In Thousands)</i>	Class A Common Stock	Class B Common Stock	Preferred Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
January 1, 2008	\$-	\$-	\$-	1,470,504	17,814	1,488,318
Comprehensive income:						
Net income	-	-	-	12,019	-	12,019
Change in unrealized gains on available-for-sale securities, net	-	-	-	-	(225,181)	(225,181)
Change in cash flow hedge on debt issuance, net	-	-	-	-	25	25
Change in additional minimum pension liability, net	-	-	-	-	149	149
Total comprehensive loss						<u>(212,988)</u>
September 30, 2008	\$-	\$-	\$-	\$1,482,523	\$(207,193)	\$1,275,330

<i>(In Thousands)</i>	Class A Common Stock	Class B Common Stock	Preferred Stock	Retained Earnings	Accumulated Other Comprehensive Income (Deficit)	Total
January 1, 2009	\$-	\$-	\$-	\$1,483,882	\$ (423,333)	\$1,060,549
Comprehensive income:						
Net income	-	-	-	65,664	-	65,664
Change in unrealized gains on available-for-sale securities, net	-	-	-	-	414,098	414,098
Change in cash flow hedge on debt issuance, net	-	-	-	-	25	25
Change in additional minimum pension liability, net	-	-	-	-	3,089	3,089
Total comprehensive income						<u>482,876</u>
September 30, 2009	\$-	\$-	\$-	\$1,549,546	\$(6,121)	\$1,543,425

*These financial statements do not include the proper disclosures to be in compliance with GAAP.*

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows (unaudited)**

<b>For the nine months ended September 30,</b>		
<i>(In Thousands)</i>	<b>2009</b>	<b>2008</b>
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 65,664	\$ 12,019
Adjustments to reconcile net income to net cash provided by operating activities:		
Changes in assets and liabilities:		
Accrued investment income	(20,735)	(14,681)
Policy acquisition costs	(64,850)	(47,779)
Policy benefit liabilities	(59,665)	69,280
Interest credited to policyholder account liabilities	329,908	76,620
Policy and contract charges	(99,505)	(81,498)
Other assets and liabilities	255,697	50,087
Provision for deferred income taxes	(24,999)	(50,062)
Net realized investment (gains) losses	(11,294)	56,505
Net options (gains) losses	(281,335)	149,997
Net corporate owned life insurance (gains)	(3,704)	(2,419)
Change in present value of future profits of insurance acquired	3,814	6,168
Depreciation	6,704	5,787
Other	(6,407)	(106,467)
Net cash provided by operating activities	<b>89,293</b>	<b>123,557</b>
<b>Cash Flows from Investing Activities:</b>		
Proceeds from sales, maturities and repayments of investments	5,181,268	1,322,747
Cost of investments acquired	(6,039,870)	(1,900,847)
Change in policy loans	6,125	(78)
Change in security lending investment collateral	26,319	131,224
Other	-	(24,639)
Net cash used by investing activities	<b>(826,158)</b>	<b>(471,593)</b>
<b>Cash Flows from Financing Activities:</b>		
Policyholders' deposits	1,429,702	1,077,706
Policyholders' withdrawals	(586,114)	(588,535)
Net change in collateral held on loaned securities	16,323	31,105
Proceeds from debt issuance	200,000	-
Debt retirement	(6,986)	-
Net cash provided by financing activities	<b>1,052,925</b>	<b>520,276</b>
<b>Net Increase in Cash and Short Term Investments</b>	<b>316,060</b>	<b>172,240</b>
<b>Cash and Short Term Investments:</b>		
Beginning of period	147,987	179,405
End of period	\$ 464,047	\$ 351,645

*These financial statements do not include the proper disclosures to be in compliance with GAAP.*

## NLV FINANCIAL CORPORATION AND SUBSIDIARIES

### Management's Discussion of Results of Operations

The discussion below, unless otherwise noted, is prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP").

#### Forward-Looking Information

This discussion contains forward-looking statements that are intended to enhance the reader's ability to assess our future financial and business performance. These statements are based on the beliefs and assumptions of our management, and are subject to risks and uncertainties. Generally, statements that are not about historical facts, including statements concerning our possible or assumed future actions or results of operations are forward-looking statements. Forward-looking statements include, but are not limited to, statements that represent our beliefs concerning future operations, strategies, financial results or other developments, and contain words and phrases such as "may," "believes," "intends," "anticipates," "plans," "estimates," "expects," "should" or similar expressions.

Forward-looking statements are based upon estimates and assumptions. These statements may change due to business uncertainties, economic uncertainties, competitive uncertainties and other factors, many of which are beyond our control. Consequently, such forward-looking statements should be regarded solely as our current plans, estimates or beliefs. We do not intend, and do not undertake, any obligation to update any forward-looking statements to reflect our future events or circumstances after the date of such statements.

#### General

This Management's Discussion of Results of Operations should be read in conjunction with the Audited Consolidated Financial Statements and Notes to Consolidated Financial Statements as of and for the year ended December 31, 2008, and Selected Historical Financial Information of NLVF as of and for the nine months ended September 30, 2009. This Discussion and Analysis of Financial Results of Operations reviews NLVF's results of operations for the nine months ended September 30, 2009 and 2008 and, where appropriate, factors that may affect NLVF's future financial performance.

NLVF's net income was \$65.7 million for the nine months ended September 30, 2009 compared to net income of \$12.0 million for the nine months ended September 30, 2008. As of September 30, 2009 and December 31, 2008, NLVF had \$17.6 billion and \$15.2 billion in assets, respectively. As of September 30, 2009 and 2008 NLVF had assets under management of \$24.1 billion and \$20.5 billion, respectively.

#### *Nine Months Ended September 30, 2009 Compared to the Nine Months Ended September 30, 2008*

	For the nine months ended September 30,	
	2009	2008
<b>Net Income</b>	<b>\$65,664</b>	\$12,019
Net realized losses, net of policy acquisition, policyholder dividend obligation, and income tax effects	537	56,294
Income tax on operations	30,120	8,271
<b>Pre-tax operating income</b>	<b>\$96,321</b>	\$76,584

*Pre-tax operating income* increased \$19.7 million, or 25.8%, to \$96.3 million for the nine months ended September 30, 2009 compared to \$76.6 million for the nine months ended September 30, 2008. This increase is primarily related to higher earnings from our equity indexed annuity products due to growth in business in force and improved market conditions; continued growth in our indexed universal life

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**Management's Discussion of Results of Operations (continued)**

business; and favorable disability income experience. These increases were offset in part by lower mortgage prepayments, and higher pension costs due to the decline in investment markets at the end of 2008.

**Insurance Premiums** includes considerations on life and disability income contracts. Premium income decreased \$11.3 million, or 5.2%, to \$205.7 million for the nine months ended September 30, 2009 compared to \$217.0 million for the nine months ended September 30, 2008. This decrease was primarily related to a \$6.9 million decrease in renewal premiums and a \$2.6 million decrease in single premiums.

**Policy and Contract Charges** includes fees charged on variable annuities, front end contract fees, cost of insurance charges and surrender charges. Policy and contract charges increased \$16.2 million, or 10.5%, to \$169.9 million for the nine months ended September 30, 2009 compared to \$153.7 million for the nine months ended September 30, 2008. This increase was primarily related to a \$12.3 million increase in annuity policy charges and a \$5.0 million increase in surrender charges related to our universal life products.

**Net investment income** represents income earned on our investments including interest income on bonds, mortgage loans, contract loans and short term investments along with bond premium/discount amortization, dividends on preferred and common stock, change in value of options and futures primarily used to economically hedge our equity indexed products, and partnership income. Net investment income increased \$266.0 million, or 63.1%, to \$687.5 million for the nine months ended September 30, 2009 compared to \$421.5 million for the nine months ended September 30, 2008.

	<b>Nine Months Ended September 30,</b>		
	<b>2009</b>	<b>2008</b>	<b>% Change 09 vs. 08</b>
	<b>(In Thousands)</b>		
<b>Net investment income:</b>			
Bonds	\$ 487,245	\$ 456,074	6.8%
Preferred stocks	3,420	4,650	(26.5%)
Common stocks	560	829	(32.4%)
Mortgage loans	80,741	87,893	(8.1%)
Contract loans	32,177	30,773	4.6%
Real estate	2,172	2,133	1.8%
Other invested assets	(1,141)	3,404	n/m
Derivatives	90,483	(157,833)	n/m
Cash, cash equivalents and short-term investments	197	2,030	n/m
Total gross investment income	<b>695,854</b>	429,953	(5.5%)
Investment expenses	<b>8,307</b>	8,441	4.7%
<b>Net investment income</b>	<b>\$ 687,547</b>	<b>\$ 421,512</b>	<b>(5.8%)</b>

**Bond investment** income increased \$31.2 million, or 6.8%, to \$487.2 million for the nine months ended September 30, 2009 compared to \$456.1 million for the nine months ended September 30, 2008. The amortized cost of bond investments increased \$1.4 billion to \$10.7 billion as of September 30, 2009 compared to \$9.3 billion as of September 30, 2008. The average amortized cost of bonds held increased

## NLV FINANCIAL CORPORATION AND SUBSIDIARIES

### Management's Discussion of Results of Operations (continued)

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\$0.9 billion, and the average yields decreased 19 basis points to 6.18% for the nine months ended September 30, 2009 from 6.37% for the nine months ended September 30, 2008.

*Preferred stock* dividend income decreased \$1.3 million, or 26.5%, to \$3.4 million for the nine months ended September 30, 2009 compared to \$4.7 million for the nine months ended September 30, 2008. The decrease is primarily related to a decrease in preferred stock holdings.

*Mortgage loan* interest income decreased \$7.2 million, or 8.1%, to \$80.7 million for the nine months ended September 30, 2009 compared to \$87.9 million for the nine months ended September 30, 2008. This decrease is primarily related to lower mortgage prepayments, a decrease in the size of the mortgage loan portfolio and a 9 basis point decrease in the average yield. The amortized cost of the mortgage loan portfolio decreased \$38.0 million to \$1,603.0 million as of September 30, 2009 compared to \$1,640.0 million as of September 30, 2008. The decrease in the mortgage loan portfolio is driven by the current economic conditions which resulted in fewer loan originations.

*Other invested assets* income, which consists primarily of partnership income, decreased \$4.5 million to a loss of \$1.1 million nine months ended September 30, 2009 compared to income of \$3.4 million for the nine months ended September 30, 2008. This decrease is primarily related to a decrease in partnership distribution income in 2009 related to overall market conditions.

*Derivatives* income increased \$248.3 million to \$90.5 million for the nine months ended September 30, 2009 compared to (\$157.8) million for the nine months ended September 30, 2008. The Company purchases and sells over the counter options on the S&P 500 index and exchange-traded futures. The derivatives are used to hedge obligations to credit interest on indexed life and annuity products tied to the S&P 500 and the Russell 2000 indexes. The change in market value of the option is generally offset by a change in interest credited to our indexed life and annuity contracts which is recorded in *Interest credited to policyholder liabilities* in our Consolidated Statements of Operations. The increase in options/futures income was primarily related to an increase in the S&P 500 during the nine months ended September 30, 2009 as compared to a significant decrease during the nine months ended September 30, 2008.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**Management's Discussion of Results of Operations (continued)**

*Net realized investment gains (losses)* increased \$79.4 million to a net realized capital gain of \$11.3 million for the nine months ended September 30, 2009 compared to a net realized capital loss of \$68.1 million for the nine months ended September 30, 2008.

	<b>For the nine months ended</b>	
	<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>
	<i>(In Thousands)</i>	
<b>Bonds and other debt securities</b>		
Gross gains	<b>\$95,741</b>	\$17,439
Gross losses	<b>(33,088)</b>	(7,962)
Other than temporary declines	<b>(35,206)</b>	(41,573)
<b>Preferred stocks</b>		
Gross gains	-	103
Gross losses	<b>(433)</b>	(985)
Other than temporary declines	<b>(1,934)</b>	(27,470)
<b>Common stocks</b>		
Gross gains	<b>1,464</b>	1,710
Gross losses	<b>(1,534)</b>	(13)
Other than temporary declines	<b>(6,109)</b>	(361)
<b>Partnerships</b>		
Gross gains	-	-
Gross losses	-	-
Other than temporary declines	<b>(6,062)</b>	(448)
<b>Other</b>		
Gross gains	<b>924</b>	639
Gross Losses	<b>(2,469)</b>	(468)
Other than temporary declines	-	(8,751)
<b>Net realized capital losses</b>	<b>\$11,294</b>	(\$68,140)

For the nine months ended September 30, 2009 the company recognized gross realized capital gains of \$98.1 million, gross realized capital losses of \$37.5 million and recognized other than temporary declines of \$49.3 million. The other than temporary declines in value were related primarily related to investments in the financial services and media sectors. The \$98.1 million in gains was primarily attributable to sales of government agency-backed securities.

For the nine months ended September 30, 2008 the company recognized gross realized capital gains of \$19.9 million, gross realized capital losses of \$9.4 million and recognized other than temporary declines of \$78.6 million. The other than temporary declines in value were related primarily related to investments in financial services related sectors.

*Change in value of trading equity securities* consists of the change in fair value during the period of securities classified as trading securities. The change in value of trading equity securities increased \$7.1 million to \$3.0 million for the nine months ended September 30, 2009 compared to (\$4.1) million for the nine months ended September 30, 2008. This increase was primarily related to an increase in the equity markets during the 2<sup>nd</sup> and 3<sup>rd</sup> quarter of 2009.

*Mutual fund commissions and fee income* consists of fees earned for assets under management and commissions for mutual fund sales related to our asset management business. Mutual fund commissions

## NLV FINANCIAL CORPORATION AND SUBSIDIARIES

### Management's Discussion of Results of Operations (continued)

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and fee income decreased \$10.2 million, or 13.3% to \$66.4 million for the nine months ended September 30, 2009 compared to \$76.6 million for the nine months ended September 30, 2008. This decrease was primarily related to lower broker dealer commissions and fees as a result of a decrease in assets under management and trade activity.

**Other Income** decreased \$3.3 million, or 22.9%, to \$11.2 million for the nine months ended September 30, 2009 compared to \$14.5 million for the nine months ended September 30, 2008. This decrease was primarily related to a reimbursement in 2008 for a reserve strengthening associated with a Modco reinsurance agreement for disability income policies that did not recur in 2009.

**(Decrease) increase in policyholder reserves** decreased \$48.2 million to (\$27.1) million for the nine months ended September 30, 2009 compared to \$21.1 million for the nine months ended September 30, 2008. This decrease is primarily related to increased surrenders of traditional life insurance policies and a reserve strengthening in 2008 related to disability income policies that did not recur in 2009.

**Policy benefits** increased \$36.1 million, or 12.6%, to \$322.9 million for the nine months ended September 30, 2009 compared to \$286.8 million for the nine months ended September 30, 2008. This increase is primarily related to an increase of \$28.5 million increase in surrender benefits in our closed block and \$7.0 million increase in death benefits in our traditional and term insurance blocks.

**Policyholders' dividends and dividend obligations** consist of the amount paid during the reporting period plus the increase (or less the decrease) in accrued dividends. Dividends are based on a scale that seeks to reflect the relative contribution of each group of policies to the Company's overall operating results. The dividend scales are approved annually by National Life's Board of Directors. Policyholders' dividends increased \$15.6 million, or 18.5%, to \$100.1 million for the nine months ended September 30, 2009 compared to \$84.5 million for the nine months ended September 30, 2008. The increase in policyholders' dividends was primarily related to a change in the policyholder dividend obligation associated with the closed block of business.

**Interest credited to policyholder account liabilities** includes interest credited to policyholder accounts as well as the change in value of the embedded derivative associated with our equity indexed products. Interest credited to policyholder liabilities increased \$262.1 million, or 386.5%, to \$329.9 million for the nine months ended September 30, 2009 compared to \$67.8 million for the nine months ended September 30, 2008. This increase is primarily related to interest credited associated with our equity indexed products which credit interest based on the performance of the S&P 500 index and to a lesser extent the Russell 2000 index which have both increased over the first nine months of 2009 as compared to a decrease during the same period of 2008. This increase is offset by income from options purchased to hedge these products which is included in net investment income.

**Operating Expenses** increased \$6.3 million, or 4.8%, to \$137.5 million for the nine months ended September 30, 2009 compared to \$131.2 million for the nine months ended September 30, 2008. The increase is primarily related to an increase in pension costs related to a decline in the assets backing our defined benefit plan during 2008.

**Interest expense on debt** was \$16.3 million for the nine months ended September 30, 2009 and 2008. In September 2009 the National Life Insurance Company issued \$200 million worth of surplus notes with a 10.5% coupon maturing in 2039. This issuance will impact interest expense in future periods.

**Federal income tax expense** increased \$19.9 million, or 240.2%, to \$28.1 million for the nine months ended September 30, 2009 compared to \$8.3 million for the nine months ended September 30, 2008. This increase is related to an increase in income before income taxes.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**Management's Discussion of Results of Operations (continued)**

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*Net income* increased \$53.6 million to \$65.7 million for the nine months ended September 30, 2009 compared to \$12.0 million for the nine months ended September 30, 2008. This increase is primarily related to an increase in net realized capital gains, higher earnings from our equity indexed annuity products due to growth in business in force and improved market conditions; continued growth in our indexed universal life business; and favorable disability income experience. These increases were offset in part by lower income from our trading equities portfolio, lower mortgage prepayments, and higher pension costs due to the decline in investment markets at the end of 2008.